

MTC Executive Committee Approves Final Transfer Pricing Initiative Design

May 8, 2015

Overview

On May 7, 2015, the Executive Committee of the Multistate Tax Commission (“MTC”), after a brief presentation by project facilitator Dan Bucks,¹ passed a motion to accept the final design for a multistate transfer pricing initiative, termed the Arm’s-length Adjustment Service (“ALAS”). MTC Deputy Executive Director, Greg Matson, also presented the Report of the Arm’s-length Adjustment Service Advisory Group² to the Executive Committee and highlighted the addition of Pennsylvania and Kentucky to the existing group of ALAS Charter Members.³ In this Alert we outline the recent developments in the ALAS initiative, discuss the components of the final design, outline the potential path forward for the initiative and suggest taxpayer considerations.⁴

Background

The MTC and the states participating in the ALAS initiative continue to work toward combining resources with the goal of strengthening their abilities to reattribute income under their respective versions of IRC § 482 as well as other applicable statutory and administrative powers.

Final Design is Largely Unchanged from December

The ALAS Advisory Group’s primary work product, the Design for an MTC ALAS, is now considered final.⁵ In February the MTC solicited commitments and suggestions or changes to the preliminary design from 48 states.⁶ To date, 31 states have responded to the MTC correspondence and six have committed to the program. Mr. Matson stated during the meeting that the MTC received “no suggested changes” to the design of the program. Through its various iterations, the core themes that ALAS would address have remained largely consistent. These include:

- **Transfer Pricing Analysis.** When there is a taxpayer-provided transfer pricing report, the MTC would hire or contract with economists for economic review of the report, and the MTC would utilize its auditors to perform non-economic analysis of the report, such as checking for calculation errors or the absence of a business purpose and selecting comparables.
- **Training.** The intent is to train auditors in a number of related areas, including how to identify issues, what information to obtain from taxpayers and how to obtain that information, and how to conduct the non-economic analysis noted above. It is important to note that training efforts are already underway. The MTC conducted a training program during March 31-April 1, which was hosted by the state of North Carolina. Ten states were in attendance: Alabama, Connecticut, Florida, Georgia, Iowa, Kentucky, Louisiana, New Jersey, North Carolina and Pennsylvania.
- **Information Exchange.** The ALAS would provide for tax authority exchange of taxpayer information related to transfer pricing issues and sharing of information for conducting joint audits.
- **Case Resolution and Litigation Support.** These activities include assisting states on strategies for appeals and litigation, providing expert witnesses in litigation and other similar activities. The design

¹ Dan Bucks was formerly the MTC Executive Director and Montana Director of Revenue.

² The Report is available [here](#).

³ The MTC previously announced that Alabama, Iowa, New Jersey and North Carolina had committed to the program during a teleconference on April 7, 2015.

⁴ Also see our [June 10, 2014](#), and [December 22, 2014](#), Alerts for further background.

⁵ The prior versions of the design are posted at <http://www.mtc.gov/The-Commission/Committees/ALAS>. During the May meeting the Advisory Group was “discharged from doing additional work on the project” and thanked by the MTC Chair and Revenue Commissioner for Alabama, Julie Magee.

⁶ An example of this letter is posted on the MTC website at the address referenced in footnote 5.

also anticipates a voluntary disclosure period to be implemented at some point during the developmental stage, which may occur during July to December of 2016.

- **Optional Joint Audits.** The plan envisions ALAS as a component of the MTC's existing Joint Audit Program. Three states joined the audit program late last year (Pennsylvania, Rhode Island and Iowa), and during the MTC December meeting Dan Bucks commented that at least one state did so in anticipation of a transfer pricing component.
- **Additional Tables.** The final program design includes in the appendix two tables that were not previously attached. The tables present "features and activities . . . in two different ways." Table 1, *Activities and Outcomes*, summarizes the types and modes of training, number of economic analyses, contractor-to-staff ratio, cost-per-state report and other activities, along with the anticipated timeframe these are intended to be achieved. Table 2, *Service Timeline*, provides in timeline format targets for certain actions over the four-year developmental and implementation periods. It includes staffing, procurement of services, voluntary disclosure and other activities, including performance evaluation.

The Path Forward

Now that the Executive Committee of the MTC has accepted the final program design, it remains to be seen whether the MTC will be able to attract enough states to commit to the program and fund it toward implementation. Matson took a moment to note that several states said they "couldn't commit at this time, but we think that it is a great project and we are very interested and want to keep an eye on what you're doing." The MTC intends the final design to be submitted to the full MTC for ratification during its annual meeting in Spokane, Washington on July 29.

It is interesting to note that during the May meeting Bucks recalled the roughly two-year implementation of the MTC's nexus program some 26 years ago and said that, regarding ALAS, he was "thoroughly convinced that this project is going to work well, certainly for the benefit of the states but also for taxpayers."

Considerations

As the final design is largely unchanged from December, the considerations we highlighted in December remain similarly unchanged. It is evident from the ongoing discussion that states have an interest in banding together to more effectively audit and address interstate and international transfer pricing issues. Furthermore, some activities, such as the above-noted transfer pricing training programs, are already under way.

With that in mind, taxpayers may wish to consider:

- Developing state-relevant, exam-ready transfer pricing documentation to the extent such information has not been prepared previously; and
- Conducting a review of any existing transfer pricing studies to determine whether an update is advisable given any changes to the taxpayer's business activities or whether such studies need to be adapted to take into account state laws, such as statutory addbacks, in particular with respect to the pricing of goods that could be perceived as including an embedded royalty, as well as penalty provisions.

Taxpayers may also wish to consider whether this initiative, coupled with the potential for increased uniform compliance projects, signals a shift away from legislative and regulatory drafting toward more emphasis on enhanced enforcement through the leveraging of state discretionary administrative powers.

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