MEXICO

Law and Practice

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1. RULES GOVERNING TRANSFER PRICING

1.1 Statutes and Regulations

In Mexico, the provisions related to the transfer pricing regime are included in the Income Tax Law (ITL) and the Federal Tax Code (FTC).

In general, taxpayers that carry out transactions with related parties, either resident in Mexico or abroad, are required to determine their taxable income and deductions in accordance with the arm's-length standard.

Through a tax audit, tax authorities may challenge the taxable income or deductions of the taxpayer derived from its related party transactions and issue a tax assessment.

The Mexican transfer pricing regime includes provisions that establish the definition of a related party, transfer pricing methods and their applicable hierarchy, what could be considered as a comparable company or transaction, comparability adjustments and business cycle considerations, and information that could be used for interpretation purposes, among other concepts.

In addition, the ITL establishes the requirements for compliance with contemporaneous transfer pricing documentation, which must be prepared and maintained on an annual basis by the taxpayer. In general, this contemporaneous transfer pricing documentation does not have to be submitted to the tax authorities; however, it may be requested through a tax audit process.

The only threshold for the requirement to maintain contemporaneous transfer pricing documentation is that it does not apply to taxpayers whose income in the immediately preceding fiscal year did not exceed MXN13 million (approximately USD6.5 million) and taxpayers whose income from the provision of professional services did not exceed MXN3 million (approximately USD1.5 million).

Three-Tier Transfer Pricing Documentation

In addition to the obligation for to keep contemporaneous transfer pricing documentation, since 2016 Mexico has included tax provisions related to the three-tier transfer pricing documentation proposed by the OECD. This is, local file, master file and country-by-country requirements.

These provisions may duplicate transfer pricing obligations for taxpayers.

This three-tier transfer pricing documentation requirement is implemented trough the obligation to file informative tax returns with similar information as proposed in Action 13 of the Base Erosion and Profit Shifting project issued by the OECD (BEPS project) consisting in a local file, master file and country-by-country report.

Regarding transfer pricing adjustments, in general there are not detailed tax provisions, but the Miscellaneous Tax Rules (MTR) have included guidelines for transfer pricing adjustments and the documentation to be prepared and filed for the applicability of the amendments of the taxable income and/or deductions derived from said transfer pricing adjustments.

The FTC incorporates rules for taxpayers and tax advisors for the disclosure of reportable schemes. The schemes that must be reported are those that generate or may generate, directly or indirectly, a tax benefit for the taxpayer in Mexico. For transactions between related parties, the FTC states the following as reportable:

- transfer of hard-to-value intangibles;
- restructures without consideration or if, as a result of said restructuring, the operating profit is lowered by more than 20%;

- transactions without consideration;
- transactions without the use of reliable comparables; and
- mutual agreement procedures (MAPs) or advance pricing agreements (APAs) obtained by a foreign-based related party regarding a transaction with a Mexican taxpayer.

1.2 Current Regime and Recent Changes

Since 1997, the Mexican tax legislation has considered transfer pricing provisions for recognising the arm's-length principle as the benchmark for related-party transactions.

Significant updates were considered in the years 2001, 2002 and 2006, with the implementation of a transactional approach versus a global approach, recognition of the OECD Guidelines for Multinational Enterprises and Tax Administrations as established in 1995 as a basis for interpretation, and its updates (OECD Transfer Pricing Guidelines) as long as they are consistent with the ITL provisions, and a hierarchy for the application of transfer pricing methods.

In 2016, an update to the ITL was carried out to include the three-tiered obligation established by BEPS (local file, master file and country-by-country reporting) for taxpayers who, in general, in the immediately preceding fiscal year had declared in their annual tax returns, taxable income equal to or exceeding MXN904,215,560 (approximately USD45 million) – which is adjusted annually considering inflation – and carried out transactions with related parties. This obligation is in addition to the annual transfer pricing compliance report.

As per the 2022 ITL, if the taxpayer has these obligations, the local informative return must be submitted on May 15th of the following year, whereas the master informative return and country-by-country report have to be submitted no later than December 31st of the following year.

From 2016 and until the ITL of 2021, the local informative returns had to be filed before the tax authorities, no later than December 31st of the immediately following year. Therefore, the update for the 2022 ITL will result in important challenges for taxpayers and transfer pricing advisors in Mexico, since this update speeds-up the filing process of this tax return by more than seven months.

2. DEFINITION OF CONTROL/RELATED PARTIES

2.1 Application of Transfer Pricing Rules

The ITL states that two or more persons or entities are related parties when one of them participates directly or indirectly in the management, control or capital of the other, when a person or group of persons participates directly or indirectly in the management, control or capital of those persons, or when there is a link between them as according to customs regulations.

