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In this installment of SALT Insights, the authors discuss the role that virtual contacts play regarding the *Wayfair* decision and the definition of substantial nexus and argue that the Multistate Tax Commission's revised statement on Public Law 86-272 and recent New York litigation show the need for further guidance from the Court.

Much has been said about the Supreme Court's landmark decision in *Wayfair*[1] since it was handed down in 2018.[2] The bulk of the conversation[3] has been focused on the fact that the *Wayfair* Court discarded the bright-line physical presence rule and, in its place, acquiesced to the use of economic thresholds to define substantial nexus under the commerce clause.[4] While the recognition and discussion of that issue is unquestionably warranted, there is another crucial aspect of the *Wayfair* decision that has been all but ignored.[5] Specifically, what role do *virtual contacts* play in the substantial nexus analysis?[6]

The Court's consideration of virtual contacts in *Wayfair* was not hidden in a footnote. To the contrary, the Court referenced the significance of the online retailer's virtual contacts several times

[1] *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018).

[2] This article is part one of a two-part series related to nexus post-*Wayfair*.

[3] *See, e.g.*, Roxanne Bland, "Local Jurisdictions and *Wayfair*: Economic Nexus Is Not Always Simple," *Tax Notes State*, Dec. 13, 2021, p. 1189; Paul Jones, "One Year Later: Experts Discuss Aftermath, Future Impact of *Wayfair*," *Tax Notes State*, June 17, 2019, p. 1050; Richard D. Pomp, "*Wayfair*: Its Implications and Missed Opportunities," *State Tax Notes*, June 10, 2019, p. 899.

[4] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (upholding the physical presence standard to define substantial nexus under the commerce clause), overruled in part, *Wayfair*, 138 S. Ct. 2080.

[5] Bland, "*Wayfair*: A Question of Economic and Virtual Presence," *Tax Notes State*, June 20, 2022, p. 1259; Jaye Calhoun and William J. Kolarik II, "Implications of the Supreme Court's Historic Decision in *Wayfair*," *State Tax Notes*, July 9, 2018, p. 125.

[6] We would be remiss to omit discussion of the Hellerstein, Hellerstein, and Appleby treatise's view of the role "virtual contacts" should play in the substantial nexus analysis. *See* Jerome R. Hellerstein, Walter Hellerstein, and Andrew Appleby, *State Taxation*, at Part V, ch. 19, para. 19.02[2][c][i], n.141 (updated through Dec. 2023). The authors view virtual presence as "simply a fact that supports a finding of substantial nexus." *Id.* We take a different view for the reasons expressed in this article, including the roots of *Wayfair*'s substantial nexus analysis, the analysis itself, and the unmitigated, unfair risk of taxation that may result from an unlimited standard of "virtual presence," which we believe support the position that virtual contacts should play a material role in the substantial nexus analysis.

in the opinion. Most notably, the *Wayfair* Court explained that the online retailers had substantial nexus "based on both the economic and virtual contacts [the online retailers] have with the State."[7] The Court goes on to reason that the online retailers "are large, national companies that undoubtedly maintain an extensive virtual presence." Thus, the Court concluded, "the substantial nexus requirement . . . is satisfied in this case." The references to virtual contacts in *Wayfair* are not dicta to be disregarded. To the contrary, it is clear that the Court considered this qualitative measuring stick crucial to the substantial nexus analysis.

All that said, every state implementing an economic nexus statute has wholly disregarded any consideration of a taxpayer's qualitative virtual contacts with the taxing state.[8] If pressed, it is likely that state tax administrators would defend their position by noting that their laws merely track the South Dakota economic nexus statute blessed by the *Wayfair* Court. The South Dakota law, they would correctly note, contains no reference to virtual contacts.[9] While this is true, it is patently evident from *Wayfair* that the Court *sua sponte* added the virtual contacts gloss to the substantial nexus analysis. In fact, the constitutional analysis in *Wayfair* makes clear that the existence of virtual contacts in our modern e-commerce world was the primary reason the Court felt compelled to overrule *Quill*.

