

Recent APMA developments: Current economic environment and more

May 27, 2020

In brief

The Internal Revenue Service's Advance Pricing and Mutual Agreement (APMA) Program handles APAs and MAP cases in the United States. This article summarizes recent developments at APMA, including: (1) developments related to the current economic environment, including handling of pending and current APAs and the allowance of electronic filing of APA applications; (2) the recently released 2019 APA statistics; and (3) PwC's interview with Mr. John Hughes, Director of APMA, from early February, while he was in Tokyo for APMA meetings with Japan's National Tax Administration (NTA), focusing on US-Japan APA and MAP relations.

In detail

Current economic environment and electronic filing of an APA application

On May 11, APMA officials provided responses to an increasing number of questions relating to how the current environment is affecting its handling of both pending and executed APAs. APMA is actively discussing various substantive and procedural issues with treaty partners, including the application of transfer pricing methods in periods of economic distress and the impact of current economic conditions on specific industries, types of taxpayers, different regions, etc.

APMA will also discuss case-specific issues: questions relating to executed APAs should be directed to the APMA Assistant Director, whereas questions relating to pending APAs should be directed to the assigned APMA Team Leader. In preparation of potential consultation, taxpayers should prepare and provide in writing background information — such as an explanation of the issues, current and forecast financial information, and a specific proposal — at least two weeks in advance.

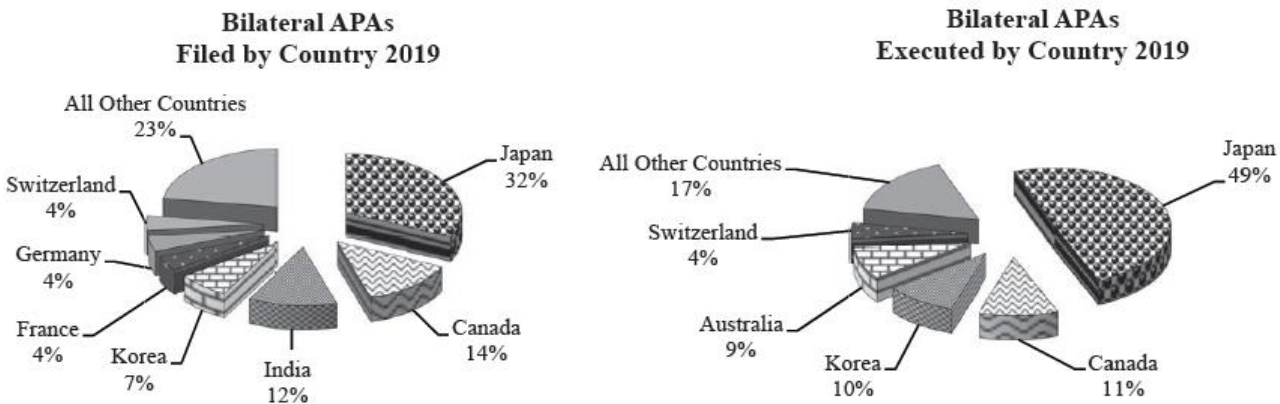
In addition, pursuant to temporary guidance issued on March 27, 2020 by the IRS Deputy Commissioner, Services and Enforcement (DCSE), an APA application may be filed electronically, and paper copies are not required. In addition, any documents requiring the taxpayer's signature may be submitted with either an image of the taxpayer's signature or the taxpayer's digital signature created using encryption techniques to provide proof of original and unmodified documentation.

2019 APA statistics

On March 25, 2020, the 2019 U.S. APA statistics were released, revealing that APMA is completing more APAs and completed them somewhat more quickly. The data on the number of APA applications filed indicates a continuing strong taxpayer interest in pursuing APAs.

Per the latest APA statistics, Japan is the largest counterparty for the IRS in terms of both the number of newly filed bilateral APA applications (32% of bilateral APA applications newly filed with the IRS), as well as executed APAs (49%), as shown below. (See Figure 1: U.S. newly filed bilateral APA applications and executed bilateral APAs in 2019, by counterparty country.¹) APMA has dedicated resources for Japan cases. The majority of APMA cases with Japan are APAs, rather than MAP.

Figure 1: U.S. newly filed bilateral APA applications and executed bilateral APAs in 2019, by counterparty country



Source: "ANNOUNCEMENT AND REPORT CONCERNING ADVANCE PRICING AGREEMENTS, Announcement 2020-2" dated March 25, 2020, issued by the IRS.

