Transfer Pricing

Contributing editor
Jason M Osborn

2019

GETTING THE DEAL THROUGH

GETTING THE DEAL THROUGH

Transfer Pricing 2019

Contributing editor
Jason M Osborn
Mayer Brown LLP

Reproduced with permission from Law Business Research Ltd
This article was first published in August 2018
For further information please contact editorial@gettingthedealthrough.com

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
James Spearing
subscriptions@gettingthedealthrough.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

Law Business Research

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3780 4147
Fax: +44 20 7229 6910

First published 2014
Fifth edition
ISBN 978-1-78915-079-7

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

CONTENTS

Preface

Transfer Pricing 2019

Fifth edition

Getting the Deal Through is delighted to publish the fifth edition of *Transfer Pricing*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our new coverage this year includes Korea.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Jason M Osborn of Mayer Brown LLP, for his continued assistance with this volume.

GETTING THE DEAL THROUGH

London
July 2018

Mexico

Ricardo León and Guillermo Villaseñor
Sánchez Devanny Eseverri, SC

Overview

1 Identify the principal transfer pricing legislation.

The principal transfer pricing legislation is as follows:
- Income Tax Law and Regulations;
- Federal Fiscal Code and Regulations;
- Revenue Law on Hydrocarbons and Regulations;
- Administrative Tax Guidelines;
- Administrative Guidelines for Expenses, Acquisitions, Accounting and Payment Considerations on Oil and Gas Exploration and Production Activities;
- OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017; and
- Administrative Criteria issued by the Tax Administration Service (SAT).

In the case of the oil and gas industry, the Revenue Law on Hydrocarbons contain specific references to transfer pricing obligations between related parties, and obligations to purchase services and goods at market values, even in the case of non-related suppliers. Specific bidding processes are contemplated to ensure transparency in procurement activities.

In the case of financial institutions, non-tax regulations require that related-party transactions be reported to the National Commission of Banking and Securities and to the Mexican Central Bank.

2 Which central government agency has primary responsibility for enforcing the transfer pricing rules?

The SAT, through the Central Administration of Transfer Pricing Audits (CAT), which is responsible for conducting audits and for the issuance of tax rulings, advanced pricing agreements (APAs) and negotiating mutual agreement procedures (MAPs).

3 What is the role of the OECD Transfer Pricing Guidelines?

They are a legal source of interpretation, when consistent with Mexican domestic legislation and international treaties executed by Mexico. Different judicial precedents have confirmed the valid use of the OECD Commentaries to the Model Tax Treaty as long as they are consistent with tax legislation. Some precedents have even tried to link the use of the OECD Commentaries to the obligations under the Vienna Convention on the Law of Treaties of 1969. A recent decision by the Federal Tax Court resulted in as yet non-binding criteria supporting the authority of the SAT to recharacterise a comparable transaction when a discrepancy exists between its substance and form. Administrative criteria issued by the SAT confirm the valid use of the OECD Guidelines to interpret local legislation.

4 To what types of transactions do the transfer pricing rules apply?

Mexican taxpayers are required to comply with transfer pricing rules with respect to any transaction conducted with national or foreign related parties. Arm's-length prices should be agreed upon to reflect valid taxable income or allowed deductions. Parties are deemed related for transfer pricing purposes when one of them participates, directly or indirectly, in the management, control or capital of the other, or when another person or group of persons participate in the management, control or capital of said parties.

5 Do the relevant transfer pricing rules adhere to the arm's-length principle?

Yes. Mexican transfer pricing rules follow the arm's-length principle. Although the rules do not explicitly state the arm's length principle, the wording of the law provides for an obligation to the Mexican tax-residents that conduct transactions with foreign related parties, to determine taxable revenue and allowed deductions, considering prices and considerations that unrelated parties would have used in comparable transactions.

6 How has the OECD's project on base erosion and profit shifting (BEPS) affected the applicable transfer pricing rules?

Mexican transfer pricing rules have not been directly amended to specifically reflect the OECD's project on BEPS actions 8 to 10. However, the fact that the OECD Transfer Pricing Guidelines have changed (2017), makes the BEPS recommendations on transfer pricing concerns applicable in Mexico by means of valid legal source of interpretation.

