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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Mexico

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TAX



Mexico



KPMG observation

Mexico has been very active in transfer pricing. The tax authority has been performing a considerable number of audits in different industries. One hot topic is service fees paid to a foreign related party. A frequent concern is lack of sufficient evidence to establish that the services were provided, and that there was a business reason that the services were required. In many cases, the deductibility of such service fees is being challenged. Additionally, documentation and reporting requirements have increased considerably, so it is very important to prepare a transfer pricing documentation study. Failure to do so may result in non-deductibility of payments to related parties.

Basic information

Tax authority name

Servicio de Administración Tributaria (SAT).

Citation for transfer pricing rules

Ley del Impuesto Sobre la Renta (Mexican Income Tax Law) Articles 86-XII, 86-XIII, 86-XV, 215, 216, and 216-Bis.

Ley del Impuesto Empresarial a Tasa Unica (Mexican Business Flat Tax Law) Article 18-III.

Effective date of transfer pricing rules

Ley del Impuesto Sobre la Renta: 1 January 1997.

Ley del Impuesto Empresarial a Tasa Unica: 1 January 2008.

What is the relationship threshold for transfer pricing rules to apply between parties?

Direct or indirect ownership of capital, administration or control. No specific threshold for the entities to be considered related parties (i.e. even if there is a 1 percent ownership of the shares, the entities are considered related).

What is the statute of limitations on assessment of transfer pricing adjustments?

Five years from filing date of the tax return.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. Mexican taxpayers are required to provide specific information in the transfer pricing studies documenting the arm's length nature of domestic and Cross-Border Intra-Group Transactions. These studies are not to be filed with the tax authority unless they are requested by the SAT. In addition, taxpayers must also disclose information regarding the conclusions of the transfer pricing documentation studies as part of the appendices of the Statutory Tax Audit report (i.e. Dictamen Fiscal) or the information alternative to the Statutory Tax Audit Report. Taxpayers are also required to submit information regarding transactions with foreign-resident related parties during the immediately preceding calendar year.

What types of transfer pricing information must be disclosed?

- Transfer Pricing Documentation Report of Domestic Intra-Group Transactions:
 - methodology used to show that the transactions were conducted in accordance with the arm's length principle.
- Transfer Pricing Documentation Report of Cross-Border Intra-Group Transactions:
 - name, domicile, tax residence and detail of the direct or indirect participation between or among the related parties
 - information of functions, assets, and risks borne by each type of operation
 - detail of the controlled transactions
 - transfer pricing methodology used.

Companies that file a statutory tax audit report must also submit the following appendices with regard to transfer pricing (the numbers of the appendices might vary depending on the type of company):

- Appendix 32 of the Statutory Tax Audit Report (Dictamen Fiscal): Type and amount of intra-group transactions by related party, transfer pricing method used, whether the intra-group transaction is at arm's length, and amount of the adjustment so that the transaction is at arm's length.
- Appendix 33 of the Statutory Tax Audit Report (Dictamen Fiscal): Business activity of the taxpayer, ownership of intangible assets used, date in which the information return was submitted and whether the taxpayer has supporting documentation of the arm's length nature of intra-group transactions, Advance Pricing Agreements (APAs) under negotiation, Tax ID of transfer pricing advisors, interests deemed to be dividends, prorated expenses, financial derivative transactions with related parties, thin capitalization issues, corresponding adjustments, etc.
- Transfer Pricing Questionnaire: The external auditors of the Mexican taxpayer filing the Statutory Tax Audit Report will also have to complete a transfer pricing questionnaire confirming that all transactions were at arm's length and that documentation requirements were met.

Companies that meet the threshold for filing the Dictamen Fiscal but choose not to do so must also submit additional information that is similar to the Appendices 32 and 33 of the Dictamen Fiscal.

What are the consequences of failure to prepare or submit disclosures?

Tax authorities might deny the tax deductions of the intra-group transactions that represent expenses for the Mexican taxpayer, (i.e. inbound transactions), if the Mexican taxpayer did not comply with the obligation of preparing the transfer pricing study or in those cases where the Information Return for Cross-Border Intra-Group Transactions was not filed. A penalty may also be imposed if the taxpayer fails to submit the Information Return for Cross-Border Intra-Group Transactions.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes, for all transactions. Transfer pricing documentation is required by Mexican legislation. However, taxpayers whose revenues during the previous fiscal year did not exceed 13 million Mexican pesos (MXN) are not required to produce supporting documentation with regard to intra-group transactions. In addition, there is no exception to the requirement of conducting the transactions at arm's length.

According to the Federal Fiscal Code, there is no specific penalty for not preparing supporting transfer pricing documentation. However, if a taxpayer does not comply with the transfer pricing documentation requirements stated in Fractions XII and XV of Article 86 of the Mexican Income Tax Law, Mexican tax authorities might deny the deduction of expenses resulting from the intra-group transactions with foreign related parties.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

Article 76 of the Federal Fiscal Code provides for a 50 percent reduction in the penalty imposed for underpaid taxes or for excess tax loss filed due to transfer pricing, if the taxpayer keeps supporting transfer pricing documentation.

The burden of proof is also shifted to the tax authority, when a company has transfer pricing documentation.

Also, having documentation will reduce the risk of a disallowance of the tax for the transactions with related parties.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

Companies filing the Dictamen Fiscal: The transfer pricing information must be filed in the appendices of the Dictamen Fiscal,

which is due on 30 June. In addition, the Transfer Pricing Information Return for Cross-Border Intra-Group Transactions must be filed contemporaneously with the Dictamen Fiscal.