The ITL does not consider a minimum percentage of capital ownership for two or more persons to be considered as related parties; the definition of related party is therefore very broad.

In addition, transfer pricing benchmarking considers a transactional approach, and no threshold amount is contemplated.

In this sense, all related party transactions that derive in income or a deduction for the Mexican entity should be analysed in compliance with the arm's-length principle as per Mexican tax provisions.

3. METHODS AND METHOD SELECTION AND APPLICATION

3.1 Transfer Pricing Methods

The ITL establishes six transfer pricing methods that could be used for analysing intercompany transactions, which in the order established therein are the following:

- the Comparable Uncontrolled Price Method (CUP);
- the Resale Price Method (RPM);
- the Cost Plus Method (PLM);
- the Profit Split Method (PSM);
- the Residual Profit Split Method (RPSM); and
- the Transactional Net Margin Method (TNMM).

Unlike the OECD Guidelines, which considers the residual analysis as part of the transactional profit split method, the Mexican ITL establishes these as separate transfer pricing methods (PSM and RPSM), and therefore their applicability must be considered individually.

3.2 Unspecified Methods

The Mexican ITL does not consider the application of unspecified methods, and only the six transfer pricing methods included in Article 180 of said law should be used for analysing intercompany transactions.

3.3 Hierarchy of Methods

According to the ITL, the CUP should, if possible, be used when analysing related party transactions. If the CUP is not applicable, any other method may be applied on the following basis:

- it is demonstrated that the CUP is not applicable in order to analyse the related party transaction, according to the OECD Guidelines; and
- it is demonstrated that the method applied is the most appropriate one to analyse the related party transaction in accordance with the available information and the OECD Guidelines, giving preference to the RPM and CPLM.

Additionally, the ITL establishes that, if applying the RPM, CPLM or TNMM, both the selling price and the costs associated with such transaction should be established under the arm's-length standard. It would be necessary to prove that the method applied is the best method or the most reliable based on the available information, giving preference to the RPM and CPLM.

3.4 Ranges and Statistical Measures

As established in the ITL, from the application of any of the transfer pricing methods specified in the law, when two or more comparables exist, a range of prices, consideration amounts, or profit margins could be obtained. These ranges would be adjusted by means of the interquartile method, the method agreed in a mutual agreement procedure as included in tax treaties to which Mexico is a signatory, or the authorised method as per the rules issued by the Mexican tax authorities.

If the taxpayer is not within the adjusted range, then the arm's-length price, consideration amount or profit margin would be the median of said range.

3.5 Comparability Adjustments

As stated in the ITL, transactions or companies are considered comparables when there are no differences that significantly affect the prices, consideration amounts or profit margins as per the transfer pricing methods established in said law, and if differences exist, where these are eliminated with reasonable adjustments. For determining said differences, the ITL establishes that, among others, the following elements should be considered.

- Characteristics of the transactions including:
  - (a) for financial transactions, elements such as principal amount, term, guarantees, solvency of the debtor and interest rate;
  - (b) for the provision of services, elements such as the nature of the service, and if the service involves an experience or technical know-how;
  - (c) in relation to the use, enjoyment or sale of tangible assets, elements such as the physical characteristics, quality, and availability of the asset;
  - (d) in relation to the exploitation or transfer of an intangible asset, elements such as if the intangible consists in a patent, trade mark, trade name or transfer of technology, as well as its duration and protection grade; and
  - (e) in the sale of shares, elements such as the updated equity of the issuing entity, present value of the margins or free cash flows, or the stock market quotation for public entities.
- Functions and activities, including the assets used and risks assumed in the transaction, of each entity involved in said transaction.
- Terms and conditions of the intercompany agreement.
- Economic circumstances.
- Business strategies, including those related to market penetration, maintenance, or expansion.

In addition, general transfer pricing practice in Mexico considers adjustments to reflect differences in the relative levels of accounts receivable and accounts payable, as well as inventories and property, plant and equipment.

Recently, it has been a common practice by the tax authorities in Mexico to apply a country risk adjustment in audit processes, which is performed when there are differences in the existing economic circumstances of the market/country in which the tested party and the comparables' operation takes place.

As part of this country risk adjustment, the Emerging Markets Bond Index (EMBI) could be considered as a factor to compute the applicable country risk adjustment. This kind of adjustment triggers a higher profit margin for the comparables and therefore a higher interquartile range.

4. INTANGIBLES

4.1 Notable Rules

As established in the ITL, transactions related to the exploitation or transfer of intangible assets must be in compliance with the arm's-length principle. For this type of transaction, elements such as the type of asset (patent, trade mark, trade name or transfer of technology, among others), the duration, and the degree of protection of the intangible must be considered.

The RPM is the transfer pricing method included in the ITL, that should generally be used to analyse intercompany transactions where significant or relevant intangible assets are used by the related parties.