Mexican Transfer Pricing Rules are broad and general; therefore, the Income Tax Law contains a provision that allows as a source of interpretation interpretative rule that allows the use 2017 OECD Transfer Pricing Guidelines, to the extent that the Guidelines are consistent with the Income Tax Law or the applicable Tax Treaty.

The Mexican Income Tax Law provides for a dynamic interpretation of the TPG, meaning that when the TPG were modified in 2017, the new version shall be fully applicable for purposes of interpreting the Mexican Income Tax Law in the section corresponding to Transfer Pricing obligations. The Mexican Tax Administration Service has confirmed its position in that sense, by expressing that the 2017 OECD Transfer Pricing Guidelines are fully applicable to the existing Transfer Pricing Rules as they aim to clarify the original principles behind the former.

New reporting obligations have been introduced in Mexico following the BEPS initiative, such as disclosure of relevant transactions and country-by-country (CbC reporting).

Pricing methods

7 What transfer pricing methods are acceptable?

Methods available under transfer pricing rules in Mexico are:
- comparable uncontrolled price (CUP);
- resale price;
- cost plus;
- profit split;
- residual profit split; and
- transactional net margin method.

8 Are cost-sharing arrangements permitted? Describe the acceptable cost-sharing pricing methods.

Cost-sharing arrangements between Mexican tax recipients and foreign entities are non-deductible for income tax purposes. An express prohibition exists disallowing any type of cost sharing or allocation of expenses pursuant to a pro rata mechanism. Cost-sharing arrangements are, however, allowed when structured between Mexican taxpayers.

A recent decision by the Supreme Court of Justice (SCJ) provides the legal basis for a broader interpretation of the tax statute. The SCJ established specific guidelines that the SAT should follow in order to allow or reject a tax deduction computed pursuant to a cost-sharing (pro rata) mechanism. In essence, the SAT shall allow a pro rata expense in Mexico when:

the expense is strictly necessary to the business activities of the taxpayer;
- the payment is calculated at arm's length;
- the taxpayer maintains and shows information:
  relative to the identity of parties involved in the transaction;
  - the activities carried out, assets used and risks assumed by each party involved;
  - of the transfer pricing method used to determine the allocation; and
- the allocation of expenses to a Mexican taxpayer must be supported by valid business reasons and not made arbitrarily.

Legally, the decision from the SCJ is not binding to the SAT with respect to any other taxpayer. The decision provided the basis for an interpretation of the statute, specifically with respect to a single case under litigation. The SCJ did not rule as to the argued unconstitutionality of the statutory prohibition.

On its official website, the SAT included the decisions and guidelines produced by the SCJ. An important number of legal considerations arise to determine whether the SAT officials will follow the SCJ guidelines in analysing whether a cost-sharing structure is acceptable and, therefore, deductible in Mexico, or if they will simply reject the deduction arguing a direct use of the existing legal provisions.

The Mexican tax ombudsman, Procuraduría de la Defensa del Contribuyente (Prodecon), issued a recommendation to encourage the SAT in applying the SCJ guidelines in any case related to a cost-sharing arrangement, and to allow a tax deduction when the conditions are met. It recommended the issuance of an administrative guideline that could give certainty to taxpayers and legal authority to SAT officials when deciding upon a cost-sharing arrangement.

Administrative guidelines reflecting the legal interpretation given by the SCJ, allowing deductible cost-sharing payments made to related parties resident of a country with a Broad Exchange of Information Agreement, to the extent that certain formal and documentation requirements are met.

9 What are the rules for selecting a transfer pricing method?

Taxpayers are required to follow the methods in a hierarchical order, with preference to the CUP method. Other methods should only be used if the CUP does not prove to be the most appropriate method, and preference should be given to transactional methods over transactional profit methods.

The SCJ has rendered a decision supporting the validity of the legal provision that required the use of the hierarchical order, with special preference to the CUP method.

