

# US APA report for 2022 shows sharp decrease in executed APAs, but strong increase in requests filed

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## In brief

The IRS Advance Pricing and Mutual Agreement Program (APMA) on March 27 issued its 24th Annual Statutory Report (the report) concerning Advance Pricing Agreements (APAs). The Report observes that during calendar year 2022, APMA completed substantially fewer APAs than in 2021, with a slight increase in processing times. A total of 77 APAs were executed in 2022 as compared to 124 APAs executed in 2021. For APAs completed in 2022, the average processing time was 42.0 months, a slight increase from the prior-year average of 39.2 months.

The data on the number of APA applications filed indicates a continuing strong taxpayer interest in pursuing APAs. The Report states that APA applications for 2022 increased to 183 filed requests as compared to 145 requests filed in 2021. The increase in APA applications in 2022 demonstrates that taxpayers continue to have confidence in the APA program and a strong interest in obtaining tax certainty for their transfer pricing matters.

Bilateral APAs continue to dominate the APA caseload, comprising approximately 86% of APAs executed in 2022. More than 60% of the bilateral APAs executed in 2022 were with Japan, Canada, and India. Japan's share of completed cases dropped slightly in 2022, from 40% in 2021 to 39% in 2022. APMA also concluded multiple APAs with several other countries, including Canada (14%), India (8%), Switzerland (8%), and Korea (5%).

**Action item:** Corporate tax executives and their advisors should evaluate the benefits and opportunities that can be afforded by an APA as a means of proactively resolving potential tax controversies, especially considering the continued uncertainty taxpayers face in the current international tax environment.

## In detail

### Decrease in executed APAs and increased processing times

The number of executed APAs decreased significantly in 2022 to 77, down from 124 in 2021. The number of executed APAs prior to 2021 had been relatively consistent, with 127 in 2020 and 120 in 2019. Of the 77 agreements executed, approximately 45% were new APAs (i.e., not renewals of existing APAs), up from 37% in 2021.

The overall average time to complete an APA increased in 2022 to 42.0 months, up from 39.2 months in 2021 and up from the recent high of 40.0 months in 2018. The number of withdrawn APAs stayed the same, with six APAs being withdrawn in 2022 and 2021.

**Observation:** The significant decrease in executed APAs and the corresponding slight increase in average processing time may be reflective of the ongoing impact of the COVID-19 pandemic, especially with respect to APA requests filed during the pandemic, as face-to-face meetings with certain treaty partners still have been somewhat proscribed. However, this 2022 outcome needs to be monitored as this is the lowest number of APAs executed since 2011.

### **APA filings increased substantially in 2022 to 183; pending inventory increased**

The number of APA applications increased to 183 in 2022, up from 145 in 2021 and 121 in 2020. In addition, APMA received, as of the end of 2022, 34 user fee payments for APAs that were not yet accompanied by APA applications (so-called “APA dollar filing requests”).

At the end of 2022, there were 564 pending APAs, compared to 461, 448, and 454 pending APAs at the end of 2021, 2020, and 2019, respectively. APAs with Japan (24%), India (22%), and Canada (11%) continued to account for over half of all pending bilateral APAs. Pending APAs with Korea, Italy, Mexico, Germany, United Kingdom, Switzerland, and other countries accounted for the remaining pending case inventory.

### **Japan continues to dominate executed cases, followed by Canada and India**

Executed APAs: In 2022, Japan accounted for approximately 39% of all executed bilateral APAs with the United States. The percentage of bilateral APAs executed with Japan has declined slightly from 40% in 2021 and 52% in 2020. Following Japan, Canada doubled their representation of completed bilateral APAs, to 14% of all completed bilateral APAs in 2022 from 7% of completed bilateral APAs in 2021. The last time Canada was the second largest was in 2019 (11%).

Next in line were India and Switzerland, each accounting for 8% of the executed APAs. Germany faced a significant drop of executed APAs, representing only 4% of executed bilateral APAs, down from 20% in 2021. All other countries combined (including Finland, United Kingdom, China, Belgium, Korea, and Italy) accounted for 27% of the APAs executed in 2022.

Pending APAs: Japan also slightly led the list of pending bilateral APAs by country, followed by India and Canada. APAs involving Japan account for 24% of the pending requests, India accounts for 22%, and Canada comes in at 11% of the pending inventory. All other countries, including Korea, Italy, Mexico, Germany, United Kingdom, and Switzerland, comprise the remaining approximately 43%. This line-up also mirrors the country specific breakdown for bilateral APAs filed in 2022, with Japan, India, and Canada accounting for 54% of the total filed.

### **Role of bilateral APAs**

Of the 183 APA submissions filed in 2022, 154 submissions (approximately 84%) requested bilateral APAs, and 22 submissions (approximately 12%) requested unilateral APAs. There also were 7 multilateral requests. Of the 77 APAs that were executed in 2022, 66 involved bilateral APAs (approximately 86%).

