



2017 US APA Report shows continued strong interest in APAs

Global Transfer Pricing Alert 2018-011

The Internal Revenue Service on March 30 released Announcement 2018-08, the advance pricing agreement (APA) annual report covering the activities of the Advance Pricing and Mutual Agreement (APMA) Program during calendar year 2017. The annual report is issued under §521(b) of Pub. L. 106-170, the Ticket to Work and Work Incentives Improvement Act of 1999, which requires the Secretary of the Treasury to report annually to the public on APAs and the APMA Program.

The annual report provides a summary of recent APA developments in the APMA Program and a statistical snapshot of the program's APA activities during 2017.

Transfer pricing enforcement is expected to increase throughout the world as countries adopt the Organisation for Economic Co-operation and Development's (OECD) base erosion and profit shifting (BEPS) final recommendations, including the enactment of country-by-country (CbC) reporting requirements. In addition, many US and foreign multinational groups have begun reviewing their existing structures and transfer pricing policies in light of the passage of the 2017 Tax Act (Pub. L. No. 115-97), which may result in operational restructurings and transfer pricing policy changes. The act includes several new international tax provisions that have created complex transfer pricing and international tax issues for both US and foreign multinational groups. Consequently, the certainty provided by APAs will play an increasingly important role in transfer pricing risk management.

Statistical highlights of the APA annual report include:

- **Incoming APA requests.** The IRS received 101 APA applications (14 unilateral, 86 bilateral, and 1 multilateral) in 2017, a similar number to the 98 APA applications received in 2016.
- **Large increase in completed APAs.** During the 2017 calendar year, APMA closed 116 APAs (30 unilateral, 85 bilateral, and 1 multilateral), compared to 86 APAs in 2016 and 110 APAs in 2015, while reporting a decrease in staffing levels in the APMA Program at the end of 2017 compared to the end of 2016. APA renewals accounted for 70 of the 116 APAs executed (or just over 60 percent), with 22 unilateral and 48 bilateral renewals. Twenty-two percent of all APAs included rollbacks. It is likely that a significant portion of APAs with rollbacks resolved transfer pricing audit activity involving either the IRS or the tax authorities of a treaty partner.
- **Treaty partners involved in bilateral APAs.** In 2017 Japan accounted for 38 percent of bilateral APA requests filed, the largest share of any country. India accounted for 21 percent, showing the continued popularity of US-India bilateral APA requests since the IRS began accepting applications for bilateral APAs with India in February 2016. Other countries accounting for meaningful percentages of filed, pending, or completed APAs with the United States are Canada, China, Germany, Korea, Mexico, Switzerland, and the United Kingdom.

Nearly three-quarters of the total number of bilateral APAs executed in 2017 involved bilateral APAs with either Japan or Canada. Based on the filed APA requests during 2017 and the IRS's pending inventory of APAs, the percentage of completed APAs with Japan and Canada is expected to decrease as a percentage of the total as other countries become more active in the APA process.

- **Months to complete APAs.** In 2017, the median time to complete a unilateral APA and a bilateral APA was 31.0 months and 35.9 months, respectively. In 2016, the median time to complete a unilateral APA and a bilateral APA was 15.4 months and 35.6 months, respectively. Overall, the median time required to complete the 116 APAs executed in 2017 was 33.8 months, one month slower than in 2016.

Processing time for unilateral APAs increased significantly from the prior year. Unlike bilateral APAs, which involve treaty partners, unilateral APAs and their processing time are more controlled by APMA. Due to significantly smaller volumes of unilateral APAs compared to bilateral APAs, the median processing time for unilateral APAs tends to exhibit higher levels of variability than for bilateral APAs.

Processing time for bilateral APAs increased slightly from the prior year. For each of the last five years, the median processing time for bilateral APAs has ranged from approximately 35 months to 38 months.

Taxpayers renewing APAs benefitted from faster processing times for their APA requests. For renewal unilateral and bilateral APAs, the median processing time was 30.5 months, compared to the median processing time for new

unilateral and bilateral APAs of 43.0 months. The median processing time required to complete new APAs decreased slightly from 46.7 months in 2016 to 43.0 months in 2017.