The collective decision of the states to ignore any qualitative analysis of a taxpayer's virtual contacts in their economic nexus laws is problematic and could prove costly. In a petition for writ of certiorari filed with the Court,[10] a taxpayer challenged a decision of the Oregon Supreme Court in which the court proclaimed that virtual contacts are irrelevant to the commerce clause analysis. Although the Court declined to review the petition, this is merely the first shot across the bow as further litigation on this point of law is almost certain as the dust settles following *Wayfair*.[11]

Irony and the Commerce Clause

The state reaction to *Wayfair* is deliciously ironic. Since the 1992 holding in *Quill* requiring physical presence to satisfy the substantial nexus requirement of the commerce clause, the states roundly criticized the Court for what they viewed as a formalistic, bright-line test for substantial nexus. The drumbeat by the states reached a crescendo when in *Direct Marketing*, Justice Anthony M. Kennedy went out of his way to invite a challenge to the Court's *Quill* precedent.[12]

Strictly speaking, the question presented to the Court in the *Direct Marketing* decision had nothing to do with the holding in *Quill*, much less the issue of nexus generally. In the case, a trade association sued in federal court, raising constitutional challenges to Colorado's notice and reporting requirements for remote retailers. The narrow issue before the Court was whether the federal district court was deprived of jurisdiction

[7] *Wayfair*, 138 S. Ct. at 2099.

[8] In this footnote, the dollar figure indicates the sales and additional figures indicate the number of transactions for that state's threshold. Ala. Admin. Code section 810-6-2-.90.03(1) ($250,000); Ariz. Rev. Stat. Ann. section 42-5044(A)(1) ($100,000); Ark. Code Ann. section 26-52-111(a) ($100,000 or 200); Cal. Rev. & Tax. Code section 6203(c)(4) ($500,000); Colo. Rev. Stat. section 39-26-102(3)(c)(I)(A) ($100,000); Conn. Gen. Stat. section 212-40(a)(12)(G) ($100,000 or 200); D.C. Code Ann. section 47-2001(w) ($100,000 or 200); Fla. Stat. section 212.0596 ($100,000); Ga. Code Ann. section 48-8-2(8)(M.1) ($100,000 or 200); Haw. Rev. Stat. section 237-2.5 ($100,000 or 200); Idaho Code section 63-3611(3)(h) ($100,000); 35 ILCS section 120/2(b) ($100,000 or 200); Ind. Code section 6-2.5-2-1(d) ($100,000 or 200); Iowa Code section 423.14A(3)(a) ($100,000); Kan. Stat. Ann. section 79-3702(h)(1) ($100,000); Ky. Rev. Stat. Ann. section 139-340(2)(g) ($100,000 or 200); La. Rev. Stat. Ann. section 47:301(4)(m)(i) ($100,000); Me. Rev. Stat. Ann. 36 section 1754-B(1-B)(B) ($100,000); Md. Code Ann. Tax-Gen. section 11-701(b)(2) ($100,000 or 200); Mass. G. L. Ch. 64H section 34 ($100,000); Mich. Comp. Laws Ann. section 205.52c(1) ($100,000 or 200); Minn. Stat. section 297A.66 ($100,000 or 200); Miss. Code Ann. section 27-67-4(2)(e) ($250,000); Mo. Rev. Stat. section 144.635 ($100,000); Neb. Rev. Stat. section 77-2701-13(2) ($100,000 or 200); Nev. Admin. Code section 372.856 ($100,000 or 200); N.J. Rev. Stat. section 54:32B-2(i) ($100,000 or 200); N.M. Admin. Code section 3.2.1.12(A) ($100,000); N.Y. Tax Law section 1101(b)(8)(vi) ($500,000 and 100); N.C. Gen. Stat. section 105-164.8(b)(9) ($100,000 or 200); N.D. Cent. Code section 57-39.2-02.2 ($100,000); Ohio Rev. Code section 5741.01(I) ($100,000 or 200); Okla. Stat. 68 section 1392(G) ($100,000); Pa. Stat. Ann. 72 section 7201(b) ($100,000); R.I. Gen. Laws section 44-18.2-3(E) ($100,000 or 200); S.D. Codified Laws section 10-64-2 ($100,000); S.C. Code Ann. section 12-36-70 ($100,000); Tenn. Code Ann. section 67-6-524 ($100,000); Tex. Admin. Code section 3.286(b)(2)(B)(i) ($500,000); Utah Code Ann. section 59-12-107(2)(c) ($100,000 or 200); Vt. Stat. Ann. section 9701(F) ($100,000 or 200); Va. Code Ann. section 58.1-612 ($100,000 or 200); Wash. Rev. Code section 82.04.067(1)(c)(i) ($100,000); W. Va. Code section 11-15A-6 ($100,000 or 200); Wis. Stat. section 77.51(13gm) ($100,000); Wyo. Stat. section 39-15-501(a) ($100,000 or 200).

[9] 2016 S.D. Laws Ch. 70 (S.B. 106), 2016 Reg. Sess. of the 91st Leg., section 1 ("S.B. 106").

[10] *Ooma Inc. v. Department of Revenue*, 369 Ore. 95 (2021), *petition for cert. filed*, No. 21-1488 (May 23, 2022).