10 Can a taxpayer make transfer pricing adjustments?

Yes, if supported with the corresponding economic analysis and supporting documentation. Taxpayers are allowed to modify any given tax transaction to increase or reduce their taxable income or allowed deductions. The new tax guidelines published in December 2016, regulate adjustments made to transactions carried out as of 2017. No obligation exists to notify the SAT of a transfer pricing adjustment, however, taxpayers are expected to:

- document and explain the reasons for the adjustments;
- actually file the respective amended returns;
- produce the corresponding electronic tax invoice;
- make the respective accounting registrations;
- make any withholding and payment that may derive from the adjustment; and
- verify that the related party recognised the taxable effect produced by the adjustment.

Taxpayers are now obligated to file an informative return on 'relevant transactions' known as Form 76, when the transfer pricing adjustment is in excess of 60 million pesos on a quarterly basis.

11 Are special 'safe harbour' methods available for certain types of related-party transactions? What are these methods and what types of transactions do they apply to?

Yes. Special safe harbours are available to the *maquiladora* industry. Mexico has adopted policies favouring the establishment of *maquiladora* companies (now known as IMMEX companies), which process or assemble imported materials and parts for resale to the country of origin or other parts of the world. One of the favourable policies is that the non-resident principal is generally shielded from permanent establishment (PE) exposure in Mexico, provided that:

- the *maquiladora* company engages with the non-resident principal in '*maquiladora* operations';
- the non-resident's country of residence has entered into a tax treaty with Mexico; and
- the *maquiladora* company's taxable profit is at least 6.9 per cent of the value of the assets used during the *maquiladora* operation or 6.5 per cent of the total costs and expenses of the *maquiladora* operation, whichever is higher. The profit is calculated per special safe harbour rules and not based on general transfer pricing methods.

Disclosures and documentation

12 Does the tax authority require taxpayers to submit transfer pricing documentation? Regardless of whether transfer pricing documentation is required, does preparing documentation confer any other benefits? What content must be included in the transfer pricing documentation? Are a separate 'master file' and 'local file' required? What are the acceptable languages for the transfer pricing documentation?

Contemporaneous documentation is not filed by the taxpayers which are obliged to comply with traditional transfer pricing obligations (ie, different to new reporting obligations related to CbC). The economic analysis is kept by the taxpayer and should be shown when the SAT makes an express request in it or during a tax investigation.

Failure to have the contemporaneous documentation in place in case of a tax audit could give ground for a tax deduction disallowance. The Federal Tax Court has rendered decisions in that sense.

In addition, taxpayers have to submit annual informative returns disclosing specific information of transactions with foreign related parties, such as names and country of residence of the related party, type of transaction and amounts, transfer pricing method used and gross or operating profit margins for each transaction. Filing must occur by 31 March of the following year, consistent with the filing date of the annual tax return (31 December of the previous year). To comply with this obligation, the economic analysis and contemporaneous documentation should be in place by 31 March.

Failure to comply or to correctly complete the transfer pricing informative return is sanctioned with a penalty in the range of US$3,500 to US$7,500.

When applicable, statutory financial audit reports prepared and filed by the taxpayer's external auditor must refer to the existence or not of the taxpayer's economic transfer pricing documentation, and of the filing of the informative transfer pricing return.

A new informative return on relevant transaction is required when transfer pricing adjustments occur to controlled transactions, in excess of 60 million Mexican pesos, in quarterly periods. Failure to comply with this obligation is sanctioned with a general fine of up to 9,661 Mexican pesos and the prohibition of holding contracts with the Federal Public Administration.

The new informative return was first due on 31 December 2015, for reporting all transactions that occurred in 2014. For 2015 and onwards, the filing is due on the last day of the second month following each quarter. Note that the SCJ ruled the legal provisions contained in the Federal Fiscal Code are unconstitutional. However, it confirmed that taxpayers may be required to submit the relevant information in case the SAT makes a formal requirement under its tax investigation authority.

In case of transfer pricing adjustments that result in the assessment of a tax deficiency, a 50 per cent reduction of penalties is available if the taxpayer had the corresponding contemporaneous documentation at the time an audit starts. Normal penalties are in the range of 55 per cent to 75 per cent of the omitted taxes. Reporting net operating losses in excess which are reduced by a tax adjustment is subject to a penalty of 30 per cent to 40 per cent.

