

Transfer Pricing News

A fresh look at the Japan-US bilateral APA relationship

May 2013



On March 26, 2013, the Internal Revenue Service (“IRS”) of the United States (“US”) issued its 14th Annual Statutory Report on Advance Pricing Agreements (“APAs”). The most interesting point of the report from the Japanese perspective is that 53% of bilateral APAs executed by the IRS in 2012 involved Japan as a counterparty (or 55 bilateral APAs in absolute numbers).

53% of US bilateral APAs completed in 2012 with Japan

On March 26, 2013, the US IRS issued its 14th Annual Statutory Report on APAs. A detailed discussion on the contents of that report and the conclusions that can be derived from it from the US perspective are contained in a PwC PKN / TCDR release in March (Note 1). From the Japan perspective however, the most interesting point of the report is that **53% of bilateral APAs executed by the IRS in 2012 involved Japan as a counterparty** (or 55 bilateral APAs in absolute numbers). Although the report is in its fourteenth year, this is the first time that data by counterparty jurisdiction has been released and suggests that, despite the growth in US trade with other countries in recent years, particularly China, the Japan / US trade relationship still appears to be the most significant from the US tax perspective. But what does this relationship look like from the Japan side?

Japan’s National Tax Agency (“NTA”) also publishes an annual report on APAs and mutual agreement procedures. However, due to differences in reporting years (ending June for Japan and December for the US), and because Japan publishes statistics by region rather than by country, it is difficult to compare statistics between the two reports. Nevertheless, the NTA’s MAP Report for 2012 (administrative year ended June 30, 2012), confirms that the treaty partner with which the NTA executed the largest number of MAP cases (including both MAP and bilateral APAs) was the US. Therefore, despite an intense focus among Japanese multinationals on expansion in the Asian region, it would appear that the Japan / US trade relationship is still significant from the Japan tax perspective.

(Note 1)

<http://www.publications.pwc.com/DisplayFile.aspx?Attachmentid=6519&Mailinstanceid=27353>

With this background in mind, it is heartening to note that both the US and Japan reports state that bilateral APAs concluded in 2012 hit an all time high. The NTA concluded 135 bilateral APAs in the year ended June 2012, while the IRS concluded 103 in the year ended December 2012 (a significant improvement on the 34 bilateral APAs executed in 2011). Not only does this indicate an increase in efficiency in the APA processes of both jurisdictions, over time it should also lead to a reduction in the number of “carry over” APA requests still pending at the end of each year (assuming the high conclusion rates continue). These positive statistics could be the result of a concerted effort by the NTA to speed up the Japan APA review process, as well as the formation of the IRS’s newly organised Advance Pricing and Mutual Agreement (APMA) Program.

The APA as a viable solution for transfer pricing issues

For taxpayers with significant transaction flows between Japan and the US, the conclusion to be drawn from these reports is that a bilateral Japan-US APA is a viable and well-functioning tool for tax risk mitigation in both countries. As a result, taxpayers who have previously been discouraged from entering the APA process due to perceived inefficiencies or concern over an inability to obtain agreement between the NTA and the IRS in a reasonable amount of time, or at all, may now wish to reconsider their position.

But what, if anything, do these results portend for bilateral APAs between either Japan or the US and other jurisdictions? Increasingly, we are seeing taxpayers obtain an APA for transactions between two affiliates in jurisdictions such as Japan and the US, where the APA programs are well established and sophisticated, as a precursor to obtaining APAs for similar transactions between affiliates in other jurisdictions where the APA programs are less mature. The reasons for prioritizing an APA between, for example, Japan and the US are varied, but include:

- Given the long experience of Japan and the US with transfer pricing in general and APAs in particular, it is likely that any bilateral APA agreed between these two countries will be based on reasonable and well founded transfer pricing principles. In addition, given the relative equality in bargaining power between Japan and the US, the reasonable and well founded transfer pricing method derived from negotiations between them may well produce a more balanced result than would negotiations between jurisdictions where there is a disparity in bargaining power. While other jurisdictions may not feel it incumbent on themselves to follow exactly what either the NTA or the IRS has agreed, a pre-existing bilateral APA with a principled transfer pricing approach could place a greater onus on those other jurisdictions for subsequent APAs to explain any deviations from that approach.
- Moreover, while many jurisdictions may not wish to directly apply (or to be seen to be directly applying) the results of an APA between Japan and the US, there may well be jurisdictions with less transfer pricing experience where the tax authorities would in fact welcome guidance from (or may be susceptible to the influence of) more experienced tax authorities such as the NTA and IRS.
- The documentation package required to be submitted for the NTA and IRS’s APA programs is clearly set out and well understood by taxpayers. These packages may provide a guide for the type of information that should be included in APA packages in other jurisdictions where the submission requirements may not be so clear.
- Before the NTA and IRS begin competent authority negotiations in regards to any APA, the relevant documentation package and transfer pricing approach will have been through an extensive review process by the tax authorities in both jurisdictions. This review process will help to identify issues that are likely to arise in other jurisdictions, and the information required to respond to those issues, but within the framework of well structured APA programs.

While this approach of leveraging the bilateral APA experience from one jurisdiction to another may not be suitable for all taxpayers, for those taxpayers with significant transfer pricing exposures across a number of territories with active APA programs, this strategy may be a means of more efficiently increasing the level of certainty around transfer prices across a wider range of countries.

For more detailed information, please consult your international tax representative or contact any of the following members listed below:

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