[11] *Id.*, *cert. denied*, 142 S. Ct. 2839 (June 21, 2022).

[12] *Direct Marketing Association v. Brohl*, 575 U.S. 1, 16-19 (2015) (Kennedy, J., concurring).

to hear the case by the Tax Injunction Act. Ultimately, the Court unanimously agreed that the TIA was not a bar to the lower court's exercise of jurisdiction. However, the more interesting part of the decision was Kennedy's concurring opinion.

Kennedy makes no mention of the TIA whatsoever. Instead, his focus was on what he viewed as a "continuing injustice" faced by the states. That injustice was an inability to impose sales and use tax on online retailers. Kennedy laid the blame for this tragedy squarely on the substantial nexus holding in *Quill*. In doing so, he noted that "the Internet has caused far-reaching systemic and structural changes to the economy" providing consumers with "almost instant access to most retailers via cell phones, tablets, and laptops."[13] This level of connectivity causes an online retailer to "be present in a State in a meaningful way without that presence being physical." For these reasons, Kennedy questioned the very foundation of the Court's then-existing commerce clause jurisprudence, commenting that "the legal system should find an appropriate case for this Court to reexamine *Quill*."

Hearing the call to action, the South Dakota Legislature mounted a frontal attack on *Quill*. Within a year after *Direct Marketing*, the lawmakers introduced a bill imposing sales tax on retailers irrespective of any physical presence in the state.[14] Less than a year later, South Dakota sued several online retailers requesting a judicial ruling that the online retailers were required to comply with the new law. In just one more year, the case was before the U.S. Supreme Court.

In its petition to the Court, South Dakota reasoned that the *Quill* bright-line test should be disregarded because it was at odds with the Court's more flexible commerce clause jurisprudence exemplified by the four-part test in *Complete Auto*.[15] According to South Dakota, if the *Complete Auto* test were used to evaluate the state's new law, "it would pass with flying colors."[16] The unifying theme between South Dakota and its several amici was that the *Quill* bright-line test was an anachronistic relic to be discarded in the dustbin of history.

As we all know, the Court responded favorably to these arguments. In *Wayfair*, Kennedy noted that *Quill* embodies a "formalistic distinction that the Court's modern Commerce Clause precedents disavow."[17] More to the point, the Court explained that the *Quill* physical presence rule is not just "artificial at its edges," it is "artificial in its entirety."[18]

The *Wayfair* Court overruled *Quill* and in its place made clear that "substantial nexus" for commerce clause purposes exists when a taxpayer "avails itself of the substantial privilege of carrying on its business"[19] in the taxing state. The Court agreed that the South Dakota law was consistent with this test for substantial nexus, stating that "this quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota."

Ironically, in a sense, the Court merely substituted one bright-line test for another.[20] Before *Wayfair*, sales and use tax nexus was characterized by the physical presence of the taxpayer. Now, substantial nexus is defined by quantitative indicators such as transaction count and sales revenue. Although this apparent irony was lost on the Court in *Wayfair*, it was gratefully accepted by the several states. Despite all of the criticisms by South Dakota and its amici that *Quill* should be eschewed because of its intractable formalism, post-*Wayfair*, formalism — at least as far as the states are concerned — is now the name of the game for purposes of defining substantial nexus under the commerce clause.

[13] *Id.* at 18.

[14] S.B. 106 (S.D. 2016).

[15] *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).

[16] Petition for Writ of Certiorari, *South Dakota v. Wayfair Inc.*, No. 17-494, 2017 WL 4404984, at *22 (Oct. 2, 2017).

[17] *Wayfair*, 138 S. Ct. at 2092.

[18] *Id.* at 2095.

[19] *Id.* at 2099 (internal citation omitted).

[20] We say "in a sense" because the actual test for substantial nexus offered by the *Wayfair* Court was whether a taxpayer "avails itself of the substantial privilege of carrying on its business" in the state. In *Wayfair*, the Court can be fairly understood to say that the operation of the disputed South Dakota law was consistent with that test. So, although the Court did not articulate its own bright-line test in *Wayfair*, it did accept South Dakota's statute containing bright-line quantitative markers as consistent with the Court's new commerce clause approach.

Are a Taxpayer's Virtual Contacts Important for Substantial Nexus?

We believe that a taxpayer's virtual contacts are not only relevant to the substantial nexus determination post-*Wayfair* but that the Court fully intended that virtual contacts play a critical role.

