

Project Plan
Design of a Multistate Tax Commission Arm's-Length Adjustment Service
and a
Process for Securing Initial Commitments of State Participation in the Service

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1. Project Goal

The goal for this project is to develop a high quality, viable design for an Arm's-Length Adjustment Service that is accompanied by commitments from states to participate in the service if approved by the Multistate Tax Commission. The final design with commitments from participating states will be available for ratification by the Commission in July 2015, with implementation ready to begin thereafter. The consultant will produce a design for the service and a membership commitment process in cooperation with MTC staff and an advisory group of interested states. The MTC Executive Director will approve all recommendations before being submitted to the Executive Committee.

2. Project Tasks and Timeline

The overall tasks and timeline proposed for the project are as follows:

2.1. Defining the Project: Memorandum of Issues and Expectations
March 11—April 22, 2014

The consultant will confer with MTC legal, audit, and economics staff, interested state staff, and other experts beyond the MTC (as agreed upon with the MTC Executive Director) to identify legal, organizational, managerial, resource, financial, and state relationship issues that should be addressed in process of designing the Arm's-Length Adjustment Service. The memorandum will also identify, on a preliminary basis, the components of the service could undertake including, but not limited to:

- Providing legal assistance to states on arm's-length issues and cases,
- Developing arm's-length policies, methodologies, and practices for state consideration,
- Providing economic analysis to assist state audits and litigation,
- Exchanging information to support arm's-length compliance,
- Conducting joint audits, and
- Supplying expert witnesses.

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The consultant will also confer with the Executive Director and/or Deputy Executive Director on key expectations, requirements and practices and applicable to the design process.

This task will be accomplished by telephone and e-mail communications. The deliverable from this step will be a memorandum describing project issues, the range of potential services, expectations, requirements, and procedures. It will be available for discussion at an initial state advisory group meeting in late April or May. The memorandum will be a foundational resource document to support the design work for the service. It will serve as a continuing reference throughout the project for the consultant, MTC staff, and the state advisory group. While it can be amended by agreement with the Executive Director, the memorandum is a critical document necessary to keep this complex project on track and to enhance its potential for a successful conclusion.

The consultant will also present an overview of the project and discuss it with MTC Audit Committee in Denver, Colorado on March 13, 2014.

2.2. Organizing the Project: Development of State Advisory Group—March 11—April 22, 2014

In conjunction with Task 2.1, the consultant will assist the Executive Director in developing a state advisory group. Membership on the advisory group will be finalized by mid-April to enable an initial meeting late April or May. The consultant will prepare a draft charter for this group by April 22. This proposal assumes that the proper avenue for communications on the formation of the group is from the MTC Executive Director to top tax administrators of interested states. The consultant will assist the Executive Director by providing suggestions for the nature of the group, preparing draft communications needed for recruiting participation, and conducting other task as determined by the Executive Director. The consultant will contact newly designated members of the advisory group to make introductions, describe the work of the group, and gather the thoughts and ideas of the members.

2.3. Designing the Project in Three Phases—April 2014 to July 2015

The design for the Arm's-Length Adjustment Service will be prepared in three phases:

- A draft service design produced by mid-November 2014 for initial review by the MTC Executive Committee in December 2014.
- A revised service design completed by March 31, 2015, to be approved by the MTC Executive Director and then submitted for review by the tax administrators of interested states.

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- A final service design accompanied by signed commitments by interested states completed by June 20, 2015, to be considered by the Commission in July 2015.

2.3.1. Draft Service Design—April 2014 to December 2014

With the assistance of the state advisory group, MTC staff, and possible outside experts, the consultant will prepare a draft design of the Arm's-Length Adjustment Service by November 18, 2014. That draft design will be available for review first by the Executive Director and then by the MTC Executive Committee at its December 2014 meeting. The draft design will describe the scope and nature of the proposed Arm's-Length Adjustment Service, its intended benefits, projected staffing details, potential budget ranges, the relationship of the service to existing MTC programs, the extent of interest expressed to date in this service, and any other relevant details deemed necessary to the project design.