Having contemporaneous documentation in place will require the SAT make legal and valid transfer pricing adjustments in case of discrepancies. Not having the contemporaneous documentation will be used by the SAT as an argument to automatically disallow tax deductions.

Transfer pricing documentation should be produced by the date of filing of the annual return and the transfer pricing informative return by 31 March of the following year. No actual submission of the traditional transfer pricing documentation is required.

There are no specific regulations dealing with the content and formal presentation of the traditional transfer pricing documentation; however, it must include:

- a clear description of the taxpayer and its related parties with respect to their corporate structure and the commercial transactions;
- a comprehensive description of functions, assets and risks assumed by each party; and
- amounts of consideration and method used thereto with respect to each transaction with related parties.

Global or regional transfer pricing documentation is not prohibited under the statute; however, the SAT officials would like to have a local specific analysis of the Mexican taxpayer on an ad hoc basis.

Documentation should be prepared in Spanish (although the SAT will allow documents in English for purposes of supporting economic analysis or in any kind of negotiation).

With respect to BEPS Action 13 country-by-country reporting, the Mexican rules require separate filings of a master file and a local file.

The new information returns required are as follows.

Master file informative return

Who must file

- Mexican tax-resident entities having declared on the prior fiscal year's annual tax return accruable income equal or exceeding 644,599,005 pesos;
- publicly traded companies;
- entities subject to the optional tax regime (the tax consolidation system); and
- state enterprises.

What information must be included

Information regarding the taxpayer's:

- organisational structure;
- business description;
- intangibles;
- financial activities with related parties; and
- financial and tax position.

Local information return

Who must file

- Mexican tax-resident entities having declared on the prior fiscal year's annual tax return accruable income equal or exceeding 644,599,005 pesos;
- publicly traded companies;
- entities subject to the optional tax regime (the tax consolidation system); and
- state enterprises.

What information must be included

Description and analysis of the taxpayer and of its operations with related parties, financial information of the taxpayer, together with the comparable operations or entities used as such in the analysis.

CbC information return

Entities qualifying in any of the above and that also meet any of the following:

- Multinational holding entities that:
  - are Mexican tax-residents;
  - have subsidiaries or PEs residing or located abroad;
  - are not subsidiaries of another entity residing abroad;
  - are obligated to file and provide consolidated financial statements;
  - report on their consolidated financial statements the results of other entities residing abroad; and
  - earned in the previous fiscal year consolidated income equivalent or higher than 12 billion pesos.
- Mexican tax resident entities or foreign tax-residents with PEs in Mexico, appointed by the controlling entity of the foreign multinational group (MNE) to be responsible for providing the CbC tax return.
- Mexican subsidiaries of foreign multinationals, if the tax authorities are unable to obtain information from the parent company's country of residence through exchange of information mechanisms. These subsidiaries will only have 120 days to deliver the requested information.

This is information regarding the worldwide distribution of income of entities forming part of the group, taxes paid and an indication of the jurisdictions where the economic activities of the group are performed.

The return must only be filed when the group earns an annual consolidated income of more than 12 billion pesos.

13 Has the tax authority proposed or adopted country-by-country reporting? What are the differences between the local country-by-country reporting rules and the consensus framework of BEPS Action 13?

The Mexican income tax law was amended to expressly include the obligation to file CbC reports. Information pertaining to 2016 transactions will be submitted by 31 December 2017.

The SAT recently issued a number of tax guidelines to facilitate understanding the scope of the new requirements and their legal, administrative and economic impact of the master and local files

Rule 3.9.15 breaks the master file informative return regulations down into five subparagraphs requesting information of the MNE.

Organisational structure

General description

- Business model description;
- value creator's description;
- supply chain description;
- list and description of the principal intragroup services agreements;
- principal geographic markets description;
- functions conducted, risk assumed and assets used description; and
- business restructures information.

