

DRAFT for ALAS Advisory Group Review

Model Arm's-Length Adjustment Service Participation Agreement and Contract for Taxpayer Compliance Services

April 2, 2015

(State) Arm's-Length Adjustment Service Participation Agreement and Contract for Taxpayer Compliance Services

This Arm's-Length Adjustment Service Agreement and Contract for Compliance Support Services ("Agreement") is between the State of _____ through the (state office legal title and agency _____), and the Multistate Tax Commission ("Commission"), through its Executive Director.

Background

- States face a major fiscal problem arising from those multijurisdictional enterprises that use sophisticated and complex methods to shift income or its constituent elements, via related party transactions, to more favorable tax jurisdictions. When improperly used, these practices result in significant lost revenues to the states, an uneven playing field for industry, and unfair shifts of public service costs to other taxpayers. While these problems typically arise in the context of taxes measured by net income, they may affect other sources of revenue, such as those based on receipts or commodity values.

- State revenue departments are responsible for fairly administering their tax laws to secure proper compliance by taxpayers. States have found, however, the challenges posed by improper corporate income shifting to be too costly to address on their own. They also recognize that working together creates opportunities to not only increase current tax compliance, but also continuously improve the capacity of states to address these income challenges in the future. Accordingly, the Service member states and the Commission have created the Service to fulfill the following mission:

The Arm's-Length Adjustment Service provides states with timely, cost-effective services and opportunities for interstate cooperation to help attain equitable compliance by corporate taxpayers with state business taxes in circumstances where improper related party transactions undermine equity in taxation.

- The Commission is an intergovernmental state tax agency created by the Multistate Tax Compact (“Compact”), an interstate compact enacted in substantially similar form by each of the states that are a party to the Compact.

- The Compact enumerates four purposes, each relevant to the operation of the Commission’s Arm’s-Length Adjustment Service (“Service”)—

1. To facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.
2. To promote uniformity or compatibility in significant components of tax systems.
3. To facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
4. To avoid duplicative taxation.

- The Commission has the power to compile and publish such information as would, in its judgment, assist the states that are a party to the Compact in implementation of the Compact and taxpayers in complying with state and local tax laws. The Commission also has the power to do all things necessary and incidental to the administration of its functions pursuant to the Compact.

- The Commission has determined that efforts to achieve the purposes of the Compact are furthered through the Service; and that its effectiveness in achieving its purposes is increased by providing the Service to as many states at one time as practicable.

- The Commission may accept for any of its purposes and functions any and all donations and grants of money, equipment, supplies, materials, and services, conditional or otherwise, from any governmental entity, and may utilize and dispose of the same.

- The Compact requires the Commission to charge fees for taxpayer compliance activities on a cost basis only. Accordingly, the Commission is prohibited from and will not accept fees from states for the Service contingent on the taxes assessed to or paid by taxpayers to states in cases assisted by the Service. Further, the Commission will not compensate employees or contractors engaged for the Service on the basis of taxes assessed to or paid by taxpayers to states in cases assisted by the Service. The Compact permits the Commission to allocate fees for the Service among states using a formula based on aggregate revenues from state taxes, such as the formula under Article VI of the Compact for assessments of party states.

- (State) would like to participate in and contract for taxpayer compliance services provided through the Commission's Service.

- The taxing authority of (State) remains inviolate. (State) does not surrender, delegate or contract away in any manner or extent its taxing authority, including its authority to determine and assess taxes due from taxpayers subject to its jurisdiction, by participating in the Service. The activities of the Service do not impair, diminish or interfere with (State) exercising its taxing authority. To the contrary, the activities of the Service support and strengthen the ability of (State) to exercise fully and effectively such authority.

- The Commission operates on a fiscal year basis, each year beginning on July 1st and ending on June 30th of the succeeding year.

With this background in mind, the parties agree as follows.

Terms and Conditions

1. Term

1.1. Initial Term and Renewal. The initial terms of this Agreement begins on the Agreement date and continues through June 30, 2019. The parties may renew the Agreement in writing for successive one-year terms thereafter.

1.2. No Obligation to Renew. Nothing in this Agreement creates any express or implied obligation on either party to renew or extend the Agreement or any right to continue the Agreement on the same terms and conditions contained in the Agreement.

1.3. Charter Period. (State) hereby commits to participating in the Service for an initial Charter Period extending from the date of this Agreement through June 30, 2019, consisting of four fiscal years beginning on July 1, 2015, subject only to the availability of sufficient appropriations for meeting the payment obligations to the Commission for the Service.