At an early stage of its work, the state advisory working group should determine the likely range of activities the service could provide for states. Task 2.1 provides examples of possible activities provided through the service. The consultant will assist the advisory group in evaluating these and other potential activities the states or MTC staff may identify for consideration. The objective will be to enable the group to make a recommendation on the combination of activities to be considered for the project early so that the draft design can be completed by November.

The design work also needs to explore whether some of the activities can be optional and undertaken by only a portion of the participating states, while other activities could be core services shared and supported by all such states. For example, legal support, developing methodologies and practices, providing economic analysis or expert witnesses and exchanging information might be supported by all states, but joint audit services by only a portion of the states. The group also needs to confirm whether the project will address only domestic arm's-length adjustments or international ones as well.

The design should consider the potential for phasing the implementation of possible components of the service over time as feasible. Some components are more complex than others, and it is entirely possible to start the Arm's-Length Adjustment Service with the simplest or most readily implementable components first. The design would assume, however, that states will commit to participate in the program for an initial period of years that would cover all the common components originally envisioned for the service. While there may be optional components, funding commitments would be sought for a period of years sufficient to operate and evaluate all the components of the service.

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Once the advisory group sorts through the likely extent or combination of potential activities, the group and MTC management may need to adjust the scope of the draft design effort. If the group pursues a full range of activities, the level of detail in the design may be less than if the group pursues a narrower range of activities.

Regardless of the extent of activities, the design process needs to address the legal standards or principles that the service will apply because those standards or principles will affect most if not all the activities undertaken by the service. Questions needing attention include whether or not states intend to apply without change the methods under federal section 482 regulations, a subset of those methods or alternative means of adjustments. Answers to these questions affect staff composition, training, information resources, the type of economic analysis and expert witnesses, audit procedures and other aspects of the project.

The design work will also consider the development of performance objectives and measures to use to guide and evaluate the service during its initial years of operation. These objectives and the measures can focus the work of the service and help keep it on track in meeting the states' common goals.

Explicit objectives and measures can also establish the basis for states in evaluating the service when it comes up for renewal after its first multi-year period of operation. Stated clearly at the outset, objectives and measures can help reduce the influence of subjective, idiosyncratic, or "after the fact" judgments that can arise in discussions of multistate programs. At the time of program evaluation, states should focus substantially on these questions:

1. Did the service achieve the objectives it was asked to achieve?
2. Do those objectives or other potential objectives continue to be important to the states?

Individual states can propose additional performance objectives and measures that meet their needs provided they do not conflict with the common objectives agreed to by all states. A performance objective and measurement process of this type can help avoid circumstances where the MTC program is evaluated by states after the fact by previously unstated standards. This process might help reduce surprise departures from the service and strengthen its stability.

Beyond the general issues of legal standards and performance objectives, much of the detailed design work will be dependent on the set of

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activities chosen by the state advisory group. If there is an exchange of information component planned for the service, the design may call for the development of an information exchange agreement that provides for automatic exchanges among states, instead of the traditional individual request procedure. Further, it may describe (but not actually develop) technological requirements for such exchange of information and explore potential cooperation with the IRS.

If an audit component is pursued, the design needs to address the potential staff composition for the service—number of auditors, information support technicians, and an economist or other specialized analysts—policies and procedures for audit operations, audit selection processes, and a host of other details. Careful attention would be needed to planning a start-up period for the joint audit effort, including staff recruitment and training, the process for developing of an initial audit manual and the first round of audit selections by the participating states. The details for the funding of the start-up period would need to be addressed as well.

If an economic analysis component is pursued, the design process needs to consider the pros and cons of an in-house process staffed by employees or the use of specialized contractors or some combination of the two. Most importantly, there needs to be a process to ensure that the economic analysis is compatible with the legal standards for arm's-length adjustments chosen by the states.

