

PRESENTATION TO MULTISTATE TAX COMMISSION

ALAS PROJECT

ECONOMIC ANALYSIS GROUP LLP

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INTRODUCTION

Technical Expertise

- Multistate
- Transfer pricing
- Economics

Backgrounds

- Big 4 backgrounds - 75 combined years of experience
- Hundreds of transfer pricing studies – every commercial business activity
- Design and implementation of approximately 100 state tax structures

QUESTIONS 1 & 2

WHAT ARE THE GREATEST CHALLENGES THAT STATES MIGHT FACE IN IMPROVING TAX COMPLIANCE RELATED TO INTERCOMPANY TRANSACTIONS THAT DISTORT THE REPORTING OF INCOME TO THEIR STATES?

WHAT ARE SOME OF THE BEST WAYS FOR STATES TO MEET THOSE CHALLENGES?

CHALLENGES & POTENTIAL SOLUTIONS

Challenges	Solutions
Taxpayer efforts & attitudes	Change resulting from a combination of factors described below; penalty provisions
Identification tools in returns are lacking	Enhanced reporting requirements
Statutes fail with respect to embedded royalties	Adopt specific regulatory language
Discovery of planning problematic	Training and research to narrow the focus in identification attempts; information sharing among states & continuous role for consultants
Proving the royalty	Section 482 transfer pricing principles and studies – broad case support serves as precedent
The next new planning technique (scheme)	Maintain contact with practitioners and continue training

QUESTION 3

WHAT TYPE OF SERVICES IS YOUR FIRM PREPARED TO PROVIDE STATES TO ASSIST WITH TRANSFER PRICING TAX COMPLIANCE AND IN WHAT MANNER MIGHT THOSE SERVICES BE PROVIDED?

POTENTIAL SERVICES

We believe that the most effective way to implement our services would begin with a two-day intensive training program

- Ensures that all impacted persons have the same base of knowledge in this area and
- We speak with a common language

POTENTIAL SERVICES – INITIAL TRAINING

Topics Covered in Training Seminar

- Fundamental elements of state income tax planning
- Embedded royalties and next generation planning
- How taxpayers sell, design and implement planning
- Transfer pricing principles and studies
- Required contents of transfer pricing studies
- Section 482 and state rules (anti-PIC, etc.)
- Identification of planning structures
- Audit essentials including IDRs, studies, taxpayer arguments, etc.

POTENTIAL SERVICES – POST TRAINING

Service	Description
Identification	We would assist in identification, which may take the form of an effective rate analysis, a focus on certain SIC or NAICS codes, a review of public company subsidiaries lists in SEC filings, and a review of existing decided cases.
Audit support	We would draft appropriate information requests; assist in securing the appropriate 3rd party documents; help build and execute the audit plan and provide support in analyzing taxpayers responses.
Transfer pricing analysis	Prepare a comparable set of economic data; choose the best method; and prepare a study to support disallowance.
Appeals support	We would be willing to participate in hearings, review documents provided by taxpayers at that level, and consult with appeals officers as needed.
Litigation support	We would be available to consult with counsel and provide expert testimony as requested.
Miscellaneous	General consulting and services related to proposed solutions.

QUESTION 4

GIVEN THE FACT-INTENSIVE NATURE OF TRANSFER PRICING WORK, HOW MIGHT STATES BEST INTEGRATE EXPERTISE IN ECONOMICS AND STATISTICAL ANALYSIS WITH THEIR AUDIT AND LEGAL STAFFS IN THE TAX ADMINISTRATIVE PROCESS?

INTEGRATION OF SERVICES

Timing

- A “fact-intensive” process requires integration when the facts are being developed
- If fact development could be done remotely, we would have sent you our comments in writing

Recommended logistics

- Integrating with dedicated professionals responsible for each administrative stage (audit, appeals, and litigation)
- This would be followed by the creation of an audit plan, selection of taxpayers for examination, and the start of the examination
- Selection of a very targeted/refined group of taxpayers for the program would further our aims of efficiently raising revenue and providing a test case for litigation, if necessary

QUESTION 5

WHAT OBJECTIONS WILL STATES FACE FROM TAXPAYERS AS THEY INCREASE THEIR COMPLIANCE WORK? WHICH OF THOSE OBJECTIONS IS A LEGITIMATE CONCERN? HOW CAN STATES BEST RESPOND TO THOSE CRITICISMS?

TAXPAYER OBJECTIONS

Cost of transfer pricing

- Initial study needed to convert CPM or other specified method
- Fee range of \$75,000 to > \$500,000

Enhanced reporting requirements

- Effort depends on uniformity of state law
- Precedent for additional reporting exists at federal level

QUESTION 6

WHAT LESSONS CAN THE PROJECT STATES LEARN FROM OTHER TAXING AUTHORITIES WITH REGARD TO TRANSFER PRICING ENFORCEMENT?

LESSONS FROM OTHER AUTHORITIES

Form 5471 (just one example)

- Enhanced reporting
 - Can facilitate audits
 - Can help in discovery
- Bolstered by substantial penalties

Accuracy related penalties

- Compliance before
- Compliance after

QUESTION 7

WHAT REMEDIES ARE MOST EFFECTIVE IN CORRECTING INCOME MANIPULATION ASSOCIATED WITH INTERCOMPANY TRANSACTIONS?

EFFECTIVE REMEDIES

Anti-PIC states will benefit from . . .

- Further training
- Transfer pricing expertise
- Additional information reporting on tax returns
- Promulgation of regulations
- Adoption of penalty provisions
- Information sharing

EFFECTIVE REMEDIES

Combined Return States

- Some spend considerable time attempting to identify ways to shift income to entities outside the combined group (non-unitary entities or foreign entities)
- Previous efforts have involved the use of sophisticated special purpose entities and other means of creating non-includable corporations
- With respect to these efforts, identification of the planning and statutory or regulatory fixes must follow the initial set up of these structures quickly
 - Information sharing is critical to a timely response

EFFECTIVE REMEDIES

Forced combined

- We believe these states have the least effective tools to combat state income tax planning
- They offer no means by which the taxpayer can undo the benefits of state income tax planning in the absence of an audit
- This contrasts with combined return states that effectively eliminate income-shifting and anti-PIC states that disallow the income-shifting through the tax return itself

QUESTION 8

WHAT OTHER ISSUES ARE IMPORTANT FOR STATES TO CONSIDER IN DESIGNING THE PROJECT MTC ARM'S-LENGTH ADJUSTMENT SERVICE?

OTHER THOUGHTS

Grouping by similarity of laws

- As the project progresses and participation is determined, we would suggest that states be grouped by the methodology used in challenging state income tax planning
- This provides for a consistent approach in the integration of transfer pricing experts with the laws of the states
- This approach would also be the most effective group for information sharing purposes

OTHER THOUGHTS

Continue training

- As you know, state income tax planning does not stand still
- Although we cannot always predict the “next new thing” we can be certain that it will come
- This will require states to stay in contact with new developments and continue training staff in the identification and audit of such developments