1.4. Minimum Number of State Participants Required. As a condition precedent to the continued operation of the Service, the minimum number of states required to be members providing financial support to the Service shall be seven (7) states. A subdivision of any state may become a member of the Service upon terms and conditions to be established by the Commission.

1.5. Termination.

1.5.1. Charter Period Termination. During the Charter Period, (State) may terminate this Agreement by providing 60 days' notice to the

Commission certifying that it does not have appropriations sufficient for meeting the payment obligations for the Service and for that reason alone is terminating the Agreement. The Commission, during the Charter Period, may terminate this Agreement on 60 days' notice to (State) certifying that the condition of the minimum number of state participants in the Service is no longer met or that circumstances beyond its control exist that prevent the Commission from operating the Service.

1.5.2. Post-Charter Period Termination. After the Charter Period, either party may terminate this Agreement for any reason by providing at least 30 days' notice to the other party.

1.5.3. Disposition of Funds and Payment Obligations. All funds committed by the (State) for the Service for the fiscal year during which the notice of termination is given, to the extent unpaid, shall remain the obligation of (State) to the Commission. Any funds for the Service paid by (State) for the fiscal year in which notice is given remain Commission funds for the Service. (State) shall be relieved of its obligation to pay its proportion of the budget allocation for the fiscal year for which the terminating notice is effective and any subsequent years. The Commission will refund any funds paid by (State) for subsequent years after the fiscal year in which the notice of termination was given. No other refund shall be made to (State) except as determined by the Commission.

2. Service Design, Organization and Management

2.1. Service Design. The parties hereby incorporate by reference the description of the service components, activities and methods of operation contained in Attachment 1 hereto, entitled "Design for an Arm's Length Adjustment Service," approved by the Commission's Executive Committee on May 7, 2015.

2.2. Arm's-Length Adjustment Service Committee. The Arm's-Length Adjustment Service Committee ("ALAS Committee") will provide oversight regarding and advise the Commission on Service's operation and future direction. The Service Committee will operate under Commission bylaws and policies applicable to its committees. The Executive Committee will establish a charter to define the role and responsibilities of the ALAS Committee.

2.2.1. Appointment and Voting. The head of the tax agency of (State) shall appoint a delegate to represent the (State) on the ALAS Committee. (State) shall have one vote regarding matters that come before the committee.

2.2.2. Reports and Recommendations. The ALAS Committee shall make a report regarding the progress of the Service and any recommendations that it may have with respect to the Service to the

Commission and to the Executive Committee at all regularly scheduled meetings of those bodies or any other meeting called for the purpose of reviewing the Service.

2.3. Executive Officer. The MTC Executive Director is the officer responsible for administering the Service in accordance with all applicable federal, state and local laws; the Multistate Tax Compact; the policies and actions of the Commission and its Executive Committee; and the terms of this Agreement. The Executive Director is responsible for the employment, supervision, and termination of staff and contractors for the Service in accordance with Article VI of the Compact.

3. Budget, Fees, Payments and State Obligations

3.1. Budget. The Executive Committee will approve a budget for the Service for fiscal year operations prior to the beginning of each fiscal year.

3.2. Allocation of Costs and Payment Obligations

3.2.1. Introduction and Process. (State) shall pay its share of the costs of the Service as determined by the methods described in this section. This section controls such allocations, and not the more general descriptions of such matters in Attachment 1. The allocation of costs is subject to change by approval of both the ALAS Committee and the Commission's Executive Committee.

3.2.2. Service Budget Overview. The Executive Director, in preparing the annual budget of the Service for consideration by the Executive Committee, will divide it into two parts: (1) the general services portion and (2) the transfer pricing analysis portion. The general services portion of the budget includes Service administration, training, information exchange, case assistance, process improvement, case resolution, litigation support services and other activities intended to support and build the capacity of states to address related party transaction issues. The transfer pricing analysis portion consists of the coordination, supervision and conduct of both technical reviews and economic analyses of taxpayer transfer pricing documentation and positions. Service member states that are not Compact or Sovereignty Members of the Commission will also pay the applicable Commission general operation's support fee in effect for any given fiscal year.

3.2.3. General Services Fee. The general services portion of the Service budget will be allocated among states by a formula, ten percent of which is an equal share per state and ninety percent based on relative revenues from state corporate income taxes and any other taxes for which a state uses the Service. The Commission will ask states each year to identify changes in the taxes for which they use the Service. The resulting amount is considered the "general services fee" for each Service member state. Training

course registration fees will also be used to support training activities in the general services portion of the budget.