In general, the RPM consists in a two-step method, where a global profit is obtained and through step one the "routine" profitability of the related parties involved is determined, which includes the application of any other of the transfer pricing methods for obtaining the minimum profit that each company must obtain. Step two will determine the residual profit, obtained by subtracting the routine profit from the global profit, which will be distributed between the related parties considering, among other things, the relevant intangible assets used by each related party.

In 2018, the tax authorities issued non-binding criteria related to royalty payments, through which it was established as a wrongful practice for royalties to be paid to foreign-based related parties for the licensing of an intangible asset that was originally owned by a Mexican entity, and for which no transfer price was established or, where the transfer price was below the market price. Furthermore, these non-binding criteria establish that Mexican entities should not consider as a deductible item the investments derived from the purchase of intangibles assets acquired from foreign-based related parties, even if a third party in Mexico is involved in the purchase of said intangible asset. The exception being if the intangible assets had been acquired earlier by the foreign-based related party from a third party and it proves the payment regarding the acquisition cost.

4.2 Hard-to-Value Intangibles

The provisions regarding intangible assets including in the ITL are limited and no broad guidelines are established. As mentioned, the OECD Guidelines are a source for interpretation, therefore they may be used for the application of these intangibles since no specific or special rules are considered in Mexican provisions.

The updated OECD guidelines recognise hard-to-value intangibles as part of Chapter VI "Special considerations for intangibles", and further considerations are established in Annex II to Chapter VI, which provides guidance for tax administrations to apply regarding these intangibles.

As part of the analysis for hard-to-value intangibles, the OECD Guidelines recommend that tax administrations should consider the application of the ex-ante and ex-post approaches, which will minimise the information asymmetry that this type of asset entails.

As mentioned, starting in 2020, the tax authorities incorporated a new section in the FTC related to reportable schemes; specifically, Section VI of Article 199 of the FTC requires taxpayers to disclose information related to intercompany transactions related to the transfer of hard-to-value intangibles.

In 2018, as a specific rule, the tax authorities issued non-binding criteria related to intangible property, which established that a taxpayer in the transfer pricing analysis should not consider companies as comparables in cases where there are significant differences due to unique and valuable contributions or when these unique and valuable contributions are not recognised correctly.

4.3 Cost Sharing/Cost Contribution Arrangements

Regarding cost-sharing, Mexican tax provisions establish that expenses from transactions with foreign-based related parties that are assigned on a pro-rata basis, are considered a non-deductible item.

As an exemption, there is a miscellaneous tax rule which establishes that the aforementioned tax provision should not be applicable if the taxpayer complies with the requirements included therein. The requirements include, among other elements, the following:

- the expense should be considered as strictly indispensable for the Mexican entity considering its business activities;
- regarding the foreign-based related party, it must be an entity that is resident for tax purposes in a country with which Mexico has an agreement for the exchange of information;

- proving that the services related to the expenses were rendered;
- for related parties, complying with transfer pricing provisions; and
- demonstrating a reasonable relation between the expense and the benefit obtained or expected to be obtained by the Mexican entity.

This documentation requirements are hard to comply with on a post-transaction basis, therefore it is strongly recommended that prior to establishing these types of agreements, Mexican residents should be aware of said documentation requirements to prepare, in time, a defence file.

5. AFFIRMATIVE ADJUSTMENTS

5.1 Rules on Affirmative Transfer Pricing Adjustments

As stated in the ITL, the tax authorities audit faculties are for tax-years ended. Mexico considers a calendar tax year to start on January 1st and end on December 31st, therefore transfer pricing provisions are applicable on an annual basis.

Regarding transfer pricing adjustments performed, the specific rules are established in the MTR.

Transfer pricing adjustments can be real (accounting and tax effects) or virtual (only tax effects) and are categorised as the following.

- Voluntary or compensatory: adjustment performed by the taxpayer prior to the annual tax return (March 31st) or May 15th for entities that obtain the accounting reporting opinion (*dictamen fiscal*).
- Primary: adjustment that derives from the audit process carried out by the tax authorities on the taxpayer.
- Corresponding national: adjustment that derives from the audit process carried out by the tax authorities on the related party in Mexico for which the intercompany transaction was carried out with the taxpayer.
- Corresponding foreign: adjustment derives from the audit process carried out by the foreign tax authorities on the foreign-based related party for which the intercompany transaction was carried out with the taxpayer.
- Secondary: Adjustment to a contribution, derived from the transfer pricing adjustment, which is generally characterised as a presumed dividend.

Rule 3.9.1.3 of the MTR establishes the list of requirements for adjustments that reduce their taxable income to be deductible, which includes the following.

