



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 controversy 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:

- Publicly traded companies;
- if the taxable income for income tax purposes of the previous fiscal year is equal to or greater than MXN \$1,103.2 million (approximately USD \$63.59 million);
- companies belonging to a tax group under Mexican rules;
- State-owned companies of the Federal Public Administration; and
- 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 \$2,013.7 million (approximately USD \$116 million).

CbCR is only required to be submitted by:

- 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 \$691 million); and
- 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.

Focus on Financial Transactions

Mexican tax authorities have increasingly scrutinized intercompany financing transactions from a transfer pricing perspective. In addition to the interest rate, they typically assess whether the amount of the debt, the terms and conditions of the financing, and the borrower's financial capacity are consistent with what independent parties would have agreed upon under comparable circumstances. Accordingly, taxpayers should maintain robust documentation supporting the arm's length nature of the financing, including the economic rationale for the transaction and the basis for the pricing applied.

It is important to note that compliance with the arm's length principle alone does not guarantee the deductibility of interest. Under the Mexican Income Tax Law, interest is generally deductible only if the financing satisfies the general deductibility requirements under domestic law, including the obligation for taxpayers to demonstrate that the borrowed funds were used for business purposes. Furthermore, Mexico applies thin capitalization rules, under which, in general, interest attributable to related-party debt owed to foreign related parties exceeding a 3:1 debt-to-equity ratio is non-deductible. Similarly, net interest expense exceeding 30% of the taxpayer's adjusted taxable profit (tax EBITDA) may also be non-deductible, subject to the statutory threshold.

Mexican domestic law also contains provisions that may disallow the deduction of payments made to related parties or through structured arrangements where the corresponding income is subject to a preferential tax regime or results in hybrid mismatch outcomes. Therefore, financing transactions should be reviewed not only from a transfer pricing perspective, but also in light of the domestic interest limitation and anti-avoidance rules applicable under Mexican law.

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 \$336,624.17 (approximately USD \$19,404.2). 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).

In recent years, 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.

The Burden of Proof in Transfer Pricing: Theory versus Practice

In Mexico, the allocation of the burden of proof is technically borne by the tax authorities. That is, when presenting a transfer pricing challenge, the tax authorities are responsible of demonstrating that the consideration agreed between related parties deviates from the arm's length principle and, in principle, should provide sufficient evidence to support a transfer pricing adjustment. Notwithstanding, in practice, the burden of proof is habitually shifted to the taxpayer under statutory provisions that require taxpayers to maintain sufficient and idoneous documentation to demonstrate that the related party transactions have been agreed at arm's length (Art. 76, sections IX of the Mexican Income Tax Law).

Based on the above, it is habitual that the practical burden of proof is shifted to the taxpayer under the grounds that the documentation provided during an audit is not ideal or lacks comprehensiveness, or that the comparables used or methodology applied is not idoneous for a relevant transaction given the lack of documentary evidence. That is, tax inspectors seldomly will have a proactive



approach in determining the arm's length remuneration and will challenge the allegations of the taxpayer until they deem the documentation sufficient. Furthermore, in practice, the Mexican tax authorities will not only impose a transfer pricing adjustment but will also challenge the deductibility of payments made to foreign resident related parties when formal issues arise. Although questionable, such denial habitually rests on the grounds that, in these cases, formal documentary requirements (broadly comprising transfer pricing documentation requirements) have not been met to support the deductibility (Art. 27, section V of the Mexican Income Tax Law).

As an exception to the statutory burden of proof described above, in the case of Advance Pricing Agreements, the taxpayer is legally required to propose the methodology subject matter and the tax authorities either accept or deny such proposal under technical grounds. That is, the tax authorities do not make propositions of their own and therefore, do not actively contribute to an "agreed" methodology. In these cases, the burden of proof does rest in the hands of the taxpayer as a matter of statute.

Considering these tendencies, taxpayers must pay special attention to gathering material and comprehensive documentation to increase the possibilities of such documentation being deemed sufficient by the tax authorities and, if required, the Court. Given that in practice the burden of proof rests on the taxpayer, and not only a transfer pricing adjustment may occur, but also the denial of the deductibility of a cross-border payment, taxpayers are urged to continuously review their transactions and the contemporaneous documentation resulting therefrom to create a robust defense file in the likely event of an audit.

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.

In this respect, during June 2024, the Mexican and the United States tax authorities concluded a Memorandum of Understanding validating the Qualified Maquila Approach methodology for the ruling requests underway, for instance, for APA's submitted during fiscal year 2021, effective until fiscal year 2024.

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.

Additional Recent Developments

In recent years, transfer pricing has become one of the main audit priorities of the Mexican tax authorities. According to publicly available information released by the Mexican tax authorities, transfer pricing audits of large taxpayers have resulted in a significant increase in tax collections compared to previous years. In consequence, transfer pricing will continue to be an area of focus by the Mexican tax authorities, with audit programs increasingly relying on data analytics, effective tax rate comparisons and industry-specific risk indicators to identify taxpayers for review. Consequently, taxpayers should ensure that their transfer pricing documentation is robust and fully consistent with the economic substance of their intercompany transactions.

From an international perspective, multinational groups operating in Mexico should also continue monitoring the implementation of the OECD's BEPS 2.0 initiatives. Although Mexico has not yet incorporated the Pillar Two Global Anti-Base Erosion Rules into its domestic legislation, these rules may still affect multinational groups with operations in Mexico through the application of top-up taxes in other jurisdictions. Likewise, Mexico has expressed its intention to evaluate the implementation of the OECD's simplified Amount B approach for baseline marketing and distribution activities. While no domestic rules have yet been enacted, these developments may influence future transfer pricing compliance obligations and should therefore remain on taxpayers' radar.



Documentation threshold

Master file	MXN \$1,103.2 million (approximately USD \$63.59 million)
Local file	MXN \$1,103.2 million (approximately USD \$63.59 million)
CbCR	MXN \$12,000 million (approximately USD \$691 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 \$226,000 (approximately USD \$13,027) and MXN \$321,770 (approximately USD \$18,548).
CbCR – late/incomplete/no filing	Penalties between MXN \$226,000 (approximately USD \$13,027) and MXN \$321,770 (approximately USD \$18,548).



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