Proposed Arm’s-Length Adjustment Service

GUIDE TO THE PRELIMINARY DESIGN

MTC EXECUTIVE COMMITTEE
DECEMBER 12, 2014

DAN BUCKS
PROJECT FACILITATOR
Introductory Comments

- Process
  - Open and Transparent
  - State of the Art Knowledge from States and Experts
  - Executive Management Perspective: Fitting Pieces Together

- Service Readily Cost Justified

- Long-Term Resource for Several Contexts & States

- Key Step: Response of States
Why States Need to Act

Improper Income Shifting Causes:

- Significant, unjustified state revenues losses.
- Uneven playing field among businesses.
- Unfair shifts of public service costs to other taxpayers.
- Loss of societal trust.
The MTC 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.

Proposed goals and objectives tailored to this mission.
Interrelated Service Elements

- Training
- Analysis of Transfer Pricing Studies
- State Capacity Building—Beyond Training
- Optional Joint Audits

All Mutually Supportive
Pre-Launch Stage

Begin Recruiting States

January 2015

Revise Preliminary Design

February 2015

“Identifying Issues” Course

March 2015

Draft Staff Recruiting Documents and Initial Performance Objectives
Pre-Launch Stage

- Sufficient # of States Triggers Staff Recruiting
- States Appoint ALAS Committee
- Tax Manager Hired

- April 2015
- May 2015
- June 2015

Draft Documents:
- RFP for Economic Services Contract(s)
- Exchange of Information Process
- Refine Performance Objectives to Submit to ALAS Committee

Preliminary Design Pages 23 & 24
Developmental Stage—Year One

Service Launched!

ALAS Committee Meets Reviews Performance Objectives

RFP Issued for Economic Services

Tax Manager Begins July 1

Information Agreement Drafted and Circulated to States

July 2015

August 2015

September 2015
Developmental Stage

Information Exchange Process Established

Contract(s) Signed for Economic Services
- States Select Cases for Transfer Pricing Analysis

October 2015
- Tax Manager Begins July 1
- Recruiting for Senior Economist

November 2015
- ALAS and Audit Committees
- Consult on Related Party Audits

December 2015
- Recruiting for Attorney

Preliminary Design Pages 24 & 25
Developmental Stage—Year One

Analysis of Transfer Pricing Studies Underway

January 2016
- Senior Economist Begins January 1
- Organizing Initial Training Efforts

February 2016
- Recruiting for Pricing Auditor

March 2016
- Attorney Begins March 1 & Organizing Case Assistance & Resolution for States

Preliminary Design Pages 24 & 25
Developmental Stage—Year One

- **Training Conference for Front-Line Staff**
  - April 2016
- **Identifying Issues & Securing Documents Course**
  - May 2016
- **Case Assistance & Resolution Begins**
  - June 2016
- **Pricing Auditor Begins**
  - April 1
- **States Designate Staff for Pricing Study Audits**
- **Developing Taxpayer Voluntary Disclosure Opportunity**
- **9 Transfer Pricing Analyses Completed**
- **Organizing Training of State-Designated Pricing Audit Staff**

Preliminary Design Pages 24 & 25
Developmental Stage—Year Two

Voluntary Disclosure Process Begins with Taxpayer Applications
First Half of Training for State Pricing Audit Staff
Process Improvement Activities Begin

Voluntary Disclosure Process Begins with Taxpayer Applications
States Submit Cases for Year 2 Transfer Pricing Study Analysis
Audit Program Expands Treatment of Related Party Issues
Recruiting for Second Economist

Preliminary Design Pages 26 & 27
Developmental Stage—Year Two

October 2016
- Second Economist Begins October 1

November 2016
- ALAS Economists Begin Supplementing Contract Economists in Analysis of Transfer Pricing Studies

December 2016
- Six-Month Taxpayer Application Period Closes for Voluntary Disclosures
- Second Half of Training for Pricing Auditors--Technical Audits of Pricing Studies Begin

Fundamentals of Related Party Compliance Course & Front-Line Staff Conference
Developmental Stage—Year Two

- Voluntary Disclosure Agreements Processed through March 31
- Fundamentals of Related Party Federal & State Law Course
- Case Assistance Expands to Include Informal Evaluations of Taxpayer Positions
- Technical Audits of Transfer Pricing Studies Increase

January 2017
February 2017
March 2017
Developmental Stage—Year Two

- Semi-Annual Training Conference of Front-Line Staff—Identifying Issues & Securing Documents Course
- 18 Analyses of Transfer Pricing Studies Completed—15 Contract, 3 Staff
- Recruiting for Third Economist
- MTC Joint Audit Program Continues to Increase Attention to Related Party Issues

- All Service Elements Operational!