- To obtain and keep documentation that supports that, previous to the adjustment, the taxpayer determined that the intercompany transaction was not in compliance with the arm's-length principle according to the ITL transfer pricing provisions.
- To obtain and keep a statement signed by the elaborator of the original transfer pricing documentation, explaining why the transaction was not originally agreed in compliance with the arm's-length principle.
- To obtain and keep a statement signed by the elaborator of the documentation, explaining the consistency or inconsistency in the application of transfer pricing methodologies and the search for comparable companies/transactions, in relation to the adjusted transaction corresponding, as minimum, to the immediately preceding fiscal year.
- To obtain and keep all documentation through which it can be verified that, with the transfer

pricing adjustment, it can be concluded that the transaction was agreed in compliance with the arm's-length principle.

- A digital tax return (*Comprobante Fiscal Digital por Internet*, or CFDI) or tax receipt regarding the original intercompany transaction.
- For real adjustments, a CFDI or tax receipt regarding the transfer pricing adjustment which must comply with certain specific requirements.
- For deductible items from the purchase of merchandise through importation, keep all documentation related to the related value-added tax (IVA) and the special tax for products and services (IEPS)
- Proof that the related party with whom the adjusted transaction was carried out, has accrued the corresponding adjustment and that the adjustment does not derive in a taxable income for a tax haven; such proof can consist in a statement under oath of the legal representative of the related party, translated into Spanish, confirming that the corresponding adjustment was performed and that the accrued income was not taxed in a tax haven.

As an important item related to transfer pricing adjustments, it should be noted that, under a non-binding criterion published by the Mexican tax authorities in 2018, taxpayers should not perform any modification to prices, amounts of consideration, or profit margins that are already within the interquartile range.

This criterion is particularly relevant in situations where Mexican taxpayers intend to decrease the transfer pricing results (for instance, from the upper to the median of the arm's-length results) and consequently decrease the taxable basis.

6. CROSS-BORDER INFORMATION SHARING

6.1 Sharing Taxpayer Information

Since 1992, Mexico has entered into several Double Taxation Treaties with the more than 60 jurisdictions, based on the OECD's and UN's Model Tax Conventions.

In addition to Double Taxation Treaties, Mexico has entered into Tax Information Exchange Agreements with the purpose of these promoting international co-operation in tax matters through the exchange of information. In general, these Tax Information Exchange Agreements align with the model developed by the OECD Global Forum Working Group on Effective Exchange of Information.

Mexico is also a member of the Convention on Mutual Administrative Assistance in Tax Matters, which entered in force as of September 2012. This Convention intends to facilitate international co-operation, through the exchange of information, including automatic exchanges, and the recovery of foreign tax claims in order to address tax evasion and avoidance issues. As part of this Convention, as of 2014, Mexico is also part of the Multilateral Competent Authority Agreement, through which the Mexican tax authorities receive and share the financial information of taxpayers with the other jurisdictions that are part of this agreement.

7. ADVANCE PRICING AGREEMENTS (APAS)

7.1 Programmes Allowing for Rulings Regarding Transfer Pricing

Article 34-A of the FTC establishes that taxpayers may submit all related documentation, data, and information to request a consultation regarding the transfer pricing methodology for intercompany transaction(s) to the tax authorities in order to obtain an advanced pricing agreement (APA).

The validity of the APA is subject to the compliance with requests that prove that the intercompany transaction in this procedure is established considering prices, consideration amounts or profit margins that would have been established by third parties in comparable transactions.

7.2 Administration of Programmes

The APA should be requested before the Central Administration of the Transfer Pricing Audit Administration of the Large Taxpayers General Administration, which is the main administration that administers the APA programme.

7.3 Co-ordination between the APA Process and Mutual Agreement Procedures

APAs are valid the fiscal year in which they are requested, the immediately preceding year, and for up to three fiscal years following the one in which they are requested.

APAs may be valid for a longer period when they derive from a mutual agreement procedure (MAP) in accordance with an international convention to which Mexico is a signatory.

MAPs are also administered by the Central Administration of the Transfer Pricing Audit Administration of Large Taxpayers General Administration.

7.4 Limits on Taxpayers/Transactions Eligible for an APA

Mexican tax provisions do not establish a list of specific transactions or taxpayers that could be subject to an APA.

In this sense, subject to the compliance with the requested information in procedure sheet 102/CFF, there are no limits on a taxpayer requesting an APA for an intercompany transaction.

7.5 APA Application Deadlines

There is no specific filling date for the application of an APA.

Once the application for an APA has been submitted by the taxpayer, procedure sheet 102/CFF establishes eight months for the tax authorities to issue a response, including a potential request for further documentation from the taxpayer.

7.6 APA User Fees

The applicable user fee for the request of an APA in 2022, is MXN275,906.07 (approximately USD13,800), and the annual APA review post-resolution MXN55,181.21 (approximately USD2,760).

