



## **2018 US APA Report shows significant continued interest in APAs**

### **Global Transfer Pricing Alert 2019-013**

The Internal Revenue Service on March 22 released Announcement 2019-03, the advance pricing agreement (APA) annual report covering the activities of the Advance Pricing and Mutual Agreement (APMA) Program during calendar year 2018. 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 2018.

Transfer pricing enforcement is expected to continue to increase throughout the world as countries continue to 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 are 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 the following:

**Significant increase in incoming APA requests.** The IRS received twice the number of APA applications in 2018 as it did in 2017. The IRS received 203 APA applications (35 unilateral, 161 bilateral, and 7 multilateral) in 2018, whereas in 2017 it received 101 APA applications. In addition, as of December 31, 2018, APMA had received 71 user fee filings that were not yet accompanied by substantially complete APA applications, almost double the number of user fee filings from 2017.

The large increase in the number of APA applications may be due in part to accelerated filings arising from the increase in user fees to request an APA that was implemented by the APMA program in two phases during the last year, with the first increase effective on July 1, 2018, and the second increase effective on January 1, 2019.

**Slight decrease in completed APAs.** During the 2018 calendar year, APMA closed 107 APAs (24 unilateral, 81 bilateral, and 2 multilateral), compared to 116 APAs in 2017. The decrease may be due in part to the reduction in staffing levels in the APMA Program at the end of 2018 compared to the end of 2017, as described further below. APA renewals accounted for 62 of the 107 APAs executed (approximately 58 percent), with 15 unilateral renewals, 45 bilateral renewals, and two multilateral renewals. Approximately 20 percent of all executed 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 2018 Japan accounted for 34 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, Germany, Italy, Korea, Mexico, the Netherlands, Switzerland, and the United Kingdom.

Nearly 60 percent of the total number of bilateral APAs executed in 2018 involved bilateral APAs with either Japan or Canada. This represents a decrease from 2017, when 73 percent of the total number of bilateral APAs executed involved bilateral APAs with either Japan or Canada. Based on the filed APA requests during 2018 and the IRS's pending inventory of APAs, the percentage of completed APAs with Japan and Canada is expected to continue to decrease as a percentage of the total as other countries become more active in the APA process.

**Months to complete APAs.** In 2018, the median time to complete a unilateral APA and a bilateral APA was 33.5 months and 42.1 months, respectively. In 2017, the median time to complete a unilateral APA and a bilateral APA was 31.0 months and 35.9 months, respectively. Overall, the median time required to complete the 107 APAs executed in 2018 was 40.2 months, nearly six and a half months slower than in 2017, which is not overly surprising given the reduction in staffing levels at APMA in 2018.

Processing time for unilateral APAs increased slightly 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 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. In 2018, the median processing time rose to 42.1 months, showing an increase in processing time for bilateral APAs compared to the last five years, which as noted above may be explained in part by the reduction in staffing levels.

Taxpayers renewing APAs benefitted from slightly faster processing times for their APA requests. For renewal unilateral and bilateral APAs, the median processing time was 40.1 months, compared to the median processing time for new unilateral and bilateral APAs of 41.7 months. The median processing time required to complete new APAs decreased slightly from 43.0 months in 2017 to 41.7 months in 2018.

**APA inventory.** The APMA Program had 458 cases in active inventory at the end of 2018: 58 unilateral APAs, 387 bilateral APAs, and 13 multilateral APAs. This represents an increase of 72 pending APAs compared to the number at the end of 2017, when there were 386 cases in active inventory, largely due to the increase in the number of APA requests filed. Over half of the pending bilateral APA requests involve either Japan or India.

**Term length of APAs (including rollback years).** Of the APAs executed in 2018, 36 cases had a five-year term including rollback years, while 63 cases had terms of six years or longer. The average term length in 2018 was seven years, the same as 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.** In September 2018, APMA restructured its management and realigned its teams. As of December 22, 2018, the APMA Program was comprised of 56 team leaders, 12 economists, six managers, and three assistant directors (each assistant director oversees two managers who lead teams comprised of team leaders and economists). The three groups overseen by assistant directors are organized by country, with each group having responsibility for multiple countries. The total number of personnel at APMA at the end of 2018 was 77, a decrease from 82 at the end of 2017, and 92 at the end of 2016.

