



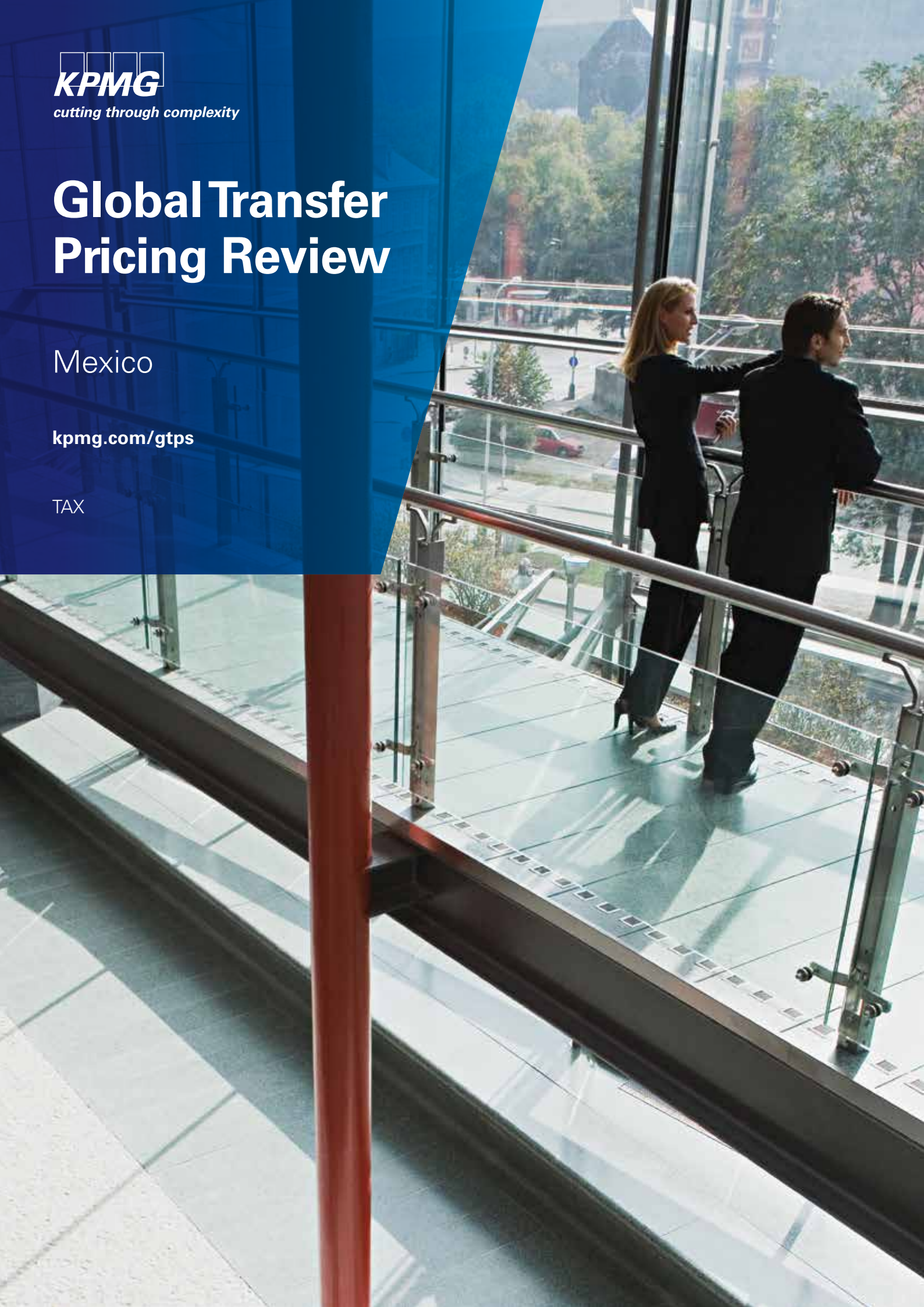
cutting through complexity

Global Transfer Pricing Review

Mexico

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TAX



Mexico



KPMG observation

Mexico has been very active in transfer pricing. The Mexican tax authorities have 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 for the services. 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 for taxpayers to prepare a transfer pricing documentation study. Failure to do so may result in non-deductibility of payments to related parties.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Required to be contemporaneous	Thresholds apply/exist
Legal requirements	●	●	●
Protection from penalties	●	●	●
Reduce risk of adjustment	●	●	●
Shifts burden of proof	●	●	●

Basic information

Tax authority name

Servicio de Administración Tributaria (SAT).

Citation for transfer pricing rules

From 2002 to 2013: Ley del Impuesto Sobre la Renta (Mexican Income Tax Law) Articles 86-XII, 86-XIII, 86-XV, 215, 216, and 216-Bis. Starting 2014: Ley del Impuesto Sobre la Renta (Mexican Income Tax Law) Articles 76-IX, 76-X, 86-XII, 179, 180 and 181. From 2008 to 2013: 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 to 31 December 2013.

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 one 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 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 transfer pricing 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: 1) name, domicile, tax residence and detail of the direct or indirect participation between or among the related parties; (2) information of functions, assets, and risks borne by each type of operation; (3) detail of the controlled transactions; and (4) 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 of the Statutory Tax Audit report (Dictamen Fiscal) — information of intercompany transactions: 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 of the statutory tax audit report (Dictamen Fiscal) — additional information of intercompany transactions: 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 transfer pricing appendices of the Dictamen Fiscal previously mentioned.

What are the consequences of failure to 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

Can documentation be filed in a language other than the local language? If yes, which ones?

No. 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 required within 15 days.

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. The Mexican Income Tax Law indicates Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations issued by the Committee on Fiscal Affairs of the OECD might be used as a reference for performing the transfer pricing documentation report to the extent that said Guidelines are consistent with the Mexican Income Tax Law and the tax treaties signed by Mexico.

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

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes. The OECD Transfer Pricing Guidelines are applicable to the extent that they are consistent with the Mexican Income Tax Law and the tax treaties signed by Mexico. In Mexico there is a priority of methods as described in the previous version of the OECD Transfer Pricing Guidelines. In general, Mexico does not accept pro rata expenses from foreign taxpayers; therefore, Cost Sharing Arrangements might not be possible to be used in Mexico.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 15 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

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, what dispute resolution options are available?

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 defenses 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, management fees that Mexican tax authorities might consider to be pro rata expenses, and marketing fees for those companies with a license to use marketing intangible assets.

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.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, always.

Does the tax authority have other preferences in benchmarking? If so, please describe.

Not applicable.

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

Low.

Are there limitations on deductibility of management fees beyond the arm's length principle?

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 (i) were actually rendered; (ii) provided a benefit to the Mexican taxpayer; (iii) 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. Additional special documentation requirements must be met based on the miscellaneous rule published on October 2014.

If the intercompany transaction is conducted with a taxpayer resident in a country with a treaty to avoid double taxation, no withholding applies. In any other case, a 25 percent withholding tax rate might apply according to the Mexican Income Tax Law.

Are management fees subject to withholding?

Yes.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

No.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

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 might be considered non-deductible.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive. Mexico has treaties to avoid double taxation with 65 countries and negotiations in progress with another 15 countries.

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

Sometimes.

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, bilateral, multilateral.

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?

No.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

No. 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.

KPMG in Mexico

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