In *Direct Marketing*, Kennedy questioned the holding in *Quill* because it treated economically equivalent taxpayers differently. As explained by Kennedy, the internet now permits online retailers to compete directly with brick-and-mortar sellers physically present in a state because the online retailer can "be present in a State in a meaningful way without that presence being physical in the traditional sense of the term."[21] This is because online retailers are merely "a click away" because most consumers "have almost instant access to most retailers via cell phone, tablets, and laptops."[22]

In *Wayfair*, the Court explained that the problem with *Quill* was that the bright-line rule created an uneven playing field between online and in-state retailers. While in-state retailers needed to be concerned with regulatory burdens and tax collection obligations, online retailers could avoid all that and, as a result, offer lower prices to consumers. This created, in the words of the Court, "artificial competitive advantages" that could not be left unaddressed.

These advantages directly stemmed from "the continuous and pervasive virtual presence" of online retailers and concomitant "opportunities for consumer and seller interaction than might be possible for local stores."[23] In sum, it is clear that virtual contacts were not an ancillary constitutional consideration in *Wayfair* — they were the *impetus* for the Court's decision to articulate a new test for substantial nexus. In its statements summarizing its commerce clause holding in the case, the *Wayfair* Court noted that the online retailers were "large, national companies that undoubtedly maintain an extensive virtual presence,"[24] and thus, "the nexus is clearly sufficient based on both the economic *and* virtual contacts [the online retailers] have with the State."[25]

There are several reasons virtual contacts should be part of the commerce clause substantial nexus analysis. First, and as was recognized by the Court in *Wayfair*, the Court's contemporary commerce clause jurisprudence "eschew[s] formalism for a sensitive, case-by-case analysis of purposes and effects."[26] Consideration of a taxpayer's virtual contacts with a taxing state comports with this statement by the Court.

It is most certainly the case that most online retailers will not have a virtual presence that measures up to that of the online retailers in *Wayfair*. Similarly, many online retailers do not have the ability to interact with or "target" consumers as the online retailers did in *Wayfair*. Given the *Wayfair* Court's statements regarding its reasons for discarding the *Quill* bright-line rule, these factual distinctions should unquestionably matter.

In *Wayfair*, the Court agreed that the challenged South Dakota law outlining a defined transaction count and revenue threshold was consistent with its more flexible contemporary commerce clause jurisprudence. If true, it must be the case that the Court understood that qualitative contacts — the extent of an online retailer's virtual presence — provide the flexibility inherent in the Court's current approach to the commerce clause. To this point, it makes no sense — as apparently almost all states have assumed — that the Court would agree that a state law containing solely quantitative economic metrics exemplifies the required case-by-case analysis under the commerce clause.

Virtual contacts are also relevant to the substantial nexus determination because they act as a proxy for actual physical presence. In *Wayfair*, the Court overruled the *Quill* physical presence rule not strictly because of a dislike for bright-line rules but rather because virtual connections were deemed to be the economic equivalent of physical connections with a taxing state. Given this equivalency, there was no basis for a bright-line

[21] *Direct Marketing*, 575 U.S. at 18.

[22] *Id.*

[23] *Wayfair*, 138 S. Ct. at 2095.

[24] *Id.* at 2099.

[25] *Id.* (emphasis added).

[26] *Id.* at 2094 (internal citation omitted).

rule that made substantial nexus determinations based solely on a taxpayer's physical contacts.

Because an online retailer's virtual contacts are a proxy for actual physical contacts, it makes sense under the required case-by-case approach to scrutinize the quality and nature of those contacts.

Wayfair Virtual Contacts Misapplied

Unfortunately, post-*Wayfair*, reliance on virtual contacts without examining their quality and nature has already reared its ugly head in the state income tax context. Most readers are well aware that the Multistate Tax Commission revised its Public Law 86-272 guidance to proclaim that essentially any out-state-state business with a functioning, modern website and customers in the state would lose the federal protection from nexus provided by P.L. 86-272.[27]

The MTC relies on *Wayfair* to support its position, citing the opinion's reliance on Kennedy's observation in *Direct Marketing* that "'a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term.'"[28] The MTC recognizes that *Wayfair* is not interpreting P.L. 86-272 and considers *Wayfair*'s analysis of "virtual contacts" to be relevant to nexus determination.