These are merely brief examples of the type of detailed design work that needs to be pursued surrounding each of the components for the service selected for inclusion by the advisory group. Whatever components are selected, the design process will contain sufficient detail to enable the individual states and the MTC to make decisions on the funding, organization, and implementation of the components of the service.

The initial meeting of the state advisory group is targeted for late April or May 2014. The meeting would be a physical meeting to enable participants to meet each other and develop common understandings necessary to productive working relationships. Two other physical meetings are projected during this period, most likely in July (at the MTC Annual meeting) and October, with teleconferences occurring between these meetings. The advisory group meeting at the MTC Annual Meeting will facilitate consultation with relevant MTC committees. Funds are included for a separate, working trip by the consultant to confer with MTC staff, the IRS, and other experts as necessary during this period.

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Through the work of the advisory group, meetings and discussions with the MTC Executive Director, staff, committees, and other parties, the consultant would complete and submit the draft design by November 18, 2014. At the discretion of the Executive Director, the draft design would be placed on the December 2014 agenda of the MTC Executive Committee to secure its guidance on the project design. The consultant proposes to attend the Executive Committee meeting in December to provide information and respond to questions about the draft design.

2.3.2. Revised Service Design—December 2014 to March 31, 2015

In this period, the consultant will work with the state advisory group, the MTC Executive Director, and staff to revise and refine further details of the service design, responding to guidance provided by the Executive Committee and other input available at that stage. This period also provides an opportunity to fill in any specifics not adequately addressed in the draft design. Finally, work will be completed on implementation and start-up issues. A final physical meeting of the advisory group is proposed in this period to complete design work and conduct a review with the MTC Executive Director. This meeting will also provide an opportunity to discuss the next stage of the effort where the Executive Director submits the service design to top tax administrators of interested states to secure commitments to participate in the Arm's-Length Adjustment Service.

2.3.3. State Commitments to Participate and Commission Approval of Service—March 2015 to July 2015.

Following the submittal of the revised service design to the MTC Executive in mid-March 2015, the Executive Director would formally send interested states a letter of invitation to enter into a contract to participate in the MTC Audit Adjustment Service, subject to a sufficient number of participating states and final approval by the Commission. The letter of invitation should not be a surprise because potential participating states would have been kept apprised of the progress of the design work of the project either through participation on the state advisory group or regular communications by other means.

The consultant would prepare the draft letters of invitation to participate in the service. The MTC legal staff would prepare the contract with states.

As discussed in Task 2.3.1, states would be asked to commit to participating the service for sufficient period of time to cover start-up activities and initial operation and evaluation of the core components of the service and any optional components desired by some states. Most likely, the start-up period will be six months and the initial operating

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period three or three and a half years. The specifics would be addressed in the service design.

The follow-up process to the letters of invitation could take a variety of forms to ensure that each tax administrator considering participation is fully informed and has an opportunity to secure a response to any question, comments or suggestions he or she may have. This process could occur through individual phone calls and/or teleconferences with interested tax administrators. Visits to individual states and/or a group meeting of the tax administrators of the most likely participating states could also occur. A positive outcome would be a meeting of top tax administrators to celebrate the joint signing of contracts to participate. The consultant will work closely with the MTC Executive Director before and during this period to secure the maximum commitments possible to the new service. Responses from states with contracts to participate would be due by June 20, 2015.

The process of consultation with top tax administrators could result in some adjustments—most likely few—in the final design of the service. The consultant would advise the MTC Executive Director on any issues arising at this stage. The Executive Director would be responsible for any decisions on the final design to be submitted to the Executive Committee and the Commission.

Assuming a sufficient level of positive responses, the final design with the sufficient number of commitments to participate—including any adjustments made in any final discussions with top tax administrators—would be submitted to the Commission for approval at its annual business meeting in July 2015. If desired, the consultant would be available at this meeting to close out the design stage of the service and provide support in responding to questions and issues with regard to the service.

The design services under this proposal are anticipated to end with the July 2015 Commission and Executive Committee meetings unless extended by agreement with the Executive Director. Any assistance potentially desired with the start-up of the service would be covered either under an extension or a separate agreement.