Preliminary Design Pages 26 & 27
Fully Operational Stage—Year Three

Training
- Semi-Annual Front-Line Staff Conference
- Three Major Training Courses Annually: Law, Compliance, and Issues & Documents

Transfer Pricing Analysis
- 24 Analyses, 12 by Staff, 12 by Contractors
- Technical Reviews in All Cases by ALAS Staff and Trained State Staff
- Informal Evaluations of Taxpayer Positions
Fully Operational Stage—Year Three

State Capacity Building

• Information Exchange, Case Assistance, Case Resolution and Litigation Support
• Process Improvement for Uniformity, Reduced Taxpayer Costs & Increased Effectiveness

Optional Joint Audits

• MTC Joint Audits Fully Address Related Party Issues
• ALAS Provides Economics Expertise and Training
Fully Operational Stage—Year Four

Training
- Semi-Annual Front-Line Staff Conference
- Three Major Training Courses Annually in Fundamental or Advanced Versions

Transfer Pricing Analysis
- 27 Analyses, 19 by Staff, 8 by Contractors
- Technical Reviews in All Cases by ALAS Staff and Trained State Staff
- Informal Evaluations of Taxpayer Positions

Preliminary Design Pages 10-18
Fully Operational Stage—Year Four

State Capacity Building
- Information Exchange, Case Assistance, Case Resolution and Litigation Support
- Process Improvement for Uniformity, Reduced Taxpayer Costs & Increased Effectiveness

Optional Joint Audits
- MTC Joint Audits Fully Address Related Party Issues
- ALAS Provides Economics Expertise and Training

Preliminary Design Pages 18-22
Evaluation Process

**Performance Objectives Year One**
- Drafted in Pre-Launch Stage
- Adopted by ALAS Committee to Guide Service in Charter Period

**Mid-Term Evaluation Year Three**
- Information Exchange
- Improvements
- Review of Training Mix & Methods
- Emerging Issues

**Final Evaluation**
- ALAS Evaluates Service Results Compared to Objectives
- Recommendations to MTC and States
## Estimated ALAS Budget for Charter Period
(Nearest $1,000—Totals Do Not Add Due to Rounding)

<table>
<thead>
<tr>
<th>Category</th>
<th>FY 2016</th>
<th>FY 2017</th>
<th>FY 2018</th>
<th>FY 2019</th>
<th>4-Yr.Total</th>
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<tr>
<td>General Services</td>
<td>$534,000</td>
<td>$789,000</td>
<td>$701,000</td>
<td>$717,000</td>
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<td>Transfer Pricing Analysis</td>
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# Staffing

## Summary of ALAS Staffing in Charter Period

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<tr>
<th>Fiscal Year</th>
<th>Positions</th>
<th>Est. Hire Date</th>
<th>FTE</th>
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<td>FY 2016</td>
<td>Tax Manager</td>
<td>July 1, 2015</td>
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<td></td>
<td>Senior Economist</td>
<td>January 1, 2016</td>
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<td>Attorney</td>
<td>March 1, 2016</td>
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<td></td>
<td>Pricing Auditor</td>
<td>April 1, 2016</td>
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<td><strong>Total</strong></td>
<td></td>
<td><strong>2.08</strong></td>
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<tr>
<td>FY 2017</td>
<td>Staff in FY 2016 Economist</td>
<td>October 1, 2016</td>
<td>4.00</td>
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<td></td>
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<td>.75</td>
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<td><strong>Total</strong></td>
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<td><strong>4.75</strong></td>
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<td>FY 2018</td>
<td>Staff in FY 2017 Economist</td>
<td>July 1, 2017</td>
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<td></td>
<td><strong>Total</strong></td>
<td></td>
<td><strong>6.00</strong></td>
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<tr>
<td>FY 2019</td>
<td>Staff in FY 2018</td>
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<tr>
<td></td>
<td><strong>Total</strong></td>
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<td><strong>6.00</strong></td>
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## Transfer Pricing Analyses and Costs Per State Report

<table>
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<th>Item</th>
<th>FY 2016</th>
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<th>FY 2018</th>
<th>FY 2019</th>
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<td>Contractor Analyses</td>
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<td><strong>Total Analyses</strong></td>
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<td>18</td>
<td>24</td>
<td>27</td>
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<td>State Reports</td>
<td>27</td>
<td>54</td>
<td>72</td>
<td>81</td>
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<tr>
<td><strong>Average Cost Per State Report</strong></td>
<td><strong>$26,700</strong></td>
<td><strong>$27,100</strong></td>
<td><strong>$21,000</strong></td>
<td><strong>$15,300</strong></td>
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