



TRANSFER PRICING

2023 US APA Report shows record number of APAs executed, continued strong interest in APAs Tax Alert

Overview

The Internal Revenue Service released Announcement 2024-16, the advance pricing agreement (APA) annual report dated March 26, 2024, covering the activities of the Advance Pricing and Mutual Agreement (APMA) Program during calendar year 2023. 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 2023. This alert covers highlights of the 2023 APA annual report.

The Internal Revenue Service on March 29, 2024 released [Announcement 2024-16](#), the advance pricing agreement (APA) annual report dated March 26, 2024, covering the activities of the Advance Pricing and Mutual Agreement (APMA) Program during calendar year 2023. The annual report is issued under section 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 2023. As discussed below, during 2023 the IRS executed a record number of APAs and received a substantial number of APA requests.

Transfer pricing enforcement is expected to continue to increase throughout the world as countries adopt the Organisation for Economic Co-operation and Development's (OECD) Pillar One and Pillar Two guidance and continue to utilize country-by-country reporting data. In addition, the IRS received a large increase in its enforcement budget from the Inflation Reduction Act, which has already resulted in the IRS issuing compliance alerts to US subsidiaries of foreign multinationals.¹ John Wall, the current IRS Acting Director of the APMA Program, also recently noted that he hoped that the OECD's Amount B would create a more efficient process and allow the IRS to resolve cases more

quickly.² Consequently, the certainty provided by APAs will continue to play an important role in transfer pricing risk management.

Statistical highlights of the 2023 APA annual report include the following:

Record number of completed APAs

During 2023, APMA closed a record 156 APAs (24 unilateral, 130 bilateral, and two multilateral), compared to 77 APAs in 2022. This is the highest total in the 33-year history since the IRS formally initiated the APA program in 1991. Initial APAs constituted 53% of total APAs executed; whereas renewal APAs constituted 47% of total APAs executed, indicating increased interest by taxpayers that did not previously have APAs.

Of the APAs executed in 2023, 19% included rollback years. It is likely that a significant portion of APAs with rollback years resolved transfer pricing audit activity involving either the IRS or the tax authority of a treaty partner.

High level of incoming APA requests

The IRS received approximately 9% fewer APA applications in 2023 compared to 2022, a year in which the IRS received one of the highest numbers of APA requests in its history. The IRS received 167 APA applications (17 unilateral, 144 bilateral, and six multilateral) in 2023, whereas in 2022 it received 183 APA applications. In addition, as of December 31, 2023, APMA had received 22 user fee filings that were not yet accompanied by substantially complete APA applications.

Treaty partners involved in bilateral APAs

In 2023 Japan accounted for 30% of bilateral APA requests filed, the largest share of any country. India accounted for 21%, the second largest share of any country. Canada accounted for 14%.

Other countries accounting for meaningful percentages of filed, pending, or completed APAs with the United States are Australia, Denmark, France, Germany, Italy, Korea, Mexico, Switzerland and the United Kingdom.

Approximately 48% of the total number of bilateral APAs executed in 2023 involved bilateral APAs with either Japan or India. The share of India and Italy APA requests continues to increase, which is not surprising as these countries are known for high levels of transfer pricing enforcement.

Months to complete APAs

In 2023, the median time to complete a unilateral APA and a bilateral APA was 31.6 months and 42.6 months, respectively, compared to 2022, median processing times of 17.7 months and 45.7 months, respectively. Overall, the median time required to complete the 121 APAs executed in 2023 was 42.0 months, which is approximately one and a half months faster than in 2022. It is encouraging that processing times for bilateral APAs, representing over 80% of all executed APAs for the year, decreased by approximately three months.

For future years, we expect processing times to continue to improve given increased staffing levels compared to 2022 and the prospect of additional new hires. During 2023 the IRS increased the number of team leaders by 11 (from 59 to 70) and economists by three (from 26 to 29).

Taxpayers renewing APAs also benefitted from faster processing times for their APA requests. For renewal unilateral and bilateral APAs, the median processing time was 31.8 months, compared to the median processing time for new unilateral and bilateral APAs of 49.9 months.

