

US OUTBOUND

KPMG in the US



Mark Martin and Thomas Bettge

IRS issues APA statistics for 2019

Mark Martin and Thomas Bettge of KPMG in the US discuss the most recent U.S. APA statistics in the context of broader trends.

On March 25 2020, the Internal Revenue Service's (IRS) advance pricing and mutual agreement programme (APMA) published its statutorily mandated annual report on advance pricing agreements (APAs) for 2019. The highlights include:

- In 2019, 121 APA applications were filed, down from a record high of 201 in 2018. For comparison, there were 98 applications in 2016 and 101 in 2017. In addition, 2019 saw 29 dollar filings, in which the taxpayer paid the APA user fee prior to completing its application. Such a filing allows a taxpayer to cover a year under the APA by paying the user fee before the tax return for that year is filed, provided a complete application is filed within 120 days from the date the user fee was paid. This is a helpful procedure because the general rule is that a year can only be covered by an APA if the user fee is paid and the application filed before the return for such year is filed, although it may be possible to cover earlier years via rollback procedures.
- APMA executed 120 APAs in 2019, up from 107 in 2018 and 116 in 2017.
- The median completion time for unilateral and bilateral APAs was 38.8 months for new and renewed APAs combined, which is a slight decrease from the prior year.
- APAs with Japan (49%), Canada (11%), South Korea (10%), and Australia (9%) comprised 79% of all bilateral APAs executed in 2019.
- Japan and Canada also had the most bilateral APA applications, with 32% and 14% respectively, followed by India at 12%. About half of all pending APA requests as of December 31 2018 involved Japan (28%) or India (21%), with Canada a distant third at 10%.
- For APAs executed in 2019, the comparable profits method (CPM)/transactional net margin method (TNMM) was used in 81% of APAs involving tangible and intangible property and 82% of APAs involving services.

These results are largely unsurprising, and speak to the continuing success of APMA's APA programme. However, there are some noteworthy items. The record number of APA applications in 2018 was due to a substantial increase in the user fee for APAs, which took effect in two stages in June and December 2018. In addition to its 201 complete applications, 2018 had 71 dollar filings in 2018, which allowed taxpayers to avoid fee increases by having their APAs considered filed as of the fee payment date. Presumably, most or all of those dollar filings became complete applications during 2019. Thus, the new applications filed in 2019 likely total around 50, plus the 29 new dollar filings. This indicates that taxpayers understandably accelerated their APA applications in order to avoid fee increases.

The continued dominance of CPM/TNMM analyses is also instructive. In February 2019, APMA released its functional cost diagnostic (FCD) model, a diagnostic tool for APAs which employs a cost-based residual profit split method, and APMA began requiring certain APA applicants (generally foreign-parented taxpayers in the automotive industry) to complete the FCD model. Despite APMA's indications that the FCD model is a diagnostic tool intended to assess a taxpayer's proposed APA pricing, there has been some speculation that the model could be used to require more APA cases to use a profit split. While most cases in which the FCD model was employed will not yet have resulted in executed APAs, the continuing preeminence of the CPM/TNMM does suggest that APMA has not been vigorously pushing profit splits.

The 2019 statistics largely paint a picture of continuity, with APMA's APA inventory generally stable (121 applications, offset by 120 completed APAs and 12 withdrawals). Yet 2020 will certainly not be business as usual. The COVID-19 pandemic has brought about significant disruptions. Taxpayers considering APAs may defer their plans until the dust settles. Those already subject to APAs may seek or be forced into APA amendments, or in some cases even cancellations, as COVID-19 leads to APA critical assumption failures. Early indications suggest APMA understands the issues taxpayers are grappling with, and will be flexible in making necessary APA adaptations. Where the parties are able to agree on reasonable amendments, APAs should continue to prove invaluable as taxpayers navigate the consequences of COVID-19.

KPMG US

T: +1 713 319 3976 and +1 713 319 2173
E: mrmartin@kpmg.com and tbettge@kpmg.com