7.7 Duration of APA Cover

As mentioned in **7.3 Co-ordination between the APA Process and Mutual Agreement Procedures**, an APA may be valid for the fiscal year in which it is requested, the immediately preceding year, and for up to three fiscal years following the one in which it is requested.

An APA may be valid for a longer period when they derive from a MAP in accordance with an international treaty to which Mexico is a signatory.

7.8 Retroactive Effect for APAs

An APA can have retroactive effect of up to one year (see **7.7 Duration of APA Cover**). In addition, bilateral and multilateral APAs are subject to agreement between the competent tax authorities and therefore a wider period for retroactive effects could be negotiated.

8. PENALTIES AND DOCUMENTATION

8.1 Transfer Pricing Penalties and Defences

Regarding penalties, failure to submit or submission with errors of the annual transfer pricing informative return established in Article 76 Section X of the ITL would entail a penalty, in FY 2022, of between MXN86,050 and MXN172,100 (approximately USD4,300–8,600). This informative return requests certain information from the contemporaneous transfer pricing report (ie, transactions analysed, related parties and transaction amounts, transfer pricing method applies, among others).

In connection with the transfer pricing informative returns (local file, master file and country-by-country) established in Article 76-A of the ITL, the penalty for failure to submit, submission with errors, incongruence or submission in a different form that stated in the tax provisions, is, in FY 2022, between MXN172,480 and MXN245,570 (approximately USD8,600–12,250).

In addition, the government will not engage in contracts with taxpayers that failed to submit the tax returns established in the ITL.

On the other hand, if the Mexican tax authorities conclude that a company underpaid taxes in Mexico as a result of non-arm's length transfer prices, the penalty could consist of a monthly interest rate payment equal to the government published rate, plus surcharges and penalties that range from 55–75% of the re-evaluated and unpaid tax. These penalties are applied after the taxpayer is audited and in case of an existing error or tax payment omission.

If determined by the tax authorities through their audit faculties, there is no specific defence mechanism for transfer pricing penalties, and more likely than not the taxpayer will be required to submit without errors the corresponding tax return.

There is an administrative mechanism that a taxpayer could apply to consider the reduction of the penalties by 100%, which is stated in Article 70-A of the FTC; however, the taxpayer must be reviewed through an audit process by the tax authorities to have this reduction considered.

8.2 Taxpayer Obligations under the OECD Transfer Pricing Guidelines

Article 76-A of the ITL, establishes that taxpayers who, in the immediately preceding fiscal year, had declared in their annual tax returns taxable income equal to or exceeding a certain amount established in Article 32-H of the FTC (MXN904,215,560 for FY 2022; approximately USD45 million), and have carried out transactions with related parties, must file the following informative returns.

- Master information return of related parties, which must include information regarding the multinational business group.
- Local informative return of related parties, which must include the organisational structure, strategic and business activities, as well as the information regarding operations with related parties.
- Country-by-country informative return of the business multinational group.

In this regard, it is established that a country-by-country informative return must be filed by taxpayers when they are within any of the following categories.

- Multi-national holding companies, which shall be understood as the companies meeting the following requirements:

  (a) resident in Mexico;

(b) with subsidiary companies defined in terms of the financial information standards, or else, permanent establishments residing or located abroad, as the case may be;
(c) not subsidiaries of any other company residing abroad;
(d) bound to prepare, file and disclose the consolidated financial statements in terms of the financial information standards;
(e) which report, in their consolidated financial statements, income for entities residing in other countries or jurisdictions; and
(f) which have obtained in the immediately preceding fiscal year consolidated income for accounting effects equivalent to or exceeding MXN12 billion (this amount may be amended by the Mexican Federal Congress for the relevant fiscal year in the Federal Income Law).

- Legal entities residing in Mexico or abroad with a permanent establishment in the country, that have been appointed by the holding company of the multinational business group residing abroad as parties responsible for providing the country-by-country informative return.

9. ALIGNMENT WITH OECD TRANSFER PRICING GUIDELINES

9.1 Alignment and Differences

The ITL considers as a source for interpretation the OECD Transfer Pricing Guidelines, and in general Mexico's transfer pricing provisions are closely aligned with the said guidelines.

A difference would be that unlike to the OECD Transfer Pricing Guidelines, which consider the residual analysis as part of the transactional profit split method, the Mexican ITL establishes these as separate transfer pricing methods (PSM and RPSM), and therefore considers six transfer pricing methods.

In addition, there is a specific Article in the ITL that considers as a non-deductible item all expenses from foreign-based related parties that are assigned to a Mexican entity considered on a pro-rata basis. There are certain requirements for the documentation that a Mexican entity can prepare and obtain to have this type of expense considered deductible, which are described in detail in **4.3 Cost Sharing/Cost Contribution Arrangements**.