3.2.4. Transfer Pricing Analysis Charges and Credits. The transfer pricing analysis portion will be allocated on the principle of sharing costs equitably in proportion to the extent and costs of services used by each state. The Service budget costs for technical reviews will be allocated through an equal charge per state. The Service budget costs for economic reviews will typically be divided equally among the states participating in a specific taxpayer analysis. Costs may be further subdivided and proportionately reallocated among the states participating in a taxpayer case if the participating states use distinctly different levels of analysis, such as (a) an informal evaluation of the taxpayer's position, (b) a formal economic and statistical analysis of a taxpayer transfer pricing study or (c) the formal analysis plus the development of an alternative transfer pricing position for use by a state. In such cases, the costs allocated to the states will be proportionate to costs incurred, will vary among states requesting different levels of analysis, but will be typically shared equally among states requesting the same level of analysis. The final transfer pricing analysis cost in a year for each state will be the sum of the equal share of technical review costs and its share of the costs of the economic analyses in which it participated and, if relevant, adjusted further for the level of analysis conducted for the state.

3.2.5. Same Calculations for Service Members Regardless of Status in the Commission's Joint Audit Program for Corporate Income Tax. There will be no difference in the method of calculating the transfer pricing analysis fees for (a) Service member states requesting the analyses for cases under audit through the Commission's Joint Audit Program for Corporate Income Tax ("Joint Audit Program") and for (b) Service member states requesting the analyses for cases being audited by those states individually.

3.2.6. Calculations for Audit Program Members that are Not Service Members. States that are members of the Commission's Joint Audit Program but that are not members of the Service may, elect at their discretion, to participate in the transfer pricing analysis of a joint audit being conducted by the Commission on their behalf. In those cases, the Commission will charge the Joint Audit Program members that are not Service members an amount reflecting their share of the analysis, covering both the technical and economic portion of the analysis, plus a proportionate share of the Service's costs of coordinating and supervising transfer pricing analyses.

3.2.7. Billing and Adjustment Process.

3.2.7.1. Base Economic Analysis Charge. The Commission will bill states for economic analysis costs in two stages each year. At the beginning of the year, the Service staff will calculate a “base economic analysis charge” using the projected total usage and costs of the transfer pricing analysis service for the upcoming fiscal year. The projected usage and cost will translate into a budget item for conducting economic reviews. This budget item for conducting economic reviews will be divided equally among Service member states to compute the “base economic analysis charge.”

3.2.7.2. Calculation of Total Service Fee for Initial Billing. The general service fee for each state and the equal charge per state for technical reviews will be added to this base economic analysis charge for purposes of the Commission’s initial billing of Service fees prior to the onset of each fiscal year. (State) will remit the payment for Service fees less any credits from prior years, when initially billed unless a state makes other payment arrangements with the Executive Director. The general service fees and the charge for technical reviews in this initial billing will be the final, fixed amounts for the fiscal year. The base economic analysis charge will be subject to adjustment by the end of the year.

3.2.7.3. Adjustments to Economic Analysis Charge. The Commission will track actual cost and usage of the economic analysis service by each state during the year and report periodically its cost and usage to each state. As promptly as feasible after the close of a fiscal year, the Commission will bill each state for costs for any usage and cost of the economic analysis service by a state in that fiscal year that exceeds the original amount calculated in the base transfer pricing analysis charge. If a state’s usage and cost of the analysis service is less than was calculated in the base charge, the state would receive a credit to be applied against Service fees charged to the state for the following fiscal year, provided that the state participated in at least the average number of transfer pricing analyses assumed in the calculation of the base charge for that year. If the state had participated in fewer than the average number of transfer pricing analyses assumed in the calculations of the base charge, the credit to be carried over to the following fiscal year would be 90% of the credit due had the state participated in at least the average number of anticipated analyses

3.2.7.4. Charges for Delayed Requests of Analyses. If a state that is a member of either the Service or the Commission’s Joint Audit Program requests access to a transfer pricing analysis in which it had

not originally participated, the requesting state will be charged its applicable share of the costs of the analysis calculated in accordance with paragraphs 3.2.5 and 3.2.6. The requesting state's agreement to the charges will be a necessary condition to its receipt of the analysis. The states that were originally charged for the full costs of that analysis will each be credited with a proportionate share of the amount paid by the state making the delayed request for the analysis, with such credits to be applied against Service fees for those states for the following fiscal year.