For more details, please refer to PwC [Tax Insight](#) dated April 10, 2020.

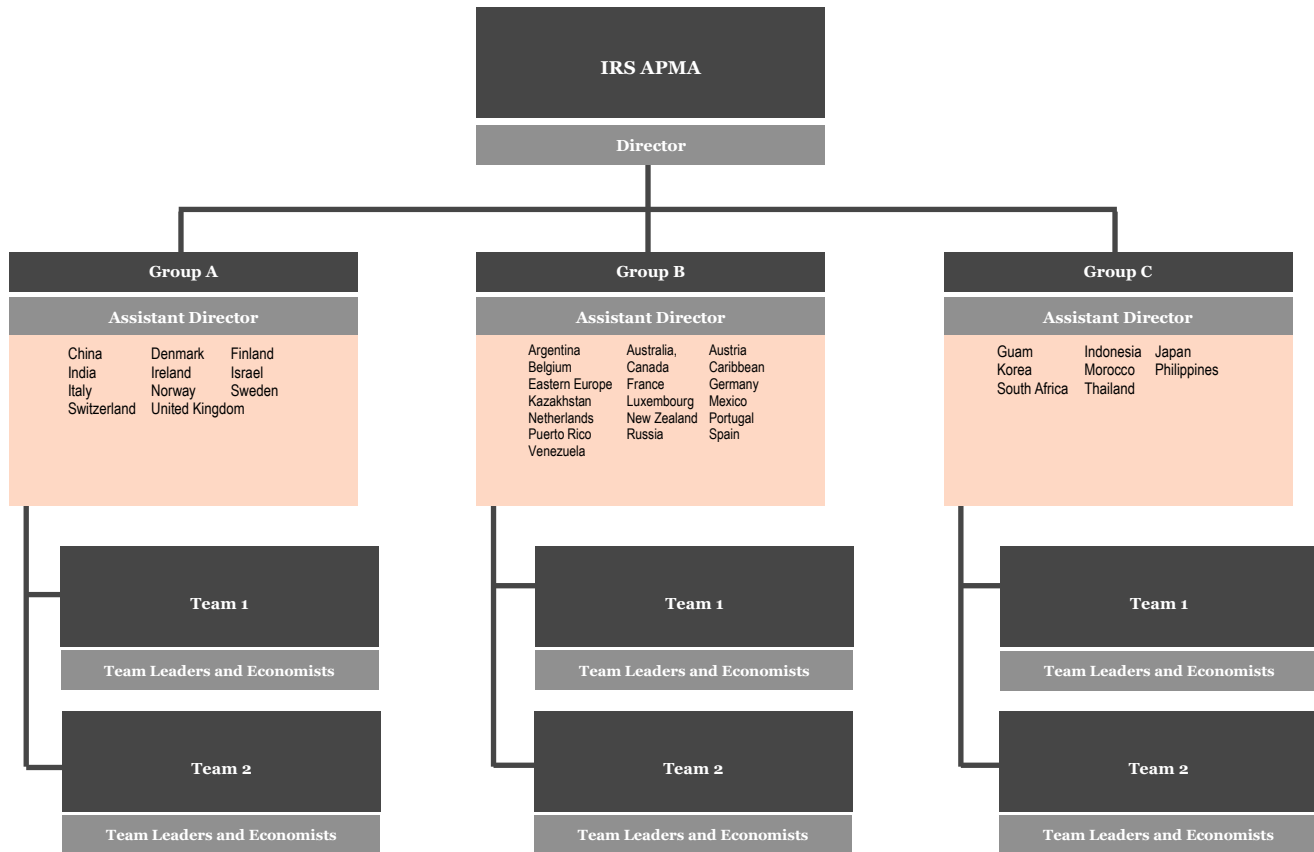
US-Japan APA/MAP relations: Interview with the APMA Director, Mr. John Hughes²

On February 3, PwC had the opportunity to interview Mr. John Hughes, the Director of APMA, while Mr. Hughes was in Tokyo for APMA's meeting with Japan's NTA. The interview is summarized below, and covers the following topics: APMA's current organization; Mr. Hughes' view on the current status of US-Japan APA/MAP relations; the IRS's FCD workbook; the future role of MAP; and Mr. Hughes' general message to taxpayers with US-Japan cases.

How is the IRS APMA Team organized?