Furthermore, the ITL contemplates a hierarchy for the application of transfer pricing methods, which differs from the OECD Transfer Pricing Guidelines in considering the most applicable method for the intercompany transaction analysis.

9.2 Arm's-Length Principle

Mexico's transfer pricing regime is aligned with the arm's-length principle as established in the OECD Transfer Pricing Guidelines, and it is the basis of analysis when reviewing whether an intercompany transaction complies with what would have been established with or between independent third parties in comparable transactions.

9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project

Mexican transfer pricing provisions consider the OECD's BEPS project recommendations from Actions 8–10 regarding more detailed and robust functional analyses for intercompany transactions, as well as thorough detail regarding supporting documentation to review materiality issues.

In addition, Article 76-A established to align with Action Plan 13 regarding the submission of annual tax returns which somewhat resemble the OECD's recommendations for a local file, master file and country-by-country report.

Furthermore, in connection with BEPS project Action 4, the ITL has implemented measures that limit interest deductions that exceed 30% of EBITDA, which applies only to taxpayers with interest expenses exceeding MXN20 million in a given fiscal year.

9.4 Impact of BEPS 2.0

As of April 2022, Mexico has only implemented certain provisions related to the VAT Law, which address the taxation of digital services for such tax.

9.5 Entities Bearing the Risk of Another Entity's Operations

Mexico's tax legislation and transfer pricing practice does not forbid entities to bear the risk of another entity's operations by guaranteeing the other entity a return.

However, in cases where a Mexican entity guarantees the interest payments of a related party (whether foreign or domestic), thus assuming the credit risk of the lender, these interest payments should be treated as dividends from a tax perspective.

10. RELEVANCE OF THE UNITED NATIONS PRACTICAL MANUAL ON TRANSFER PRICING

10.1 Impact of UN Practical Manual on Transfer Pricing

Mexican legislation does not consider the UN Practical Manual on Transfer Pricing as a source for interpretation of transfer pricing practice.

Mexican tax provisions consider only the OECD Transfer Pricing Guidelines as a source for interpretation of transfer pricing practice.

11. SAFE HARBOURS OR OTHER UNIQUE RULES

11.1 Transfer Pricing Safe Harbours

The use of safe-harbour rules is limited to a targeted sector, which is the *Maquiladora* industry.

The safe-harbour mechanism established in the ITL for this industry, consists in determining the tax profit base as the maximum value that results from applying 6.9% on the total value of the assets and 6.5% on the total amount of costs and expenses.

Articles 181 and 182 list the specific computational characteristics that must be considered for determining the total value of the assets and the total amount of costs and expenses.

In addition, *Maquiladora* entities that apply these safe-harbour rules, must submit annually a tax return with the corresponding computations.

From 2021, the FTC has established a new faculty for the tax authorities to publish information regarding reference parameters with respect to profit levels, deductible concepts or effective tax rates, based on the industry in which the taxpayer operates.

11.2 Rules on Savings Arising from Operating in the Jurisdiction

Mexican tax provisions do not consider any rules governing savings that apply to transfer pricing and related-party transactions.

11.3 Unique Transfer Pricing Rules or Practices

Mexican tax provisions consider specific rules for transfer pricing adjustments which have been discussed in detail in **5.1 Rules on Affirmative Transfer Pricing Adjustments**.

In addition, there is a restriction regarding expenses arising from transactions with foreign-based related parties that assign said expenses on a pro-rata basis, which are considered a non-deductible item. There are certain requirements regarding the documentation that a Mexican entity can prepare and obtain to have this type of expense considered as deductible, which are described in detail in **4.3 Cost Sharing/Cost Contribution Arrangements**.

12. CO-ORDINATION WITH CUSTOMS VALUATION

12.1 Co-ordination Requirements between Transfer Pricing and Customs Valuation

Transfer pricing provisions included in the ITL are only applicable for purposes of said law, this is, only for income tax purposes.

Mexican Customs Law establishes the taxes to be considered for the determination of customs value in import and export transactions. The Customs Law considers specific methods for determining the customs value, which are different to transfer pricing methodologies.

In general, there is no co-ordination between transfer pricing documentation and customs valuations, since generally transfer pricing documentation will not be valid for customs purposes and vice versa.

13. CONTROVERSY PROCESS

13.1 Options and Requirements in Transfer Pricing Controversies

Mexican tax provisions consider a five-year statute of limitation.

The audit process starts once the taxpayer receives a ruling from the tax authorities, which in general will require several information and documentation to be submitted by the taxpayer, stating the initiation of a tax audit.

The tax authorities have up to two years to notify the taxpayer of an Observations Ruling, which will include the specifics of their qualification of the facts or of the omissions in the information provided by the taxpayer through the audit process.

