

## All Signs Point to 2018 as a Year of Escalating Conflict

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In *Game of Thrones*, a red comet arrives as a portent of a great conflict yet to come. We may not have a celestial harbinger, but all signs point to 2018 as a year of escalating conflict.

2017 may be remembered as the year in which states gave up the pretense of attempting to circumvent the U.S. Supreme Court *Quill Corp. v. North Dakota* <sup>21</sup> physical presence nexus standard by adopting novel — even exotic — theories, such as click-through nexus, software cookie nexus, and economic presence nexus. South Dakota led that charge, legislating that even a small internet merchant making a mere 200 sales of any amount to in-state residents would be obligated to collect tax for all 142 tax jurisdictions in the state. The South Dakota Supreme Court struck down the law on commerce clause grounds, and the state of South Dakota has filed a cert petition seeking to reverse *Quill*. If South Dakota were to succeed in that effort, the substantial nexus standard would be replaced by no standard at all, and remote sellers would be obligated to collect use tax for all 12,000 sales and use tax jurisdictions in the United States.

This past year also saw numerous states follow Colorado's lead in imposing "tattle tale" reporting requirements on out-of-state retailers. Those notice and reporting laws require, among other things, the filing of annual reports with state revenue departments disclosing confidential customer transaction information, which implicates serious First Amendment and privacy concerns. The U.S. Court of Appeals for the Tenth Circuit upheld Colorado's law, but, with other states joining the fray, further challenges can be expected.

While court battles rage on, Congress is considering federal legislation that would expand state tax authority but require the states to simplify the administration of their state sales and use tax laws as applied to interstate transactions. To date, even as states push for expanded taxation authority, they nonetheless continue to resist proposals to reduce the compliance burdens associated with the complexity of multistate taxation.

In 2017 there was an uptick in class action and private attorney general lawsuits against interstate sellers arising from their alleged failure to comply with state and local tax obligations. New York, which previously expanded the scope of its False Claims Act to reach state tax cases, has experienced a surge in such cases, and in Illinois whistleblower tax cases swelled as well. Although those lawsuits have had mixed results, plaintiffs' lawyers will undoubtedly test the limits of their power to intervene in state tax matters through private court actions.

With the increased focus on the taxation of computer services, center stage may turn to the sourcing of services that occur in the cloud, where traditional sourcing principles — such as place of delivery or performance — have little or no meaning. As states battle to grab their share of cloud-computing taxation, conflicting state sourcing rules will likely generate litigation. 2017 also saw several states, including Washington, Rhode Island, Pennsylvania, and South Carolina, going after so-called "online marketplaces," seeking, in some instances, to treat the marketplace as the retailer (with tax collection and remittance obligations).

Electronic commerce was not the only aspect of the “new economy” that experienced major state tax developments. There were tax-related repercussions relating to the legalization of the sale of marijuana for recreational purposes. The pattern has been to obtain voter approval of pro-marijuana ballot measures based on the promise of substantial new tax revenue. Most states are opting for a licensing and registration scheme for growers, wholesalers, and retailers, with the potential for taxes and fees at each level, and involving requirements as detailed as the tagging and recording of each individual plant. Litigation has already commenced over licensing rules, and tax controversies are likely to blossom in 2018. Overhanging the tax and regulatory issues is the white elephant in the room: the possibility of federal prosecution of marijuana growers, sellers, and buyers for violation of federal-controlled substances laws.

The so-called “sharing economy” also received considerable attention in 2017, with Uber and Airbnb as leading examples. A core question facing those companies is whether they are sellers with concomitant tax obligations, or merely facilitators or agents for individuals who participate in the shared economy. In 2017, Airbnb agreed to collect and remit sales and lodging taxes in numerous states, including Kentucky, Michigan, Wyoming, and South Dakota.

2017 was an exciting year for tax practitioners, but a period of uncertainty for companies that venture into new economic frontiers and find themselves in the cross hairs of state tax administrators.