

# Transfer Pricing

Country Guides





# Mexico

## Arm's Length Principle

From January 1997, as part of the tax reform, new transfer pricing rules based on the arm's length principle have been applicable, providing the legal basis for the current system. The current system recognizes the need to apply the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the OECD Guidelines) and follow the recommendations with regard to transfer pricing matters, especially with regard to the traditional and alternative transfer pricing methods accepted by the OECD.

## Transfer Pricing Methods

In general terms, article 180 of the Ley del Impuesto Sobre la Renta (Income Tax Law), LISR, specifies six methods for determining transfer prices, either by taxpayers (as they are, in the first place, the obligated subjects) or by the tax authorities (if taxpayers fail to determine their taxable income or deductible items pursuant to transfer pricing principles). The six methods conceptually fall into two categories, namely:

- methods that apply to specific transactions, namely the CUP method, resale price method (RPM) and cost-plus method (CPM); and
- methods that focus on profits, namely the profit split method (PSM), residual profit split method (RPSM) and transactional net margin method (TNMM).

The income tax provisions on the selection of transfer pricing methods allow the application of the OECD Guidelines to the extent consistent with Mexican laws and an applicable treaty (article 179, last paragraph of the LISR). Therefore, it is widely interpreted that the ordering criteria above should be evaluated consistent with such guidelines. In that context it is often thought that the methods should be considered in the following order of priority:

- (1) CUP method;
- (2) RPM;
- (3) CPM;
- (4) TPSM, (Método de Partición de Utilidades (transactional profit split method));
- (5) RPSM;
- (6) TNMM

## Scope of Legislation

As stipulated in articles 76-IX, 76-XII and 179 of the LISR, all legal entities that enter into transactions with related parties are required to produce transfer pricing documentation proving that said transactions were carried out in accordance with the arm's length principle. In this way, the LISR includes all businesses, individuals, permanent establishments, and branches required to pay taxes under this law. It also indicates that transactions made with companies based in countries considered to be tax havens should be analysed as if they were transactions made with related parties.

The transactions subject to the regulations governing transfer pricing are basically all those transactions celebrated between related parties based in Mexico and abroad, whether tangible or intangible. The term "related parties" is defined in articles 179 for legal entities.

Article 179 of the LISR defines the term as follows: "It is considered that two or more persons are related parties when one participates, directly or indirectly, in the administration, control or capital of the other or when a person or group of persons participates directly or indirectly in the management, control or capital of such persons. Partners in joint ventures and the related parties of such partners are considered as related parties."

This definition applies to Mexican resident legal entities; non-residents' permanent establishments in Mexico; and non-residents with taxable sources of wealth in Mexico, as established by title V of the LISR.

## Reporting Requirements

As a result of the 2014 fiscal reform and the pronouncements made by the SAT in 2015, taxpayers must submit informative declarations.

## Country-by-Country Reporting

On 18 November 2015, the tax reform package for 2016 was published in the Official Gazette. The package includes amendments to the Federal Tax Code and Income Tax Law in connection with tax measures included in the Budget proposal for 2016. The provisions include new information returns for transfer pricing purposes, in line with requirements developed under the Action Plan on Base Erosion and Profit Shifting (BEPS).

Specifically, Mexican entities will be required to file:

- a Master File;
- a Local File; and
- a Country-by-Country Report (applicable to entities earning at least EUR 750 million annually).

Such information returns will be required for fiscal year 2016 and must be filed before 31 December 2017. Non-compliance will be subject to penalties ranging from MXN 140,540 to MXN 200,090.

## Automatic Exchange of CbC Reports – Signed by 31 Jurisdictions

On 27 January 2016, Mexico and 30 other jurisdictions signed to a Multilateral Competent Authority Agreement (MCAA) (2016) on the automatic exchange of Country-by-Country reports. The signing ceremony marks an important milestone towards implementation of the OECD/G20 BEPS Project and a significant increase in cross-border co-operation on tax matters.