Intangible assets owned by the group

- Global strategy for the development, ownership and exploitation of intangible assets;
- list of intangible assets owned by the group;
- list of the principal intragroup agreements;
- description of the transfer pricing policies on research and development and intangible assets; and
- description of the principal intangible assets transfer.

Financial activities

- Description of the groups finance, even with independent parties;
- name of the groups entity in charge of central financing activities for the group; and
- transfer pricing policies for finance activities between related parties.

Financial and tax position

- Consolidated financial statements for the declared fiscal year; and
- list and description of the unilateral APAs and any other ruling obtained by the entities of the group.

The local file informative return regulations breaks down into three subparagraphs requesting information about the obliged taxpayer and each of its counterparties, for all the controlled transactions conducted during the declared taxable year.

Structure and information of the obliged taxpayer

- Administrative and organisational structure description and list of individual in charge of the local administration;

- detailed description of the business strategy of the obliged taxpayer, even if participate into business restructures;
- value chain description of the group to which the obliged taxpayer belongs; and
- principal competitors of the obliged taxpayer.

Information of transactions conducted with related parties

- Detailed description of the transactions conducted between the obliged taxpayer and related parties in Mexico and abroad;
- description of the transfer pricing policies by type of transaction;
- description of the strategy for the development, enhance, protection and exploitation of intangible assets of the group;
- copy of the contracts between the obliged taxpayer and related parties (in English or Spanish);
- justification of the tested party, and the reason for rejecting the counterparty;
- analysis of the functions performed, risks assumed and assets used by the obliged taxpayer and related parties for each transaction type;
- justification of the selection of the transfer pricing methodology applied to the analysed transactions;
- detail and justification for the use of financial information of comparable enterprises for more than one year;
- detail of the search and selection process of comparable enterprises or transactions including the source of information, criteria, for acceptance and reject comparable enterprises, profit level indicators, among other;
- segmented financial information of the obliged taxpayer and the tested party, providing detailed information for the profit level indicator calculation; and
- list of unilateral, bilateral or multilateral APAs and rulings for any related-party transaction where the Mexican internal revenues is not involved.

Financial information

- Individual and consolidated financial statements of the obliged taxpayer and its counterparty;
- financial and fiscal information of the foreign related parties that are counterparties in any analysed transaction;
- obliged taxpayer's and tested party financial information used for the application of the transfer pricing methods; and
- relevant financial information of the comparable enterprise used, as well as the database used and dates of information extraction.

Rule 3.9.15, regarding the CbC informative return regulations, contains five subparagraphs detailing requests for information of the MNE:

- total income of the multinational business group;
- financial profit/loss before income tax;
- income effectively paid;
- amount of taxes accrued;
- profit or loss amount for previous years;
- equity paid at the closing of the year;
- number of employees at the closing of the year;
- material assets;
- list of names of the related parties belonging to the group; and
- additional information.

Failure to comply with filing the new informative returns, as applicable, will be subject to the following sanctions:

- a fine of between 140,540 and 200,090 pesos; and
- a restriction on entering into public procurement agreements with the Mexican government.

Consistent with the OECD recommendations, Mexico has signed the Multilateral Competent Authority Agreement for Automatic Exchange of Country by Country Reports and entered the Convention on Mutual Administrative Assistance in Tax Matters. These new exchange-of-information agreements will essentially allow the tax administrations of signatory countries to automatically exchange, on a reciprocal basis, information collected from MNEs and their local subsidiaries through the new transfer pricing returns.

14 When must a taxpayer prepare and submit transfer pricing documentation?

An informative return should must be filed by no later than March 31 of the following year to the closing of the taxable year declared. Miscellaneous regulations 3.9.3. for the taxable year 2018 allow taxpayers to submit the Transfer Pricing Informative Return no later than 15 July for those that elected in accordance with the Mexican Income Tax Law to have audited its financial statements by a certified public accountant under article 32-A of the Federal Fiscal Code.

15 What are the consequences for failing to submit documentation?

Failure to submit the Transfer Pricing Informative Return is sanctioned with fines that range from US$10,000 to US$42,000.