Companies not filing the Dictamen Fiscal: Both the Transfer Pricing Information Return for Cross-Border Intra-Group Transactions and the transfer pricing documentation must be ready by the time the income tax return is due, i.e. 31 March.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, provided that the analysis is conducted by using a transaction-by-transaction approach.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No. However, companies filing the Dictamen Fiscal must disclose the personal tax identification number of the person that prepared the transfer pricing study or provided transfer pricing assistance to the taxpayer, when it is not prepared by the taxpayer. When the transfer pricing study is prepared by the taxpayer, it should disclose the taxpayer's tax ID number.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes.

Is there a priority among the acceptable methods?

Yes. Comparable uncontrolled price (CUP) should be applied first, then the resale price or cost plus methods, and then the profit-based methods (i.e., comparable profit split method, residual profit split method, and transactional operating profit margin method).

If there is no priority of methods, is there a "best method" rule?

Not applicable.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, how long does the taxpayer have to submit its documentation?

The taxpayer has 15 business days. An extension of 10 business days could be granted by the tax authorities upon request.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

Yes, taxpayers can submit the resolution to an administrative area within the Ministry of Finance, in order to object to the procedures. Also, taxpayers may appeal to tax court, or if the related party of the adjustment is a resident of a country with which Mexico has a tax treaty, Competent Authority may be applied.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes. General tax penalties only: 55 to 75 percent of the omitted income tax or 30 to 40 percent of excess loss if due to transfer pricing. However, if the taxpayer prepared transfer pricing documentation, they may be entitled to a 50 percent reduction in the penalty.

To what extent are transfer pricing penalties enforced?

Often.

What defences are available with respect to penalties?

Article 76 of the Federal Fiscal Code allows the Mexican tax authority to assess penalties (i.e. 55 to 75 percent of the omitted income tax or 30 to 40 percent of excess loss if due to transfer pricing) in cases in which it deems a company's transfer pricing is not consistent with the arm's length standard under the Mexican transfer pricing regulations detailed in the Mexican

Income Tax Law (LISR). The article also provides for a 50 percent reduction in the penalty imposed for underpaid taxes or for excess tax loss filed due to transfer pricing, if the taxpayer keeps transfer pricing supporting documentation. However, if imposed, penalties cannot be negotiated.

What trends are being observed currently?

Current audits focus on business restructuring, domestic intra-group transactions, sales of shares that trigger tax losses and management fees that Mexican tax authorities might consider to be pro rata expenses.

Special considerations

Are secret comparables used by tax authorities?

Yes. Any information to which the tax authority has access may be used. However, use of secret comparables is not very common.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Usually North American comparable companies are used by the SAT for audit purposes.

Do tax authorities have requirements or preferences regarding databases for comparables?

The Mexican tax authorities use Compustat (i.e. North American public companies) and RoyaltyStat.

What level of interaction do tax authorities have with customs authorities?

Low.

Are management fees deductible?

Yes. It should be taken into account that pro rata expenses from foreign parties/ service providers are non-deductible from a Mexican tax standpoint. Therefore, taxpayers must have evidence showing they were

not prorated, as well as information demonstrating that the services (1) were actually rendered; (2) provided a benefit to the Mexican taxpayer; (3) were not duplicative services. When supporting evidence can be provided, service fees might be considered to be deductible, otherwise the tax authority will consider them as non-deductible.

Are management fees subject to withholding?

Yes. However, tax treaties may disallow withholding.

Are year-end transfer pricing adjustments permitted?

Yes, year-end adjustments might be conducted to support that the intra-group pricing could be concluded to be at arm's length. However, it is important that the year-end adjustments are accounted for before the end of the fiscal year to make sure tax and accounting figures are consistent. It is advisable to conduct periodic reviews in order to avoid significant year-end adjustments. Customs issues must also be taken into account.

Other unique attributes?

Pro rata expenses (cost-sharing) made to foreign entities are considered non-deductible.

Other recent developments

On 12 November 2012, Miscellaneous Rule 1.3.8.3 was published in the Mexican Official Gazette. This establishes that Mexican taxpayers are not required to comply with the obligation of preparing a transfer pricing report supporting the arm's length nature of domestic intra-group transactions to the extent that their annual gross receipts the previous tax year did not exceed MXN13 million or, in the case of taxpayers providing professional services, their gross receipts did not exceed MXN3 million. Therefore, based on the new tax provision, the exception for the requirement to prepare supporting

documentation of the arm's length nature of the intra-group transactions does apply not only to cross-border intra-group transactions but also to domestic intra-group transactions.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive. Mexico has double tax treaties with 58 countries and negotiations in progress with another 20 countries.

If extensive, is the competent authority effective in obtaining double tax relief?

Sometimes. However, it should be noted that there have not been many competent authority cases submitted by Mexican taxpayers. In most cases the competent authority has been effective in obtaining double tax relief.

When may a taxpayer submit an adjustment to competent authority?

Depends on the time frame allowed by the tax treaty.

May a taxpayer go to competent authority before paying tax?

Yes.

Advance pricing agreements

What APA options are available, if any?

Unilateral and bilateral.

Is there a filing fee for APAs?

Yes. Approximately 1,000 US dollars (USD) for the first year and USD100 for a review to be conducted every year of the APA term.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

As of January 2013, there is no official publication of APA data. However, APA information is usually disclosed by Mexican tax authorities in public forums.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

The APA program can be viewed as successful if we compare the number of APAs filed with the number of APAs that have been concluded. However, there are still opportunities to reduce the length of the process.

Language

In which language or languages can documentation be filed?

The Mexican tax authorities require all documentation to be in Spanish. However, in those cases in which the initial documentation is provided in English, a translation by a certified translator will be subsequently required. The time to provide the information will be 15 business days.

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