During 2018-2019, APMA went through a reorganization, and is now organized into three groups (Groups A, B, and C). Each group is led by an Assistant Director and has two teams (Team 1 and Team 2). Each team is comprised of an average of 12 members, including managers, team leaders, and economists. Groups A and B are based in Washington D.C., and Group C is based in Los Angeles. (See Figure 2: APMA Organization Chart.)

Figure 2: APMA Organization Chart



Source: IRS Website: <https://www.irs.gov/businesses/corporations/apma-contacts>

While case assignments depend on the profile of each case, many Japan cases are handled by Group C on the West Coast. Notwithstanding the division into groups, APMA aims to be a coherent organization with fluid communication among the groups/teams so that the knowledge and expertise on particular types of issues or fact patterns can be leveraged in an efficient and effective way.

What is your view in general on the current US-Japan MAP/APA relations?

Currently, APMA meets with the NTA for negotiations three times per year, generally in the spring, summer, and fall. Meetings are typically for one or two weeks. Mr. Hughes considers the US-Japan MAP/APA relationship to be a long-standing, mature, and respectful relationship that has been developed over many years by many predecessors, and one that is built upon a deep commitment on both sides to the principles of the mutual agreement article of the US-Japan tax treaty. It includes the dedication of sufficient staffing and resources to the US-Japan case inventory.

Mr. Hughes noted that there are many US-Japan cases that are relatively simple and can be resolved through basic application of the TNMM (e.g., low-risk distribution or manufacturing activity performed by a US subsidiary of a Japanese parent company). However, some cases present more difficult issues. Mr. Hughes mentioned some of these issues and provided APMA's views on them:

- a) Marketing vs. Technology. APMA feels that, in at least some cases, marketing can be as important a driver of profits in the North American market as technology; in these cases, APMA seeks a balanced solution that takes into account the contributions of both technology and marketing intangibles. Any solution, though, should be case-specific, per the OECD Guidelines.

- b) **Global Trading and the Role of Capital.** Mr. Hughes said there still is room to further enhance a common understanding on the role of capital in relation to trading activities in global trading and related cases, although the situation has improved significantly recently. The IRS sees the role of capital as very important in some cases, while still recognizing that ‘people functions,’ such as traders, are also important. Again, a balanced solution is needed in these difficult cases.
- c) **Multilateral Aspect.** Mr. Hughes noted that transactions are increasingly multilateral, rather than merely bilateral, in nature, involving a number of group companies. APMA sees the need to understand and consider all intercompany transactions that may be related to a particular covered transaction (such as purchases of final or intermediate goods from other group companies or sales to other group companies in countries not participating in the APA). In general, there is a need for appropriate and balanced outcomes that take into account the multilateral nature of transactions. In seeking such outcomes, APMA would consider the materiality of these other intercompany transactions and the impact of adjustments to these intercompany transactions that might be made by countries not part of the bilateral APA.
- **FCD Workbook:** The IRS is trying to address the multilateral aspect of intercompany transactions with its FCD workbook, the latest version of which the IRS is in the process of designing to gather information on all the intercompany transactions related to the APA-covered transaction(s).
 - **Multilateral APAs:** Mr. Hughes believes that multilateral APAs can be achieved if taxpayers are committed, although such APAs need to be well-orchestrated.
- d) **Long negotiation period.** Mr. Hughes indicated that APMA would like to shorten the bilateral APA application process, and he recognized the efforts of the NTA in working with APMA to this end. One example Mr. Hughes gave of how the APA application process could be shortened is by the tax authorities agreeing APAs on a more prospective basis, based on the anticipated facts and functional and risk analyses, and have the results fall where they may, rather than waiting to see actual results to evaluate the allocation of profit, which can occur in some cases. For a straightforward CPM/TNMM case, APMA’s goal is to reach agreement in just over two years, which would shorten the current average time for reaching agreement.

How is the FCD workbook helping resolve cases?

APMA is using the FCD workbook for information collection during the APA review process in a minority of cases, based upon specific facts and circumstances those cases present. The first version of the workbook was issued in 2019 (see PwC [Tax Insight](#) dated February 27, 2019), and, as noted above, is now being enhanced through an updated version that brings all the intercompany transactions related to the covered transaction(s) into the scope of the workbook, in order to address the multilateral aspects of the covered transaction.

