



Overview

Mijares, Angoitia, Cortés y Fuentes, S.C., Taxand Mexico

We offer general Transfer Pricing "TP" planning and structuring services in cross-border transactions, as well as the review of TP documentation and drafting of intercompany agreements. We also offer tax litigation services with regards to TP matters, and negotiation and implementation of Advance Pricing Agreements "APA" and Mutual Agreement Procedures.

General: Transfer Pricing Framework

Mexican resident taxpayers who execute transactions with related parties are required to calculate their gross income and authorized deductions using the prices, considerations, and profit margins that would have been used by independent parties in comparable transactions (i.e., the arm's length principle is applied). For such purposes, they shall keep the supporting documentation to demonstrate compliance with the arm's length principle.

Chapter II of Title VI of the Mexican Income Tax Law "MITL" contains the relevant TP provisions. Additionally, the OECD Guidelines can be used to interpret such provisions to the extent that they are consistent with the provisions of the MITL and the tax treaties entered into by Mexico.

Mandatory TP documentation generally follows BEPS Action 13's guidelines and includes the preparation of TP studies as well as the submission of a Local File, a Master File, and Country by Country Reporting "CbCR", observing certain preferred methods and formalities set forth in the MITL. The TP documentation habitually contains a description of all related party transactions, benchmark analysis, and the disclosure of the comparable transactions used in the analysis.

In addition to the documentation in compliance with BEPS Action 13 described above, taxpayers must also file an informative return disclosing transactions executed with related parties no later than May 15 of the following fiscal year to which the informative return corresponds.

Accepted Transfer Pricing Methodologies

Mexican resident taxpayers shall apply first the CUP method and may only use the other methods when the CUP method is inappropriate for determining if transactions were conducted at arm's length and, in such cases, RP and CP methods are preferred over the remaining methods.

The MITL does not recognize cost sharing or cost contribution agreements, therefore, such agreements are usually challenged when implemented given the formalistic approach required by the tax authorities for tax documentation.

In the case of the Mexican toll manufacturing industry, commonly known as maquiladoras, Mexican resident companies that operate under the Program for Manufacturing, Maquiladora and Exportation Services Industry ("Mexican Maquiladoras") are deemed to comply with the arm's length principle when certain safe harbors are met. It will be deemed that the services rendered by Mexican Maquiladoras to their

non-Mexican resident principals are at arm's length when their taxable profits equal to the greater of either (i) 6.9% of the total asset value used in the toll manufacturing operation in a given fiscal year, or (ii) 6.5% of the total operating costs and expenses incurred by the Mexican Maquiladora.

Transfer Pricing Documentation Requirements

Mexican resident taxpayers entering into transactions with related parties are required to submit Local File and Master File documentation if they fall under any of the following assumptions:

- a) Publicly traded companies;
- b) if the taxable income for income tax purposes of the previous fiscal year is equal to or greater than MXN \$974.6 million (approximately USD \$55.37 million);
- c) companies belonging to a tax group under Mexican rules;
- d) State-owned companies of the Federal Public Administration; and
- e) related parties of a publicly traded company or a company with taxable income for income tax purposes in the previous fiscal year is equal to or greater than MXN \$1,779 million (approximately USD \$101.07 million).

CbCR is only required to be submitted by:

- 1) Mexican resident controlling multi-national companies, as defined in the MITL, which are not in turn subsidiaries of a non-Mexican company and have earnings exceeding MXN \$12,000 million (approximately USD \$681.81 million); and
- 2) Companies appointed by a non-Mexican resident controlling multi-national company as responsible for filing the CbCR of its multi-national group.

Local File documentation must be submitted no later than May 15 of the following fiscal year to which the report corresponds. The Master File documentation and CbCR must be filed no later than December 31 of the following fiscal year to which the report corresponds.

Local Jurisdiction Benchmarks

Benchmark analysis is required to comply with the arm's length principle. There is preference for local comparable transactions. However, they are generally unavailable, and therefore, regional and global comparable transactions are mostly used in practice.

Depending on the type of transaction and industry sectors, different transfer pricing methods are preferred. However, in general, the TNM method is most used, rather than the CUP, RP or CP methods, given the sensitivity to available information for benchmarking.



As of 2022, information regarding comparable transactions corresponding to the year under analysis shall be considered, and only when the business cycles cover more than one year, information corresponding to two or more years, either before or after, may be considered.

In Mexico, internal CUPs are acceptable. Conversely, PS and RPS methods are constantly scrutinized and challenged by the Mexican tax authorities.

