

Legal Alert: MTC Launches Transfer Pricing Effort



June 2, 2014

On June 2, the Arm's Length Advisory Group (the Group) of the Multistate Tax Commission (MTC) met in St. Louis, Missouri, to begin the process of developing a multistate arm's length pricing adjustment service. States participating in the meeting included Alabama, Florida, Georgia, Iowa, Kentucky, New Jersey, North Carolina and the District of Columbia. Joe Garrett (Alabama) was elected to chair the Group. The Group is primarily concerned with addressing the inability to effectively conduct transfer pricing audits at the state level. It seeks to create a viable project design sufficiently developed for an operational model by July 2015.

The need for the Group—according to the representatives from the participating states—derives from an inability to successfully rectify corporate income tax returns that states assert are distorted. While most states participating in the Group have applied expense disallowance rules for the better part of a decade, the states still believe that many intercompany transactions not covered by expense disallowance are distortive.

One issue contributing to this problem from the state's perspective is the lack of substantial resources to successfully enter into a dispute with a taxpayer asserting that a transfer pricing agreement accurately represents the value of an intangible asset. For example, while the taxpayer consults with economists to accurately determine the true market value of an intangible asset, states lament their inability to obtain such a costly, detailed and thorough report. Moreover, states lack the human capital necessary to conduct an extensive transfer pricing audit, thus increasing the demand for the MTC to participate in such audits. New Jersey, the District of Columbia, Alabama and Kentucky have all previously contracted with third-party consultants to assist in transfer pricing assessments or audits.

Two substantive recommendations were offered for discussion by Dan Bucks, the project facilitator. First, to compensate for

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the lack of state resources, the MTC could develop institutional knowledge and experts with statistical and economic expertise. This expertise would be utilized by participating states to determine the true market value of intangible assets transferred by intercompany agreements. How the economist or other expert would develop the report for the state was still to be determined. With limited public taxpayer financial information, an economist would inherently fail to make a precise calculation without all relevant financial information. Simply put, the economic expertise is useless without the economic figures needed to develop a legitimate transfer pricing report. Ultimately, the viability of an expert to assist the MTC was left unresolved.

Second, the Group discussed the possibility of creating a joint audit function to assist with corporate taxpayer compliance and expedite the development of state institutional audit knowledge. The Group cited the ability of joint audits to “accelerate the training and acquisition of expertise by the staff of individual agencies.” However, it is unclear where—if at all—joint audits in the context of transfer pricing fit in with the current joint audits under the MTC. Moreover, it is unclear how many states would be interested in the joint audit program. For example, Florida indicated that it had no desire to be a part of the joint audit program, but indicated its interest in the development of economic expertise. Surprisingly, several states participating in the Group were intrigued by the apparent success of the District of Columbia’s transfer pricing audit program. The District of Columbia program has been widely criticized for resulting in taxpayer assessments where taxpayers were never actually audited.

The next meeting will take place via teleconference on June 25. The Group will meet in person and via teleconference at the 2014 Annual MTC Conference and Committee Meetings on July 28. Members of the public are invited to join both meetings.

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