Once this Observations Ruling is notified, as an alternative tax resolution mechanism, the taxpayer has 20 business days to request a conclusive agreement procedure before the Mexican Taxpayer's Ombudsman (PRODECON). This resource consists in holding discussions with the tax authorities through the assistance of PRODECON, to reach an agreement before a tax assessment is issued. If no agreement is reached in this procedure or a partial agreement is negotiated, then the audit process will continue its course until a tax assessment is determined.

Once the tax authorities have determined their tax assessment, taxpayers are entitled to challenge these results through the following options.

Administrative Appeal (Recurso de Revocación) before the Legal Department of the Mexican Tax Authorities

Once the tax assessment is notified to a taxpayer, they will have 30 business days to file for an administrative appeal. This defence mechanism provides taxpayers with a final instance to provide additional information to that already provided through the audit process.

It is important to mention that, for the duration of this defence mechanism, the taxpayer will not have to secure the amounts determined in the tax assessment.

In general, if the audit process derives from transfer pricing implications, which include intercompany transactions from foreign-based related parties that are resident for tax purposes to countries to which Mexico has a tax treaty, a MAP can be requested. If initiated, the MAP will suspend the administrative appeal process until its termination.

If no agreement is reached in the MAP, the administrative appeal will continue its term process.

If the taxpayer obtains an unfavourable result through the administrative appeal, this can be appealed before the Tax Court.

Nullity Petition (Juicio Contencioso Administrativo Federal) before the Tax Court

Taxpayers can proceed to a nullity petition after the tax assessment is notified, and as a general recommendation, if the administrative appeal resolution obtained is partially or totally unfavourable. After said resolution, taxpayers have up to 30 business days to file the nullity petition.

Taxpayers that begin this process need to secure the amounts derived from the tax assessment, including the principal amount plus all corresponding extras such as the update adjustment, surcharges, and penalties.

If the resolution of the nullity petition is partially or totally unfavourable, the taxpayer can dispute this resolution through an amparo complaint.

Amparo before the Collegiate Circuit Court

After the taxpayers get a partial or total unfavourable resolution by the tax court regarding the tax assessment, they have fifteen business days to file for an *amparo*.

It is important to emphasise that this resource proceeds only against a final decision made by a court that goes against any of the following:

- the applicability of the law to the case;
- the interpretation of laws; and
- the general principles of Mexican law in the absence of an applicable law.

If the resolution obtained by the taxpayers is an unfavourable one, they can dispute it through an extraordinary appeal before the Supreme Court of Justice.

Extraordinary Appeal before the Supreme Court of Justice

An extraordinary appeal needs to be verified and accepted by the President of the Supreme Court. For the filing to be admitted by the President of the Court it must comply with certain requirements. For instance, that the filing made by the taxpayer to the Collegiate Circuit Court includes a proposal on the constitutionality of an interpretation, rule, or human right included in an international treaty, or the resolution made by the Collegiate Circuit Court includes a pronouncement of this nature.

Furthermore, the President of the Supreme Court will verify that the requirements of importance or transcendence are met, which means that if the resolution appealed by the taxpayer implies the omission or contradiction of a judgment upheld by the Supreme Court of Justice relevant to a constitutional matter, or if there is an issue of constitutionality that could result in the creation of a new criteria of relevance, the appeal is likely to be admitted.

14. JUDICIAL PRECEDENT

14.1 Judicial Precedent on Transfer Pricing

There are few judicial precedents on transfer pricing matters in Mexico.

In general, such precedents consider the formalities behind the transfer pricing provisions as established in the ITL rather than substantive controversies.

14.2 Significant Court Rulings

The following are some of the relevant judicial precedents on transfer pricing matters in Mexico.

One of the most relevant court rulings was issued in August 2013, in which the Federal Court of Fiscal and Administrative Justice issued an isolated ruling that established that in accordance with the OECD Transfer Pricing Guidelines, the tax authorities may ignore the self-characterisation of an intercompany transaction carried out between related parties and recharacterise it according to its economic substance. [August 2013- Court precedent number VII-P-2aS-353]

In June 2014, in an isolated ruling, the Supreme Court of Justice ruled that expenses assigned on a pro-rata basis carried out between related parties could be considered as a deductible item, provided that several conditions were met. [June 2014- Court precedent number 2a. LIV/2014 (10a)] This precedent contributed to the publication of the requirements included in Rule 3.3.1.27. of the MTR regarding the information that must be complied by a Mexican entity to consider the expenses assigned on a pro-rata basis, as deductible, which are explained in detail in **11.3 Unique Transfer Pricing Rules or Practices**.