In the case local, master and CbC reports, failure to file the relevant return is fined with penalties that go from US$7,000 to US$10,000, plus a prohibition to enter into procurement contracts with the federal government.

Adjustments and settlement

16 How long does the tax authority have to review an income tax return?

The statute of limitation in Mexico is five years after the filing of tax returns. Taxable revenue and allowed deductions coming from related-party transactions are reported in the annual tax return that is filed no later than 31 March of the following year.

Tax authorities have to initiate a formal tax audit within the statute of limitation period, and must formally request transfer pricing information.

As of 2014, the tax authorities are empowered to conduct electronic audits, which are already taking place with the review of electronic fiscal invoices and electronic accounting information that the taxpayers have to generate and send through electronic means.

With the recently enacted electronic mechanisms, the SAT will have extended periods to review information and to initiate tax audits, in excess to the statute of limitation.

17 If the tax authority asserts a transfer pricing adjustment, what options does the taxpayer have to dispute the adjustment?

Once a transfer adjustment that results in a tax deficiency is assessed, taxpayers are entitled to contest through the filing of legal remedies under domestic legislation, or to request a MAP under the respective applicable tax treaty when a double taxation issue arises.

Under domestic rules, taxpayers are required to file an administrative appeal that is reviewed and decided by the Legal Section of Large Taxpayers of the SAT (in the case of transfer pricing controversies). The appeal must be filed within the 30 working days following the official notification. No obligation to pay or guaranty the deficiency exists for the period in which the appeal is under review by the SAT. Having the case reviewed at the administrative level allows the taxpayers to continue formal legal and technical discussions with the Legal and Transfer Pricing Sections of the SAT.

The SAT is granted with a three-month period to resolve an administrative appeal. Complex cases normally take from six months to one year to reach a ruling at this stage.

The Legal Section deciding the appeal can either rule to revoke the assessment or to confirm it, in which case the taxpayer would be entitled to file a nullity petition before the Federal Administrative Court, within a 45-working-day period after the administrative appeal is ruled.

Taxpayers may elect to appear directly to the Federal Administrative Court, without being required to file the administrative appeal.

Nonetheless, because of a relatively recent decision by the SCJ, taxpayers are forced to file the administrative appeal in cases where the tax audit was not properly handled, in terms of not having produced in full documentary evidence that can be used to demonstrate a valid tax position or to legally defend a case if litigation is reached. The binding decision from the SCJ makes an interpretation of the statute in the sense that taxpayers cannot produce and file information and documents to be used as evidence at the Federal Administrative Court level, if such information and documents were not shown to the SAT during the audit process or at the administrative appeal level.

Considering the excessive formalisms in the tax statute in Mexico, and based on the current trend in tax investigations where excessive information and documents are requested by the SAT during any audit, it is highly advisable to evaluate the filing of administrative appeals and have a last opportunity to integrate a solid documented legal defence in case it is necessary to request judicial reviews.

The obligation to secure the tax interest with a valid guaranty (normally through a bond) will be triggered 10 days after the ruling in the administrative appeal is served to the taxpayer. Taxpayers may elect to pay the deficiency and contest without being deemed as having consented with the assessment. This may represent a better financial position when a final decision is reached by avoiding excessive guaranty costs (ie, bonding fees and commissions calculated on a yearly basis throughout the duration of the controversy), and by obtaining the right to interests if a favourable decision is rendered to the taxpayer (a refund claim could be supported for incorrect and illegal collection from the SAT).

A nullity claim process lasts between 18 and 36 months in the Federal Administrative Court depending on the complexity of the case, the request of expert witness testimonies and the fact that the Superior Chamber may attract the case by virtue of its value, the novelty of the concepts under controversies or if they involve the interpretation of a tax treaty.

Decisions rendered by the Federal Administrative Court can be further challenged by the taxpayers in a 15-working-day period through a direct *amparo* (constitutional remedy), that is reviewed and decided by a Federal Circuit Court (part of the Federal Judicial System). The SAT can also file appeals against decisions by the Federal Administrative Court, but only in specific circumstances expressly contained in the Federal Tax Code.