- **APA inventory.** The APMA Program had 386 cases in active inventory at the end of 2017: 57 unilateral APAs, 321 bilateral APAs, and 8 multilateral APAs. The number of pending APAs has continued to decline since 2015.
- **Term length of APAs (including rollback years).** Of the APAs executed in 2017, 38 cases had a five-year term including rollback years, while 68 cases had terms of six years or longer. The average term length in 2017 was seven years, compared to six years in the previous year. In our experience, the APMA Program and foreign competent authorities are willing to extend the standard APA term of five years when additional years are needed to address difficult results during a rollback period and/or completed APA years, or to provide some prospectivity in cases when the APA request took a long time to complete. Further, in the context of renewal APAs that were handled expeditiously, the APMA Program has shown a willingness to accept APA terms longer than five years.
- **Staffing.** As of December 30, 2017, the APMA Program was comprised of 55 team leaders, 17 economists, and 10 senior managers organized into 10 groups (seven team leader groups and three economist groups). Compared to 2016, this represents a decrease of seven team leaders and three economists. The team leader groups are organized by country, with each group having responsibility for multiple countries. Because of the large volume of cases with certain treaty partners, some countries are the responsibility of more than one group.
- **Cancellations, revocations, and withdrawals.** No APAs were cancelled or revoked during 2017. Eight APA requests (one unilateral, six bilateral, and one multilateral) were withdrawn in 2017, which is significantly lower than the 24 applications withdrawn in 2016, and more consistent with the 10 applications withdrawn in 2015.
- **APAs executed by industry.** In 2017, manufacturing and wholesale/retail trade accounted for 41 percent and 37 percent, respectively, of the total number of executed APAs. Within the wholesale/retail trade industry, merchant wholesalers of durable goods were most common (77 percent of such cases).
- **Covered transactions and transfer pricing methods.** Forty-four percent of the transactions covered in APAs executed in 2017 involved the sale of tangible goods, 35 percent involved the provision of services, and 21 percent involved the use of intangible property, which is consistent with the covered transactions in 2016. For potential cost sharing APAs, taxpayers should also consider that the preamble to the final cost sharing regulations under Treas. Reg. §1.482-7 provides that the IRS has the authority to negotiate an APA covering a platform contribution transaction and include a commensurate with income waiver.

The comparable profits method (CPM) was used to evaluate 87 percent of the transactions involving the transfer of tangible and intangible property in 2017. Of those transactions, 85 percent used the operating margin as the profit level indicator (PLI) and 15 percent used other PLIs, such as the Berry ratio and return on assets or capital employed.

For services transactions, the most frequently applied method was also the CPM (86 percent of cases). Of those services transactions applying the CPM, 62 percent used the operating margin as the PLI. In 2017, the majority of APAs that covered services transactions also included tangible or intangible transactions, which were not tested under a separate PLI.

- **Adjustment mechanisms.** The majority of the transactions covered in APAs executed in 2017 target an interquartile range. Those APAs include a number of mechanisms for making adjustments to the tested party's results when the results fall outside the range or do not match the point required by the APA. Some examples of the mechanisms included in the 2017 executed APAs include an adjustment bringing the tested party's results to the closest edge of the range applied to the results of a single year, an adjustment to the closest edge of the range applied to the results over the APA term, an adjustment to the specified point or royalty rate, and an adjustment to the median of the range for a single year.
- **APA boilerplate and APMA Program contact information.** The annual report also includes the latest version of the APMA Program's model APA agreement and a link to the list of primary APMA Program contacts. The model APA agreement has been unchanged since 2009; however, APMA solicited comments on a proposed major revision in September 2017, which has yet to be finalized.

The APMA Program also recently announced a significant increase in user fees to request an APA, for user fees paid after June 30, 2018, and December 31, 2018. Taxpayers that are planning to request an APA in the next 12 to 18 months should consider expediting the payment of the APA user fee prior to those dates, through what is known as a "dollar file" APA request, to take advantage of the existing lower user fees. For prior coverage, see [Global Transfer Pricing Alert 18-004](#).

In light of the BEPS final reports and the adoption of CbC reporting requirements by many jurisdictions and corresponding increased audit activity, the demand for APAs will undoubtedly continue to be strong. To discuss whether an APA may be advisable for your organization, please reach out to one of the contacts listed.

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