Finally, in February 2018, in an isolated ruling, a Collegiate Circuit Court ruled that the tax invoices issued in connection with transfer pricing adjustments must correspond to the tax year in which the transfer pricing adjustments were effectively performed. [February 2018- Court precedent number I.1o.A.190 A (10a.)]

15. FOREIGN PAYMENT RESTRICTIONS

15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions

The ITL closely aligns with the OECD Transfer Pricing Guidelines and treats them as a source of interpretation.

Currently, the only uncontrolled transactions subject to restriction are expenses that are assigned on a pro-rata basis, as explained in **4.3 Cost Sharing/Cost Contribution Arrangements**, which in general are considered as a non-deductible item unless several requirements are complied with.

In addition, payments made to an individual or entity subject to a preferential tax regime (REFIPRE per its acronym in Spanish) which will be subject to a withholding tax rate of 40% with no deductions allowed. This would apply regardless of whether the transaction is controlled or uncontrolled.

A jurisdiction is considered as REFIPRE if the income is subject to an effective income tax rate lower than 75% of the Mexican income tax rate, which is 30%. Therefore, a jurisdiction with an income tax rate below 22.5% would be considered as a REFIPRE. This applies even if Mexico has a tax treaty in force with such jurisdiction.

Furthermore, since year 2020, deductions have not been allowed from transactions considered as hybrid mechanisms, which occur when a payment, person, legal entity, income or an asset's owner is recharacterised and, therefore results in a tax mismatch. In this sense, if a transaction results in a deduction for the taxpayer in Mexico and the related party does not recognise the transaction as subject to income tax in the foreign jurisdiction, a hybrid mechanism would be present. This would apply regardless of whether the transaction is controlled or uncontrolled.

15.2 Restrictions on Outbound Payments Relating to Controlled Transactions

As of today, Mexican transfer pricing provisions limit payments made to an individual or entity subject to a REFIPRE; these will be subject to a withholding tax rate of 40% with no deductions allowed. As mentioned in **15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions**, this would apply regardless of whether the transaction is controlled or uncontrolled.

15.3 Effects of Other Countries' Legal Restrictions

As of today, Mexican transfer pricing provisions do not have any restrictions regarding the effects of other countries' legal restrictions.

16. TRANSPARENCY AND CONFIDENTIALITY

16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes

In Mexico there are no publications regarding APAs or transfer pricing audit outcomes.

The OECD periodically publishes the APA and MAP statistics of its member countries.

16.2 Use of "Secret Comparables"

Any information to which the tax authorities have access may be used in an audit process, which mainly consists of public information. However, the tax authorities have used secret comparables in certain audit processes, which are case-specific.

17. COVID-19

17.1 Impact of COVID-19 on Transfer Pricing

Overall, the COVID-19 global pandemic did not modify or affect the transfer pricing landscape in Mexico, since the corresponding tax authorities did not issue any specific position regarding the measures that would be taken.

However, as a practiced recommendation, taxpayers had to gather all the information regarding how COVID-19 affected their policies, supply chains, etc, to prepare solid defence documentation that support changes stemming from COVID-19 effects.

Additionally, certain transfer pricing policies and agreements (eg, leasing, royalty and financing transactions) had to be reviewed to determine whether adjustments would be necessary or even cancelled certain transactions with the purpose of reflecting the applicable market conditions.

17.2 Government Response

The Mexican tax authorities did not establish measures to be considered due to the COVID-19 global pandemic, therefore there were no relieved payment obligations, nor were standards relaxed due to this situation.

The analyses made, as well as the filing dates of the various tax returns regarding transfer pricing documentation remained without changes, as established for previous years.

17.3 Progress of Audits

There were no formal publications by the tax authorities to limit their actions to address the pandemic situation, that is, as a general practice, no home-office or suspension policies were applied, and for certain specific sectors an increase in the number of audits carried out was observed.

In this sense, it may be understood that transfer pricing audits did not stall due to the COVID-19 pandemic, since all the deadlines continued as established in tax provisions.

Chevez Ruiz Zamarripa was founded in 1981 and is one of the leading firms in Mexico for advisory, consulting, transfer pricing and tax litigation. It is a one-stop shop providing a comprehensive, specialised and high-quality multidisciplinary service in the anti-corruption, anti-money laundering, administrative and regulatory, corporate, M&A, finance and banking, labour law, and IP sectors. Chevez Ruiz Zamarripa believes that transfer pricing analyses require an interdisciplinary vision in order to identify and structure the commercial and financial relationships of the related parties integrating a business group, going beyond mere compliance with legal and tax requirements. The transfer pricing team is comprised of experts with an interdisciplinary profile who combine tax and legal expertise with the most advanced financial, economic and accounting analysis techniques, which – together with vast international experience and a deep knowledge of the characteristics of the Mexican business environment – promises high added value for clients.

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