

Memorandum

To: Arm's-Length Adjustment Service Advisory Group

From: Dan Bucks, Project Facilitator

Date: July 21, 2014

Re: Summary of Issues for Training Related to Transfer Pricing Topics: Item III.E for July 28 Meeting

Disclaimer: Unless specifically noted, this document does not represent the views of the Multistate Tax Commission, the MTC Arm's Length Adjustment Service Advisory Group, or any state. The author prepared it to help facilitate discussions by the advisory group.

This memorandum briefly summarizes issues related to training state and MTC staff on transfer price topics for purposes of discussion at the July 28 meeting of the advisory group. The term "training" here includes both formal classes and more informal coaching of staff in the course of conducting compliance work.

The issues are described here by the subject matter of the training or coaching. In each instance, potential sources of the training and audiences for it are noted. In addition, the possible evolution over time of how the training would be provided is discussed.

This is not an exhaustive or definitive presentation of the issues. States may have additional ideas as to subject matter, sources and audiences for training. Again, the purpose of the memorandum is to provide a basis for discussion.

It should be noted that unlike the current MTC training programs, much of the expertise needed initially for the training may well be outside of the MTC staff and individual states. That could generate, in some cases, higher costs than states typically associate with MTC training courses. That potential creates an added incentive for developing the expertise within the MTC project and the individual states.

Further, the MTC might well reach out to the IRS in terms of exploring its assistance with training of state staff on transfer pricing issues.

Training on IRS 482 Regulations

Although states do not necessarily replicate the practices of the IRS, transfer pricing studies prepared for taxpayers typically purport to follow IRS regulations. If that is the standard claimed for taxpayer studies, then state and MTC staff should be

sufficiently aware of relevant IRS standards in order to evaluate the validity of such studies. Such training will also assist states in ensuring that alternative transfer pricing studies for which they may contract also meet federal standards.

The sources for training on this topic might be the IRS, private firms offering transfer pricing and economics consulting services, experts from states and, eventually, MTC staff. The audience for the training would be state and MTC staff involved in transfer pricing issues, be they auditors, attorneys or policy staff.

Over time, members of the MTC legal and arm's-length services staff and an increasing number of state staff may become sufficiently expert on these matters to service as faculty for this training.

Training on Transfer Pricing Compliance Methods

A wide range of subjects may fall under this heading. Indeed, as this subject is explored further it may be divided into several parts. At this point, it covers at least the following:

- Audit selection procedures,
- Planning audits for cases that include related party transactions,
- Methods of identifying transfer pricing problems,
- Understanding how to integrate economic analysis into the audit process,
- Using and enforcing effective information document requests,
- Conducting technical reviews of transfer pricing studies (see companion memorandum on "Maximizing Cost-Benefit of Economics Expertise") prior to economic analyses, and
- Developing defensible transfer pricing adjustments.

The sources for this training might initially be firms offering transfer pricing and economic consulting services, the IRS, and some veteran state staff. Over time, it may well be desirable from both a cost and relevance standpoint to develop the training expertise within staff of the MTC project.

The audience for this training would be similar to that for the IRS regulatory training: state and MTC staff involved in transfer pricing enforcement, primarily auditors, attorneys and anyone being trained to conduct technical, pre-economic reviews of transfer pricing studies.

Coaching on Transfer Pricing Audit Issues

This topic may be viewed as an extension of the previous one, but it differs in the sense that it involves coaches or mentors assisting auditors in dealing with particular transfer pricing issues in the course of an audit. These efforts would typically involve economists assisting auditors in identifying particular transfer pricing issues in audits, tailoring information document requests to particular audit circumstances and advising on audit adjustments. The reason that a need may exist

in this area, despite high costs, is the high level of detail and complexity involved in transfer pricing cases.

Two types of situations might typically require such coaching. The first would be the case of state or MTC auditors who are relatively new in dealing with these issues. The second would involve unusually complex cases that require advanced expertise by auditors and economists to address effectively.

The sources of this coaching would likely be contract economists or an MTC economist. The costs associated with this activity might make the development of economics expertise within the project attractive. Further, some emphasis might be placed on developing mentors within state staffs for new staff members.

Emerging Compliance Issues Training

The MTC audit program typically serves as a vehicle for educating participating states on emerging tax compliance issues. Similarly, the optional joint audits that for transfer pricing issues would provide a similar forum for keeping pace with issues in this area. If there is a sufficient information exchange framework developed for the project, states not participating in the joint audit services could similarly join these discussions on emerging issues. There are minimal incremental costs beyond the audit activity itself for this type of training.

Litigation Training

As with other areas of state tax litigation, periodic consultation among state attorneys on legal issues involved in transfer pricing cases may well be desirable. This type of training accomplished through mutual discussion processes is relatively inexpensive as compared to the other types of transfer pricing training.

A formal course in the use and presentation of economic analysis in litigation might be a useful adjunct to this consultation process. Such training might involve an economist and an attorney as faculty.

Final Note

Again, this memorandum does not exhaust the potential areas of training for state staff. Hopefully, it does provide a useful framework for organizing the discussion of the training elements of an MTC Arm's Length Adjustment Service.