Advance Pricing Agreement “APA”/Bilateral Advance Pricing Agreement “BAPA” Overview

It is possible to obtain rulings issued by the Mexican tax authorities with the effects of an APA or a BAPA. General requirements include submitting information, data and documentation regarding methodology used for determining prices or consideration amounts in transactions with related parties.

A ruling with the effects of an APA or a BAPA consists of a methodology proposal filed by the taxpayer with aims to be confirmed by the tax authorities. Therefore, there is no negotiation between the taxpayer and the tax authorities to reach an arm’s length result, and as such, a proposed methodology may only be confirmed or denied by the tax authorities. If confirmed, a ruling is valid for the fiscal year in which it is granted, the previous fiscal year and the following three fiscal years.

A BAPA may be granted for a longer term, typically up to five years, if provided for under a double taxation treaty entered into by Mexico.

Filing fees of requests for rulings with the effects of an APA or a BAPA are applicable and amount to MXN \$275,906 (approximately USD \$15,676). Upon a request, Mexican tax authorities are required to issue a ruling within three months of the date in which the request is filed. As previously stated, it is the tax authority’s discretionary ability to issue a positive or a negative ruling. Negative rulings may be challenged in court.

Transfer Pricing Audits

The Mexican tax authorities tend to audit TP matters commonly on manufacturing activities and financial services, specifically challenging the comparable transactions that are used for benchmarking analyses.

Further, the Mexican tax authorities tend to question the valuation methods used or intangible assets and benchmarking related to royalty payments and technical assistance fees. Likewise, the functional analysis related to these matters is carefully reviewed from a substance perspective (i.e., whether the functions were effectively carried out).

Recently, it has also become common for the tax authorities to question commonly used stock valuation methods, such as the discounted cashflow method, giving preference to the equity value of the relevant company, adjusting such equity for inflation.

Transfer Pricing Penalties

The Mexican tax authorities may impose penalties to those taxpayers that are required to submit TP documentation and fail to do such submissions or submit TP documentation with mistakes, inconsistencies or in a different manner than the indicated in the applicable tax provisions.

Likewise, such tax authorities may adjust taxable income and authorized deductions when they deviate from the arm’s length principle. In this case, any taxes omitted from such adjustments shall be covered with inflation and surcharges levied at a 1.47% monthly rate. Furthermore, penalties equal to 55% to 75% of the historical omitted taxes may be levied.

Local Hot Topics and Recent Updates

Until 2022, Mexican Maquiladoras were able to secure rulings for their manufacturing transactions with USA resident related parties, with the effect of an APA by determining their profit margin under the Qualified Maquiladora Approach that was negotiated between the Mexican tax authorities and the USA tax authorities through a Memorandum of Understanding. Such procedure was referred to as the fast-track procedure. This APA was available as an alternative to the existing safe harbors set forth in the MITL and to APAs requested pursuant to another proposed methodology.

Derived from the tax reform that entered into force on January 1, 2022, APAs, and therefore also APA’s under the fast-track procedures, are no longer available to the Mexican Maquiladora regime. Notwithstanding, any request for a ruling filed before 2022 may still be eligible for the fast-track procedure, and therefore, it may be valid for the fiscal year in which it has been requested, and for the following years according to the terms of the authorizations.

Finally, the tax reform that entered into force on January 1, 2022, requires the TP analysis to consider comparable transactions corresponding to the year under analysis and only when the business cycles or commercial acceptance cover more than such year, it is allowed to consider comparable transactions corresponding to previous or following years.



Documentation threshold

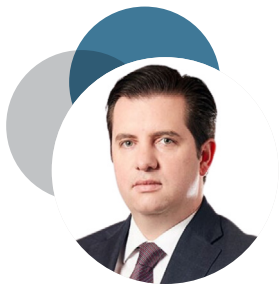
Master file	MXN \$974.6 million (approximately USD \$55.37 million)
Local file	MXN \$974.6 million (approximately USD \$55.37 million)
CbCR	MXN \$12,000 million (approximately USD \$681.81 million)

Submission deadline

Master file	December 31 of the following fiscal year to which the report corresponds.
Local file	May 15 of the following fiscal year to which the report corresponds.
CbCR	December 31 of the following fiscal year to which the report corresponds.

Penalty Provisions

Documentation – late filing provision	No penalties apply as long as compliance is spontaneous.
Tax return disclosure – late/incomplete/no filing	Penalties between MXN \$199,630 (approximately USD \$11,342) and MXN \$284,220 (approximately USD \$16,148).
CbCR – late/incomplete/no filing	Penalties between MXN \$199,630 (approximately USD \$11,342) and MXN \$284,220 (approximately USD \$16,148).



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