**Cancellations, revocations, and withdrawals.** No APAs were cancelled or revoked during 2018. Twenty-one APA requests (seven unilateral and 14 bilateral) were withdrawn in 2018, which is significantly higher than the eight applications withdrawn in 2017, and more consistent with the 24 applications withdrawn in 2016.

**APAs executed by industry.** In 2018, manufacturing and wholesale/retail trade accounted for 45 percent and 33 percent, respectively, of the total number of executed APAs. Within the wholesale/retail trade industry, merchant wholesalers of durable goods were most common (69 percent of such cases).

**Covered transactions and transfer pricing methods.** Forty-four percent of the transactions covered in APAs executed in 2018 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 2017. 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 86 percent of the transactions involving the transfer of tangible and intangible property in 2018. Of those transactions, 68 percent used the operating margin as the profit level indicator (PLI) and 32 percent used other PLIs, such as the Berry Ratio and the mark-up on total cost.

For services transactions, the most frequently applied method was also the CPM (86 percent of cases). Of those services transactions applying the CPM, 76 percent used the operating margin or the mark-up on total cost as the PLI. In 2018, the majority of APAs that covered services transactions also included tangible or intangible transactions, which were not tested under a separate PLI.

Given that the CPM was used to evaluate 86 percent of transactions involving the transfer of tangible and intangible property and services, it is interesting to note that the IRS APMA Program recently released an Excel-based Functional Cost Diagnostic Model to assist in its analysis of whether certain intercompany transactions may be more reliably measured by applying a profit split methodology rather than

a one-sided CPM methodology. For prior coverage, see [Global TP Alert 2019-007](#).

**Adjustment mechanisms.** The majority of the transactions covered in APAs executed in 2018 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 2018 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. APMA made significant revisions to the model APA agreement in May 2018,<sup>1</sup> representing the first substantial update to the model APA agreement since 2004. For prior coverage of the updates to the model APA agreement, see [Global TP Alert 2018-018](#).

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.

## Contacts

**Kerwin Chung (Washington DC)**

[kechung@deloitte.com](mailto:kechung@deloitte.com)

**Dave Varley (Washington DC)**

[dvarley@deloitte.com](mailto:dvarley@deloitte.com)

**John Breen (Washington DC)**

[jobreen@deloitte.com](mailto:jobreen@deloitte.com)

**Kirsti Longley (Washington DC)**

[kilongley@deloitte.com](mailto:kilongley@deloitte.com)

**Darrin Litsky (New York)**

[dlitsky@deloitte.com](mailto:dlitsky@deloitte.com)

**Jamie Hawes (Washington DC)**

---

<sup>1</sup> On September 4, 2018, APMA released a revised version of the model APA agreement that fixed two problems, including allowing comments and edits to be saved under the specific name of the editor and fixing incorrect phrasing under Appendix A, section 4(b), regarding the royalty for the license of intangible property.

[jhawes@deloitte.com](mailto:jhawes@deloitte.com)

**Maria Wolter (Washington DC)**

[marwolter@deloitte.com](mailto:marwolter@deloitte.com)

[Back to top](#)

## Useful links

### Resources

- [Arm's length standard](#)
- [Transfer pricing alerts](#)

### Get Connected

- [Deloitte tax@hand](#)
- [Join Dbriefs](#)
- [Follow @Deloitte Tax](#)
- [www.deloitte.com/tax](http://www.deloitte.com/tax)

[Back to top](#)



Get in touch



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more about our global network of member firms.

Deloitte provides audit & assurance, consulting, financial advisory, risk advisory, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 245,000 professionals make an impact that matters, please connect with us on [Facebook](#), [LinkedIn](#), or [Twitter](#).

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2019. For information, contact Deloitte Touche Tohmatsu Limited.

To no longer receive emails about this topic please send a return email to the sender with the word "Unsubscribe" in the subject line.