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MTC Advisory Group Nears Completion of Design of Transfer Pricing Audit Program

Overview of the Recent Advisory Group Meeting

On November 3, the Arm's-Length Adjustment Service (ALAS) Advisory Group of the Multistate Tax Commission (MTC) tentatively approved a project design for its proposed multistate transfer pricing service ("ALAS Program" or "program"). Although the ALAS Program is steadily moving closer toward its projected launch, the member states remain very concerned over the cost of the program. To both justify the expense of the program and make a business case for its existence, the new design includes (1) a projection that participating states will recover *at least* $25 million annually and (2) an early six-month voluntary disclosure period to expedite settlement agreements with taxpayers.

The new project design of the ALAS Program is a variation of a previous design ("base design") proposed at the ALAS Advisory Group's October 7 meeting.[1] Both proposed designs were authored by project facilitator (and former commissioner of the Montana Department of Revenue) Dan Bucks.[2] The primary distinction between the new project design and the base design is that most activities, with the exception of transfer pricing services, are delayed about six months.

However, the core elements of the proposed ALAS Program remain intact. For instance, the program will still rely on a combination of permanent MTC staff and third-party contract economists for technical audit expertise. Moreover, the program will still have an initial charter period of four years, with the first taxpayer audits projected to commence during 2015. Finally, the ALAS Program will still rely exclusively on the

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1 See Alston & Bird, LLP, The MTC's Transfer Pricing Audit Program Comes into Focus, *available at* http://www.alston.com/advisories/MTC-transfer-pricing/.

2 For an overview of both the new project design (referred to as the "deferred staff" design) and the base design, as well as a third proposed design not adopted by the ALAS Advisory Group, see Dan Bucks, "Comparisons among Three Design Scenarios: Base, Deferred Staff, and Contractor Focus Versions" (2014), *available at* http://www.mtc.gov/getattachment/The-Commission/Committees/ALAS/Comparison-among-Three-Design-Scenarios.pdf.aspx.

contract economists for substantive transfer pricing analyses at the outset of the program, with the MTC staff gradually increasing their share of taxpayer audits over the initial charter period.

The ALAS Advisory Group plans to submit a draft design for the ALAS Program to the MTC Executive Committee in December. Prior to submitting the proposed design for final approval, however, the ALAS Advisory Group intends to circulate the design among the member states for comment. Once approved by the Executive Committee, the program would formally launch in July 2015. It is intended that the first round of transfer pricing analyses will be completed by December 2015.

Projected Fiscal Impact of the ALAS Program

According to representatives from the participating states, the perceived use of aggressive transfer pricing on corporate tax returns has had a major fiscal impact on the states. In a memorandum[3] submitted to the ALAS Advisory Group, Bucks estimates that state revenue loss from such income shifting approaches $20 billion per year.

Although the precise impact on the states is difficult to quantify, states anticipate that they would collect an additional $5 to $10 million annually through improved compliance activities. Cutting the low end of this range in half, Mr. Bucks conservatively estimates that participating states could anticipate recovering together an additional $25 million annually through the ALAS Program.

Details of the Voluntary Disclosure Period

Under the new project design, the ALAS Program will offer a six-month disclosure period for taxpayers seeking to resolve related party issues. The taxpayer application period for a voluntary settlement would start in July 2016 and end six months later in December 2016. The ALAS Program would then process disclosure applications with a target of completing agreements in March 2017.

According to the member states, the voluntary disclosure period is intended to generate revenue early in the ALAS Program's four-year charter period so that tax administrators can convince others in state government to renew the program. The need for immediate revenue is important in light of the program's projected price tag of $2 million per year. With only eight states and the District of Columbia presently contributing seed money to the development of the program, the per-member cost would exceed $200,000 per year.

Conclusion

The states' concern over the cost of the ALAS Program reveals one of the program's flaws and leads us to question whether taxpayers will be treated fairly on audit. States will undoubtedly be monitoring the revenue generated by the program closely as they consider whether to continue their funding. Similarly, third-party firms retained by the program will be incentivized to take aggressive positions on audits to demonstrate their own value.

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[3] Id.

Although the scope and timeline for the ALAS Program are still developing, taxpayers should anticipate the states to continue to conduct their own transfer pricing audits—both before and after the program's launch. Thus, the proposed ALAS Program only increases the need for taxpayers to make sure that their intercompany transactions have been reviewed by a transfer pricing expert.

Alston & Bird has extensive experience assisting clients with reviewing and defending transfer pricing issues at both the federal and state levels and would be happy to answer any questions our readers may have. We will continue to monitor developments related to the ALAS Program and will provide updates as they become available.

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