As in prior years, more than half of the APAs executed in 2022 (62%) involved transactions between non-US parents and US subsidiaries.

Renewal bilateral APAs as a percentage of all executed APAs accounted for 41% of APAs in 2022; this is a decrease from 47% in 2021 and 50% in 2020, and slightly more than 40% in 2019. All renewal APAs (bilateral and unilateral) accounted for approximately 55% of all APAs executed in 2022. The overall number of renewals executed in 2022 was almost half of those that were signed in 2021 (19 unilateral APA renewals were executed in 2021 versus 10 in 2022).

## Types of transactions covered in APAs

Approximately 37% of the transactions covered by completed APAs in 2022 involved the transfer of tangible goods, including both inbound and outbound sales; this is a decrease from 45% in 2021. About 39% of the APAs involved inbound and outbound services transactions and 22% involved the use of intangible property (an increase from 16% in 2021). Overall, the types of covered transactions remain stable.

## Industries covered in APAs

Completed APAs in 2022 covered five general industry segments — manufacturing (40%); wholesale/retail trade (42%); services (13%); finance, insurance, and real estate (4%); and all other industries (1%).

## TPMs and PLIs: CPM and OM lead again

Consistent with the approximately 31-year history of the APA program, the comparable profits method (CPM)/transactional net margin method (TNMM), with varying profit level indicators (PLIs), was the primary transfer pricing method (TPM) used. In 2022, 77% of APAs involving transfers of tangible and intangible property applied the CPM/TNMM (compared to 85% in 2021). Similarly, 80% of APAs involving services transactions relied on the CPM/TNMM (compared to 90% in 2021).

The operating margin (OM), defined as the ratio of operating profit to sales, was the most common PLI used in applying the CPM/TNMM to tangible and intangible transactions, accounting for 73% of these cases. For APAs that applied the CPM/TNMM to services transactions, the OM and operating profit to operating expense were the most common PLIs and accounted for 53% of the PLIs employed.

**Observation:** The report does not specify the number of APAs that used the residual profit split method (RPSM). Although the report does not give visibility as to the TPM used for the remaining 23% of tangible or intangible property transactions (and 20% for services transactions), the CPM/TNMM continues to be the dominant method.

## Ranges, goals, and adjustment mechanisms

Most transactions covered in APAs target a result that falls within the applicable interquartile range. In transactions involving the payment of royalties for the use of intangibles, both specific royalty rates and ranges were used. Where the covered transaction relied on the use of external agreements, a secondary method testing the post-royalty operating margin or cost-plus markup was used.

For APAs concluded in 2022, several mechanisms were used for making adjustments to the tested party's results when those results fell outside the range or did not match the point required in the APA. The report provides several examples of the mechanisms used: an adjustment bringing the tested party's results to the closer edge of the range applied to the results of a single year; an adjustment to the closer 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.

## APA terms

Just less than half of the completed APAs in 2022 had a five-year term, which is the standard length for an APA term. The longest APA term agreed to in 2022 was 11 years. Five of the executed APAs had terms shorter than five years. The overall average number of years for an APA term was six years. Approximately 16% of the APAs executed in 2022 included rollback years, a decrease from 22% in 2021.

**Observation:** As in the past, in 2022 APA terms were set, to the extent feasible, to allow for a reasonable amount of prospectivity at the time the APA was executed.

## The takeaway

The IRS's 24th Annual Statutory Report concerning Advance Pricing Agreements records a low output for 2022 in terms of the number of APAs executed, but reflects a growing interest of taxpayers in pursuing APAs as APA requests significantly increased in 2022. The resulting jump in inventory of open cases demonstrates an important and steady area of focus and continued interest of taxpayers in using the APA program to manage risk around transfer pricing disputes.

## Let's talk

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

### Transfer Pricing

**Jozef Kavuliak, Washington, DC**  
+1 773 817 1712  
[jozef.kavuliak@pwc.com](mailto:jozef.kavuliak@pwc.com)

**Jana Lessne, Washington, DC**  
+1 703 819 0793  
[jana.lessne@pwc.com](mailto:jana.lessne@pwc.com)

**Kristina Novak, Dallas**  
+1 469 878 4552  
[kristina.novak@pwc.com](mailto:kristina.novak@pwc.com)

### Transfer Pricing Global and US Leaders

**Horacio Peña, New York**  
Global Transfer Pricing Leader  
+1 917 478 5817  
[horacio.pena@pwc.com](mailto:horacio.pena@pwc.com)

**Paige Hill, New York**  
US Transfer Pricing Leader  
+1 917 923 8412  
[paige.hill@pwc.com](mailto:paige.hill@pwc.com)