While we credit the MTC for recognizing that virtual contacts should be relevant in a nexus determination,[29] the MTC's interpretation of "virtual contacts" deemed to constitute in-state business activity is unreasonably overbroad and unsupported by *Wayfair*. Inconsistent with *Wayfair*, the MTC's interpretation does not consider whether an out-of-state business has an extensive national reach that markets to potential customers located anywhere using targeted advertising and regularly interacts with in-state customers. Rather, the MTC believes that the "general rule" is that a business's interaction with a customer through the business's website is in-state business activity, even when the customer initiates the activity.[30]

The MTC's overly broad interpretation of "virtual contacts" is a far cry from *Wayfair*'s endorsement of a "substantial nexus" determination under the commerce clause that looks to sensitive case-by-case analysis of purposes and effects. Standing on its own, the MTC's interpretation of *Wayfair* virtual contacts leaves almost all of today's online businesses susceptible to multistate income taxes. This limitless notion of nexus cannot be what the *Wayfair* Court envisioned and is contrary to its concerns related to small businesses and undue compliance burdens.

Also, like the MTC, the New York courts have recently misapplied *Wayfair* virtual presence.[31] In *Matter of Zelinsky*, a New York administrative law judge upheld the Division of Taxation's determination that Edward Zelinsky owed New York income tax on work he performed at his home in Connecticut during 2019 and 2020, including when COVID-19 pandemic shutdown orders were in effect, prohibiting Zelinsky from working at his employer's New York City campus.[32] The ALJ observed that even though Zelinsky was not physically present in New York for most of 2020, he "remotely connected to Cardozo and had a virtual presence in New York when hosting Zoom classes and meetings with his

[27]Multistate Tax Commission, Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272 (4th revision adopted Aug. 4, 2021) (revised statement). While the MTC also recommends that states adopt a factor presence nexus statute, most state income taxes do not have factor presence nexus laws. Thus, the MTC's encouragement of factor presence nexus is seemingly insufficient to counter its recent P.L. 86-272 recommendation, a federal law that is broadly applicable to state income taxes.

[28]*Id.* at 2 (citing *Wayfair*, 138 S. Ct. at 2095) (citing *Direct Marketing*, 575 U.S. at 18 (Kennedy, J., concurring)).

[29]For purposes of our analysis, we set aside the distinction that *Wayfair* interprets nexus for sales tax purposes while the MTC sets forth its position related to state income tax nexus.

[30]MTC, revised statement, *supra* note 27, at 8.

[31]Further, New York is the first state to formally adopt the MTC's revised statement. *See* N.Y. Department of Taxation & Finance, Corporate Tax Reform, Adopted Regulations (last visited Mar. 5, 2024).

[32]*Matter of Petition of Zelinsky*, DTA Nos. 830517 and 830681 (N.Y. Div. Tax App. Nov. 30, 2023).

students."[33] The ALJ cited *Wayfair* to support the notion that "one can be present in a state without needing to physically be there."[34]

On appeal to the New York State Tax Appeals Tribunal, Zelinsky argued that the ALJ's ruling misapplies *Wayfair* by "push[ing] *Wayfair* further than it should go, creating an unmanageable standard of 'virtual presence' which causes duplicative, extraterritorial state income taxation since every day a worker in the modern world may have virtual presence in many jurisdictions throughout the nation and the world."[35] Zelinsky asserts that the ALJ's application of "virtual presence" is "undefined and unlimited" and suggests that a person can be taxable anywhere, which leads to "untenable conclusion[s.]"[36]

Setting aside the different concerns, including those related to double taxation and apportionment, that underlie sales tax and income tax, both *Zelinsky* and the MTC's revised statement demonstrate that *Wayfair*'s virtual contacts analysis is important. Without further guidance, clarification, and attention regarding the quality of virtual contacts, there is a significant risk of taxation based on tenuous virtual contact.

Concluding Thoughts

Wayfair undoubtedly transformed the landscape of substantial nexus under the commerce clause. As its contours are still forming, we believe that virtual contacts have a material role to play in the SALT world — as evident in recent MTC guidance and in New York tax litigation. Given the Supreme Court's precedent, the recently received short shrift treatment of virtual contacts cannot be what the Court envisioned. Going forward, if and until the Court further interprets "virtual presence," taxpayers should advocate for, and states should seriously consider, implementation of a qualitative virtual presence test to ensure taxation of online retailers passes constitutional muster. ■

[33] *Id.* at 20.

[34] *Id.*

[35] Brief of the Petitioners-Taxpayers Edward and Doris Zelinsky, DTA Nos. 830517 and 830681, at 23 (N.Y. Tax App. Trib. Jan. 20, 2024).

[36] *Id.* Although the ALJ did not cite *Wayfair* to reject Zelinsky's argument that New York's convenience of the employer rule should not apply to him in this case, Zelinsky's slippery slope warning for unchecked virtual presence has the potential to occur in jurisdictions that use convenience of the employer rules deeming remote workers physically present in their employer's jurisdiction to support income tax imposition.