

Multistate Tax Commission Arm's-Length Adjustment Service (Part II): "An Expression of Grief, Pity, or Concern"

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Executive Summary

- Multistate Tax Commission (MTC) transfer pricing program moving forward in some fashion;
- Priority includes information sharing among participating states (and possibly their third party vendors) on transfer pricing issues. Because a formal agreement was found necessary, the scope of the information shared is presumed to include taxpayer specific information; and
- States currently have significant inventory of transfer pricing audits that they admit they do not have the expertise to properly examine or defend in a protest.

The inaugural meeting (via conference call) of the Multistate Tax Commission's Committee (Committee) addressing transfer pricing issues (ALAS) took place on April 7, 2016, and was certainly interesting. A predecessor Working Group had [created an extensive plan](#) that is intended to be implemented by the Committee over 4 years. The plan initially anticipated that approximately 10 states (at least) would agree to fund the cost of the multi-year program, but meeting that goal has not materialized. Instead, the Committee is moving forward hoping to add more states (or limit services provided) as the plan progresses. The anticipated program has multiple parts such as training, additional MTC staff resources and multistate transfer pricing audit and litigation support for participating states.

Ten states identified themselves on the call – only Pennsylvania was new to the process; the rest of the states on the call had all been involved in the predecessor Working Group. Also on the call was Eric Cook, co-founder of Chainbridge, the company that is currently involved in the controversial transfer pricing approach adopted by the District of Columbia (and previously by some other states). To no one's surprise, all of the states agreed that Joe Garrett, Deputy Co-Commissioner of Revenue of Alabama, should be Chair of the Committee (he was the chair of the Working Group as well). The group will have monthly calls which are open for the public to listen in on.

Importantly for multistate corporate taxpayers, the group identified that a high-priority purpose of the Committee would be to facilitate information sharing among the participating states regarding transfer pricing issues. The Committee hopes to get an agreement in place to start such sharing in the second half of this year. The staff was asked to have a draft agreement, or at least an outline, by the next call in late May—with the goal of having a final draft ready for approval by the Annual Conference & Committee Meetings in late July. It is anticipated that the information sharing will require the inclusion of independent vendors, such as an economist or auditor. Because of the issues this raises, the scope and language of this agreement will be quite important to taxpayers in the future, and will likely increase the importance of: (1) carefully documenting return positions based on inconsistent state laws and (2) multistate consistency in document production positions during an audit.

Early in the call, Garrett noted that it did not matter how well the MTC built the program, they still needed states to participate. Thus, a fundamental and ongoing question was whether the plan needed to be changed. Essentially, many states have not been able to come up with the budget to support the program as a whole as originally envisioned. Several participants asked whether there should be different levels of pricing based on participation. While not raised on the call, one question that comes to mind is whether states could participate only in the information sharing part of the program, or whether that will be used as a reward for full financial support.

Dan Bucks, former MTC Executive Director and former Commissioner of the Montana Department of Revenue, was the advisor that crafted the comprehensive plan with the Working Group. On the call, he emphasized that the program should be seen as a complete package that only the MTC could offer. Not only would the MTC be supporting states in finding taxpayer intercompany pricing problems, but the MTC would also provide its existing programs, such as its voluntary disclosure program, alternative dispute resolution program, and informal resolution during a multistate audit, as remedies for taxpayers to the risk of multiple taxation. Taxpayers have long been concerned about the lack of the equivalent of the federal/international Competent Authority at the state level. There is no mechanism to make compensating adjustments between states. Bucks's suggestion seems to attempt to address this concern. However, the limits of the MTC to act in a "Competent Authority-lite" role became clear when, later in the call Pennsylvania, questioned whether it could fully participate in the program because of possible statutory limitations in participating in the alternative dispute program. Pennsylvania's comment was addressed to how to price the program, but it does demonstrate problems with transfer pricing adjustments at the state level. There is simply no comprehensive process by which pricing adjustments can be made by or at the request of the taxpayer in all of the relevant jurisdictions following an audit.

The ALAS program will also include training. The MTC has already offered transfer pricing training through outside vendors in the past. Currently 6-7 vendors have proposals with the MTC to offer such training programs in the future.

For taxpayers, perhaps the most disheartening point of the 90 minute call was that the states have apparently repeatedly expressed to MTC and ALAS leaders that there is no lack of demand for the program. The problem is that the program has a long start-up time and the states need help *now*. The difficulty, from some states' perspective, is that the plan is not quick enough. One participant noted that all of the states he had spoken to had an inventory of pending transfer pricing cases. Several participants noted that states acknowledged they don't know how to audit and defend such cases. While it is understandable that if a state thinks there is an intercompany pricing problem they will want to fix it, but it really is not fair to taxpayers for states to either spend time learning the transfer pricing regime during an audit or issue deficiencies that are unsupportable in litigation. This

is an expensive approach to audit and can only result in some precedential case law that binds the states in unintended ways. For taxpayers of course, the message is, 'hang in there, get the assessment and then head to court. You have a strong chance of winning.'

Finally, an interesting side point was a request from an MTC staff member to incorporate some type of help for participating states in defining and defending economic substance arguments. It was noted that even before pricing becomes an issue, the state must determine whether a given transaction (or structure) has economic substance.

More information on the project can be found at <http://www.mtc.gov/The-Commission/Committees/ALAS>.

Finally, if any of this is troubling to you, we encourage you to check out the [DC Bald Eagle Nest Cam](#) and "take it easy" prior to calling the authors to discuss these state transfer pricing developments.

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