The agreement was developed within the scope of the OECD's BEPS project on corporate taxation. It describes the type of information to be exchanged between states on the activities of multinationals in their territories.

The signatory countries comprise Australia, Austria, Belgium, Chile, Costa Rica, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malaysia, Mexico, Netherlands, Nigeria, Norway, Poland, Portugal, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland and the United Kingdom. ng guidelines.

## Documentation Requirements

Taxpayers that perform transactions with foreign related parties are obliged to obtain and maintain evidentiary documentation to demonstrate that the amount of income and deductions were made according to prices or consideration that would have been used by independent parties in comparable transactions.

According to article 76, section IX, such documentation shall include the following information:

- names, domicile and tax residence of related parties with which the transactions were carried out, as well as documentation that evidences the direct and indirect participation between related parties
- information on the functions or activities performed, assets used and risks assumed by the taxpayer for each sort of transaction
- information and documentation on the transactions with related parties and amounts per related party and per transaction, according to transfer pricing rules contained in article 179 of the LISR
- a description of the applied method in accordance with article 180 of the LISR, including information and documentation on comparable transactions or companies for each type of transaction.

This documentation shall be registered in the accounting records, identifying it as transactions performed between foreign related parties. The official language for all transfer pricing documentation is Spanish. The tax authorities will not accept any other language. For this reason, business descriptions of companies used as comparables, for example, must be translated into Spanish.

It is considered an administrative infringement (according to article 80 of the CFF) if taxpayers do not provide to the tax authorities information and documentation applicable to the transactions carried out with related parties during the preceding fiscal year, as well as not filing the corresponding information return. According to article 81 of the CFF, the fines fluctuate from MXN 50,000 to MXN 100,000 approximately.

## **Cost Sharing**

There is no specific legislation concerning cost contribution agreements. However, such agreements need to be evaluated in light of the existing provisions and specific fact patterns of the taxpayers.

## **Business Structuring**

Transfer pricing rules generally apply to business restructurings that are done on a taxable basis. Certain business restructurings, including certain cash increases or cash decreases in capital of the corporation, tax-free spin-offs or mergers, are not subject to transfer pricing considerations. On the other hand, intercompany transfers of Mexican shares, even as contributions, are generally subject to tax and, therefore, require the application of the transfer pricing regulations.

In addition, certain business restructurings involve the transfer of certain activities and assets of existing Mexican businesses abroad, such as the conversion of regular manufacturing arrangements to toll or contract manufacturing arrangements. The tax authorities scrutinise these transactions to ascertain whether there has been a taxable migration of the assets or trade or business abroad.

## **Interaction Between Customs Valuation and Transfer Pricing**

The application of transfer pricing provisions for customs purposes requires not only the existence of a relationship, but also that said relationship has an effect on the value of the transaction. The main aim of the relevant transfer pricing provisions is for sales transactions between related companies to be carried out at market prices.

## **Dispute Resolution**

Mexico has entered into several tax treaties with other countries. Such treaties contain a MAP which is similar to that in article 25 of the OECD Model. Article 184 of the LISR provides that any adjustment made by foreign authorities from a jurisdiction that has entered into a tax treaty with Mexico should be previously accepted by the Mexican tax authorities in order for the Mexican resident to modify its tax basis.

In Mexico, Congress is the sole authority entitled to enact taxes. Therefore, an adjustment made by foreign authorities may imply income or deductions for Mexican tax residents. In some cases, such adjustments are not provided for by law and, therefore, could create a constitutional breach. In those cases, the MAP could not be an effective means to solve issues regarding double taxation under tax treaties signed by Mexico.

The Código Fiscal de la Federación (Federal Fiscal Code), CFF, in article 34-A provides the regime for advance pricing agreements, APAs. From this provision we can say that an APA is not an agreement by itself – it is more a unilateral APA ruling, based on information that the taxpayer submits. Therefore, an administrative procedure is to be followed.

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