A decision from a Federal Circuit Court takes six to 12 months, and in most of the cases it is final and cannot be further challenged. Only in situations where the constitutionality of a legal provision is questioned by the taxpayer in its direct *amparo* may the case ultimately reach the SCJ.

An alternative dispute resolution option available is the use of MAPs under the double tax conventions executed by Mexico. Currently, Mexico has entered into more than 50 tax treaties that contain clauses dealing with MAPs.

There is no clear regulation in the Federal Tax Code as to the formalities that a taxpayer must follow in order to request a MAP. Recent provisions are clear on the fact that taxpayers will be relieved from securing the tax interest through a guaranty in case a MAP is requested. Taxpayers can validly file legal remedies under domestic legislation and at the same request a MAP, in which case domestic remedies will be suspended until a decision is reached under a MAP.

A decision under a MAP cannot be challenged through the filing of an administrative appeal or a nullity petition.

Recent legislative reform introduced a new form of tax controversies where taxpayers may contest substantive legal considerations arising from formal tax assessments. This can be achieved on both, through administrative appeals or through formal nullity petition with the Federal Administrative Court, without having the obligation to secure the fiscal interest by valid mean of guaranty. A specialised chamber in tax matters has been created within the Federal Administrative Court to handle and decide cases that relate to substantive tax litigation.

Relief from double taxation

18 Does the country have a comprehensive income tax treaty network? Do these treaties have effective mutual agreement procedures?

Mexico currently has 56 income tax treaties in place, with the following countries: Australia, Austria, Bahrain, Barbados, Belgium, Brazil, Canada, Chile, China, Colombia, Czech Republic, Denmark, Ecuador, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway, Panama, Peru, Poland, Portugal, Qatar, Romania, Russia, Singapore, Slovak Republic, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, the United States and Uruguay.

It is also party to the Convention on Mutual Administrative Assistance in Tax Matters.

Five additional treaties are expected to become effective in 2018, with Argentina, Costa Rica, Guatemala, Philippines and Saudi Arabia.

All of these treaties have MAP provisions.

19 How can a taxpayer request relief from double taxation under the mutual agreement procedure of a tax treaty? Are there published procedures?

There are no extensive published procedures established under the Income Tax Law or Federal Fiscal Code, with the exception of a recently published tax guideline rule 2.1.31. In the event of double taxation, taxpayers must initiate MAPs pursuant to the MAP process established in the treaties.

Also, taxpayers may initiate a MAP pertaining to transfer pricing adjustments or correlative adjustments, by filing a request for such an adjustment by means of filing an APA petition, which is also applicable to transfer pricing adjustments and correlative adjustments.

A writ should also be filed disclosing:

- the taxpayer's and its related party's general information (ie, name, taxpayer identification number, country of residence, etc);
- the shareholders' registry and corporate diagram reflecting the corporate structure and contractual relationship among the entities;
- activities undertaken by the different entities in the group that are involved with a brief description of each;
- financial information of the parties involved; and
- copies of independent auditor certified tax returns filed in Mexico for the three years prior to the one in question and the year itself, as well as yearly tax returns; description of the currency used for the related-party transactions, among others.

The writ must also include specific information of the functions performed and activities undertaken by each of the parties involved, including a breakdown of assets and risks undertaken by each party involved. If a transfer pricing methodology has been determined, a description should be included and the reasoning for electing the method or support of it as the best method. If a given methodology has been asserted or elected by a foreign tax authority, support of such election and copies of such communication with the foreign authorities should be provided.

If a comparable analysis exists, it must be provided, showing the reasonable adjustments to eliminate economic differences between markets. Considering that this process stems from a MAP or will lead to a MAP, and that correlative adjustments are likely, the taxpayer must provide all the information available regarding procedures that have transpired with foreign authorities and, if available, the proposed adjustments being suggested.

20 When may a taxpayer request assistance from the competent authority?

At any time within the five-year statute of limitations, or within the time limits specified in the applicable convention.

Requesting a MAP procedure is optional to the taxpayer and can be initiated prior to or after the legal remedies in Mexico to contest tax assessments are conducted and concluded. It is expressly prohibited to request a MAP after definitive legal decisions are rendered after the initiation of tax controversies through administrative appeals or with the Federal Administrative Court.