Processing times are highly dependent on the treaty partner involved. In the future, when new uniform APA reporting requirements of the OECD become effective, we expect the IRS will disclose processing times on a country-by-

country basis as it currently does for mutual agreement procedure requests. The OECD encourages countries to resolve bilateral APAs within 24 months.³

APA inventory

The APMA Program had 558 cases in active inventory at the end of 2023: 44 unilateral APAs, 480 bilateral APAs, and 34 multilateral APAs. This represents a small decrease of six pending APAs compared to the number at the end of 2022, when there were 564 cases in active inventory. Nearly half of the pending bilateral APA requests involve either Japan or India.

Term length of APAs (including rollback years)

Of the 156 APAs executed in 2023, 70 cases had a five-year term including rollback years, while 67 cases had terms of six years or longer. The average term length in 2023 was six years. 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 noted, the IRS benefited from increased staffing levels in 2023. As of December 31, 2023, the APMA Program was comprised of one director, three assistant directors (each of whom oversees four managers who lead teams comprised of team leaders and economists that have responsibility for multiple countries), six managers, 52 team leaders, and 16 economists. The total number of personnel at APMA at the end of 2023 was 115, increased from 98 at the end of 2022. Notably, staffing is geographically diverse with offices not only in Washington DC, but also northern California, southern California, and the Atlanta, Boston, Chicago, Denver, Miami, New York, and Seattle metropolitan areas. This geographic diversity allows the IRS to take advantage of available talent outside of its Washington DC headquarters.

Cancellations, revocations, and withdrawals

No APAs were cancelled or revoked during 2023. Thirteen APA requests (two unilateral and 11 bilateral) were withdrawn in 2023, which is higher than the six withdrawn cases in each of the prior two years.

APAs executed by industry

In 2023, manufacturing and wholesale/retail trade accounted for 31% and 30%, respectively, of the total number of executed APAs. Within the wholesale/retail trade industry, merchant wholesalers of durable goods were most common (approximately 53% of such cases).

Covered transactions and transfer pricing methods

44% of the transactions covered in APAs executed in 2023 involved the provision of services, 36% involved the sale of tangible goods, 18% involved the use of intangible property, and 2% involved other types of covered transactions.

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 80% of the transactions involving the transfer of tangible and intangible property in 2023, which is roughly consistent with recent past years. Of those transactions, 60%

used the operating margin as the profit level indicator (PLI) and 40% 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% of cases in 2023). Of those services transactions applying the CPM, 48% used the operating margin or the mark-up on total cost as the PLI. In 2023, 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 2023 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 2023 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 version of the APMA Program's model APA agreement and includes a link to the list of primary APMA Program contacts. For India APAs only, the IRS also uses a variation of this model APA, which was not included in the APA Annual Report.

In light of recent OECD developments, increased IRS funding and increased worldwide audit activity, the demand for APAs should continue to be strong.

To discuss whether an APA may be advisable for your organization, please reach out to one of the contacts listed.

Get in touch

[Darrin Litsky](#)

[Kerwin Chung](#)

[Kirsti Longley](#)

[Jamie Hawes](#)

[Maria Wolter](#)



Footnotes

¹ <https://www.irs.gov/newsroom/irs-ramps-up-new-initiatives-using-inflation-reduction-act-funding-to-ensure-complex-partnerships-large-corporations-pay-taxes-owed-continues-to-close-millionaire-tax-debt-cases> (last visited Apr 3, 2024).

² Michael Rapoport, IRS Says 2023 Was Strong Year for Closing Advance Pricing Deals, <https://www.bloomberglaw.com/product/tax/bloombergtaxnews/daily-tax-report-international/BNA%200000018e-108b-d20b-abce-98cfdecf0001> (last visited Apr 3, 2024).

³ OECD (2022), Bilateral Advance Pricing Arrangement Manual, OECD Publishing, Paris, <https://doi.org/10.1787/4aa570e1-en>.

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30 Rockefeller Plaza
New York, NY 10112-0015
United States

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