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From 30,000 Feet Into the Weeds

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In the early days of the internet, no one could have predicted the transformative forces being unleashed that would irrevocably change the essence of our culture. So it will be with artificial intelligence, which may represent even a greater force for change.

In general, AI involves processes that can learn, reason, plan, perceive, problem solve, or process phenomenon imitating human intelligence.

In our world of taxation, the IRS is using AI to predict: the risk of nonpayment, the likelihood of abusive tax returns, underreporting, and nonfiling. The IRS is at work in using neural networks to identify emerging areas of noncompliance. It is using AI to mine personal information posted on social media to identify identity theft and tax refund fraud. No doubt there are other secret uses of AI by the IRS that have not yet surfaced.

A Toronto-based start-up is using AI to predict how courts will resolve legal issues in tax cases. Corporate tax departments are using AI to sift through large volumes of documents to determine eligibility for research and development credits. Litigation firms are using AI in analyzing large-scale data.

And this is just the start, of course.

Descending into the weeds, what can we expect on a more mundane level in state tax in the next few years? We can anticipate a string of cases dealing with market-based sourcing and ambiguous terms like "benefit," "delivery," and "use." We can expect more challenges to the intersection of market-based sourcing and single-sales-factor apportionment, a method no state has adopted because it produces a more refined measure of income attributable to that state — which it does not. There will be a rash of constitutional and "as-applied" challenges and appeals to equitable apportionment.

Hopefully, there will be a rejection of "but for" reasoning by the states that try to take a complicated multistate transaction and look only to the last step — payment by that state's customer. The states argue that "but for" that payment, there would be no income to apportion, and under single sales apportionment with market-based sourcing, this reasoning can apportion 100 percent of income to a state. These states are oblivious or indifferent to the fact that "but for" all the value added outside that state, there would be no income to apportion in the first place. "But for" reasoning simply proves too much (as it typically does when used to show causality in tort cases).

We should expect more attempts by states to look to the customer of the taxpayer's customer in assigning receipts, using metrics that do not generate the very income that is being apportioned in the first place.

It will be nice to watch further recognition by the European Union and the OECD that the states came up with a better mousetrap — formulary apportionment — decades ago, rather than arm's-length accounting.

And we should see more attempts by taxpayers to enter into joint ventures with American Indian tribes, to exploit the somewhat incoherent and bankrupt case law on tribal sovereignty and immunities.

Finally, the gig economy and marketplace statutes will provide us all with work.

Happy 2020.

Luckily, I feel confident in making these predictions because no one ever looks back on prognosticators five years later to determine whether they were right or not (a phenomenon that also saves revenue estimators from criticism).