APMA understands segmented information is often difficult to obtain, and expansive in terms of the ask. However, it also expects that there should be some level of information prepared for management or internal reporting purposes that is available within the organization, as management would need to evaluate investments made into different markets, such as North America. APMA recognizes that the FCD workbook requests information that is with the HQ. Although APMA believes this fact alone should not interfere with completion of the workbook, APMA is willing to work with the taxpayer to minimize administrative burdens in obtaining it.

A request by APMA to fill in the FCD workbook does not necessarily mean APMA would prefer an alternative method, such as the profit split method, to the one proposed by the taxpayer. Rather, APMA wants the information in order to make an appropriate determination. If the case is a clear-cut CPM/TNMM case, the workbook should indicate as such. APMA thinks it is fair that foreign tax authorities also ask US MNCs for information similar to what is required in the FCD workbook. The IRS’s vision is that the FCD workbook and its input could provide a common ground ‘starting point’ for all stakeholders, including the tax authorities.

Mr. Hughes emphasized that APMA is open to robust dialogue on the FCD workbook and welcomes any questions, in order to help taxpayers fill in the necessary data and complete the workbook.

How would you view the role of MAP in the future (including with respect to the Pillar One and Pillar Two proposals)?

Mr. Hughes has been a member of the OECD's FTA MAP Forum since 2014 and the chair of the MAP Forum since 2018. At the OECD MAP Forum, countries are sharing best practices and administering BEPS Action 14. Mr. Hughes noted that finding practical, but still principled, ways to resolve cases is emphasized in the MAP Forum.

There are currently three 'focus group' initiatives under the MAP Forum: (1) the APA process; (2) reference benchmark sets; and (3) multilateral MAPs and APAs. Each of these three areas has 10 to 15 countries participating. Working papers and project outlines will be issued during the next 6 to 8 months. Mr. Hughes feels encouraged by Japan's and the United States' joint participation in the APA process focus group under the MAP Forum.

With regard to the benchmarking project, Mr. Hughes explained that one of the various ways APMA has developed for finding efficient and effective ways for processing cases is standardized benchmarking approaches for typical fact patterns or common 'profiles.' APMA has discussed its benchmarking initiatives with various treaty partners and is presenting its work in this area to this focus group for further development.

What are the key messages to taxpayers who have US-Japan APA/MAP cases?

Mr. Hughes made it clear that communication is a key to successful MAP/APA cases. APMA expects taxpayers and their advisors on both sides of the transaction — in the United States and in Japan — to coordinate well with each other and with all tax authorities in a consistent manner. APMA often sees communication failure as one of the issues in problematic cases. APMA expects taxpayers to provide the same degree of cooperation with regional tax bureaus and the NTA as APMA expects to receive from taxpayers.

Problems arise, for example, where information is provided asymmetrically to the IRS and the NTA, or where information is submitted just before a competent authority meeting, leaving no time for the tax authority teams to review the information and reflect it in their respective positions. The governments spend thousands of dollars on APA and MAP negotiations, and they would like to be prepared well in advance of meetings so that they are fruitful.

The APMA team will work hard with U.S. and Japanese taxpayers who are willing to work with them. MAP and APA will continue to be an important tool for resolving double taxation.

The takeaway

APMA's recent announcement permitting electronic filing of APA applications and its issuance of responses to questions about how the current environment is affecting its handling of both pending and executed APAs show that APMA is addressing taxpayers' concerns in this challenging time. Meanwhile, the 2019 APA statistics on the number of APA applications filed indicates a continuing strong taxpayer interest in pursuing APAs.

PwC, including transfer pricing members from both PwC US Washington National Tax Service and PwC Tax Japan, greatly appreciated the opportunity to interview Mr. Hughes during his week in Tokyo in early February. Hearing Mr. Hughes' views, and seeing his dedication to the role of APMA, left us feeling confident that the US-Japan MAP/APA relationship remains strong and will continue to play a key role going forward in eliminating transfer pricing double taxation. As advisors, we are reminded of the importance of communicating taxpayers' willingness to work with the tax authorities throughout the MAP/APA process, as well as of the need to have good communication among ourselves as the advisor teams in both the United States and Japan.

Endnotes

1. Based on an NTA press release in November 2019, the United States is also the largest counterparty for Japan in terms of MAP cases (including APAs), at 25% of the total number of cases.
2. The original content appeared in Japanese in the article titled "US-Japan APA and MAP Relations: Interview with Mr. John Hughes, IRS APMA Director" in the April issue of Journal of International Taxation by Zeimu Kenkyukai, which was subsequently modified and added for this PwC Tax Insight.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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