

## Global Transfer Pricing

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## 2013 U.S. APA Report Shows Significant Efficiency Gains



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The Internal Revenue Service on March 27, 2014 released Announcement 2014-14, the Advance Pricing Agreement (APA) annual report covering the activities of the Advance Pricing and Mutual Agreement (APMA) Program during calendar year 2013. 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 brief summary of recent developments in the APMA Program and a statistical snapshot of the APMA Program's activities during 2013.

The annual report highlights the continued successes of the APMA Program, the most notable of which was the seven-month reduction in the median amount of time to complete an APA. This is a welcome development as companies consider the role of APAs in their transfer pricing risk management strategies in anticipation of changes to the Organization for Economic Cooperation and Development transfer pricing guidelines resulting from the BEPS project.

Statistical highlights of the APA annual report include:

- *Increase in Completed APAs:* During the 2013 calendar year, APA case closures increased for the second year in a row to a record 145 APAs (39 unilateral, 105 bilateral, and one multilateral), compared with 140 APAs in 2012. Renewal APAs represented 77 of the 145 APAs executed, with 27 unilateral, 49 bilateral, and one multilateral APA renewals. This increase in executed APAs was attributed to the increased resources and processing efficiencies as a result of the combination of the former APA Program with the U.S. Competent Authority.
- *Months to Complete APAs:* In 2013, the median time to complete a unilateral APA was 27.9 months, and 37.2 months for a bilateral APA. In 2012, the median times to complete unilateral and bilateral APAs were 27.8 months and 44.9 months, respectively. Overall, the median time required to complete the 145 APAs executed in 2013 was approximately seven months shorter than in 2012, a significant and welcome improvement.
- *New Cases:* The IRS received 111 APA applications (20 unilateral, 89 bilateral, and two multilateral) in 2013, a slight decrease from the 126 APA applications received in 2012. Interestingly, almost 75 percent of the bilateral applications filed in 2013 involved either Japan or Canada, with Korea accounting for approximately 5 percent.
- *APA Inventory:* The APMA Program had 331 cases in active inventory at the end of 2013 that were either unilateral APAs (51 cases), bilateral APAs (277 cases), or multilateral APAs (3 cases). Given the APMA Program's increased efficiency, the number of cases in active inventory decreased in 2013 from the

391 cases in active inventory at the end of 2012. While the number of pending APAs at the end of 2013 was still higher than in some recent years, the IRS believes the streamlining of the APMA Program's internal processes and implementation of new procedures will result in a continued decrease in pending inventory in future years.

- *Term Length of APAs:* Of the APAs executed in 2013, 41 percent had a five-year term, while more than half had terms of six years or longer.
- *Staffing:* The APMA Program is currently comprised of 55 team leaders, 26 economists, and 10 senior managers organized into 10 groups (seven team leader groups and three economist groups). The team leader groups are organized by country, with each group having responsibility for multiple countries.
- *APAs Withdrawn:* Nine APAs were withdrawn in 2013 (three unilateral and six bilateral), a slight increase from the six APAs withdrawn during 2012, but equal to the number withdrawn in 2011.
- *Inbound v Outbound:* Inbound cases continued to account for the majority of the APMA Program's caseload in 2013, with 55 percent of the APAs executed involving foreign multinationals with U.S. subsidiaries. In 2012, inbound cases accounted for approximately 75 percent of the APAs executed.
- *APAs Executed by Industry:* In 2013, the wholesale/retail trade and manufacturing industries accounted for 41 percent and 35 percent, respectively, of the total number of executed APAs. Within the wholesale/retail trade industry, merchant wholesalers of durable goods were most common (55 percent of cases). Meanwhile, the transportation equipment segment was largest among manufacturers (29 percent of cases).
- *Covered Transactions and Transfer Pricing Methods:* Similar to 2012, 41 percent of the transactions covered in APAs executed in 2013 involved the sale of tangible goods and 36 percent involved the provision of services. The comparable profits method (CPM) was used to evaluate approximately 77 percent of the transactions involving tangible and intangible property in 2013. Of those transactions, approximately 78 percent used the operating margin as the profit level indicator (PLI). For services transactions, the services cost method was used most frequently (39 percent of cases). In addition, the CPM was used in 36 percent of cases involving service transactions with the Berry ratio representing the most commonly used PLI.
- *Adjustment Mechanisms:* Almost 70 percent of the transactions covered in APAs executed in 2013 target an interquartile range. Those APAs include a number of mechanisms for making adjustments to tested-party 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 2013 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; or an adjustment to the median of the range for a single year.
- *Boilerplate and APMA Program Contact Information:* The annual report also includes the latest version of the APMA Program's boilerplate APA agreement and a list of primary APMA Program contacts.

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