3.2.8. Training Course Fees and Exception Thereto. The Commission will charge fees for training courses separate from and in addition to other fees for the Service. The Commission will not, however, charge training course fees for the training of state review auditors to perform technical reviews of taxpayer transfer pricing studies.

3.2.9. Prepayment Allowed. (State) may, in its discretion, pay in any fiscal year amounts otherwise due under this Agreement for subsequent fiscal years.

3.2.10. Special Payment Arrangements and Multiple Billings. Some states may not be able to contribute their funds at the same time as other states are able for reasons related to the budgetary cycle or the amount of discretionary funds available to the states. The Executive Director is authorized to exercise discretion and collect each state's funds in such increments and at such times as may be necessary, consistent with the best interests of sustaining the Service. If the urgency of paying contractor or staff costs for transfer pricing analyses so requires, the Executive Director may bill states for excess economic analysis costs at multiple times in the course of a fiscal year as necessary to ensure solvency of Service funds and meet commitments to contractors and staff.

3.3. Project Funds. All funds paid by states to the Commission for the Service shall be deemed state funds that are specially appropriated for the operation of the Service. Such funds shall be specifically accounted for in the Commission's books and records and any Service member state has the right to examine the books and records regarding such funds.

3.4. State Designated Transfer Pricing Review Auditors. (State) will designate at least one person from its state tax agency staff to conduct technical reviews of taxpayer transfer pricing studies. The Service will provide training for the state designated staff without separate course fees for such training. (State) agrees to maintain a level of effort in conducting such reviews comparable to that of other Service member states.

4. Confidentiality and Exchange of Information

4.1. Confidentiality and Information Exchange Agreement Required. (State) and the Commission shall enter into and sign the Arm's Length Adjustment Service Confidentiality and Exchange of Information Agreement (Attachment 2).

4.2. Applicable Confidentiality Laws. The Commission and its agents and employees, as authorized by (State) with respect to services provided under this Agreement, are required to comply with the applicable laws of (State) regarding the confidentiality of information received during and after the term of this Agreement.

4.3. Disclosure. All taxpayer information derived from the activities of the Service by the Commission under this Agreement belongs to (State) and is subject to (State's) laws, policies, and procedures with respect to information sharing and disclosure.

4.4. Non-Disclosure in Certain Cases. (State) agrees not disclose transfer pricing analysis information to another state that is making a delayed request for the analysis in which it did not participate until the Commission advises that the requesting state has agreed to the terms of paragraph 4.3.7.4 of this Agreement.

4.5 Consent to Limited Disclosure. (State) consents to limited disclosure of administrative information, e.g., taxpayer name, process reports, and status, to other states participating in the Service and states that are parties to the Compact during closed sessions of the Commission's ALAS and Executive Committees held in accordance with section 15 of the Commission's Public Participation Policy. (State) also authorizes and consents to allow the Commission to release transfer pricing analyses to states making a delayed request for such analyses to administer subsection 4.3.7.4 of this Agreement.

5. Miscellaneous Clauses

5.1. Entire Agreement. This Agreement constitutes the sole agreement of the parties with respect to its subject matter. It supersedes any prior written or oral agreements or communications between the parties. It may not be modified except in a writing signed by the parties.

5.2. Waiver. If either party fails to require the other to perform any term of this Agreement, that failure does not prevent the party from later enforcing that term. If either party waives the other's breach of a term, that waiver is not treated as waiving a later breach of that term.

5.3. Notices. All notices and other communications required or permitted under this Agreement must be in writing and must be sent to the party at that

party's address set forth below or at whatever address other address the party specifies in writing.

5.4. Severability. If any part of this Agreement is for any reason held to be unenforceable, the rest of it remains fully enforceable.

5.5. Headings. Headings are for convenience only and do not affect the interpretation of this Agreement.

5.6. Applicable Law. (State) law applies to this Agreement without regard for any choice-of-law rules that might direct the application of the laws of any other jurisdiction.

5.7. Counterparts. This Agreement may be signed in counterparts, each one of which is considered an original, but all of which constitute one and the same instrument.

Executed on the dates shown below by the following parties:

MULTISTATE TAX COMMISSION
444 North Capitol Street, N.W., Suite 425
Washington, D.C. 20001

By: _____
Joe Huddleston, LL.D.
Executive Director

Date: _____

(State and Agency)
(Address Line 1)
(Address Line 2)
(Address Line 3)

By: _____
(Name of Signatory)
(Title of Signatory)

Date: _____