By requesting a MAP, taxpayers are relieved from securing the fiscal interest until the procedure concludes.

21 Are there limitations on the type of relief that the competent authority will seek, both generally and in specific cases?

There are no limitations to request MAPs with respect to tax controversies arising in Mexico. MAPs can be used to eliminate or to reduce a double taxation issue arising in general from any Mexican source-related income or by virtue of transfer pricing adjustments.

22 How effective is the competent authority in obtaining relief from double taxation?

The Tax Administration Service published reports have consistently averaged over 50 per cent resolution of its MAP procedures pertaining to transfer pricing matters, particularly with its OECD counterparts since 2010. The latest official report shows that over 60 per cent have

Update and trends

Currently the efforts of the tax authorities are focused in implementing and improving the reporting framework in matter of tax affairs in order to comply successfully with the newest policies in matter of BEPS. Some taxpayers have challenged the new reporting obligations implemented by the tax authorities and the legislator, but the actual stance of the Constitutional Courts (strongly in favour of the current tax administration) has made almost impossible to nullify the new reporting obligations under constitutional grounds.

However, on the other hand, we have seen a modest increase in the favourable precedents regarding the evidential value of private documents. We have also witnessed some new precedents limiting the presumption faculties of the tax authorities.

In that sense, while the Constitutional Courts seems to remain reluctant to assume a protective stance against the most aggressive policies implemented by the tax authorities in recent years, some Tax Courts seems to be willing to establish some legal padlocks to the almost unlimited faculties of the tax authorities regarding the presumption of taxable income.

Finally, it is worth mentioning that, in recent years, the Mexican Taxpayer's General Attorney has assumed a more reticent stance against the tax authorities in the conclusive agreements and legal complaints filed before him. Therefore, this ombudsman has gone from being one of the most revolutionary institutions in favour of taxpayers' rights to becoming a scantily useful tool, valuable only against clear and extreme transgressions against taxpayers' rights.

involved the US, 10 per cent each of Sweden and Germany, 5 per cent each of Japan and Luxembourg, and the rest of the 2015 inventory involved Austria and Singapore.

Advance pricing agreements

23 Does the country have an advance pricing agreement (APA) programme? Are unilateral, bilateral and multilateral APAs available?

Yes. Under the Federal Tax Code, unilateral APAs are available, as well as bilateral and multilateral in cases where a double tax convention exists with the country or residence of a related party.

APAs are also available to negotiate thin capitalisation issues arising from excess indebtedness by Mexican taxpayers.

24 Describe the process for obtaining an APA, including a brief description of the submission requirements and any applicable user fees.

Taxpayers are entitled to request APAs to agree upon the methodology and amount of considerations in related-party transactions. Per specific administrative tax guideline, taxpayers are allowed to approach the SAT on a non-name basis for a pre-analysis of the methodology and level of information that will be presented in support of an APA request.

APAs are initiated upon request of the taxpayer by using official form 102/CFF, containing a list of specific information of the taxpayer, its related parties in Mexico or abroad and the corporate shareholding structure. In the case of multinational groups, this includes a description of the different entities, their activities and location or place where they carry out their business. General financial information should be filed, including a list of expenses incurred with related parties and evidence of the past three fiscal years' tax returns. There should also be a copy of contracts and agreements that contain the different related-party transactions, translated into Spanish.

More specifically, with respect to the transactions that trigger the APA request, the taxpayer must submit a detailed description of the functions, activities, assets and risks involved in the related-party transaction. There should also be a description of the method proposed to calculate amounts of consideration in the related-party transaction, supported by any necessary information that objectively supports the request. Also necessary is information of comparable transactions and entities, making reference to any adjustment made to achieve comparability. The taxpayer shall disclose if a related party in a foreign country is subject to a transfer pricing investigation or is under litigation in a tax controversy.

A governmental fee is payable in the amount of 216,300 pesos, due prior to the filing of APA requests.

Numerous meetings with the SAT will occur to review and discuss the APA request and the information submitted by the taxpayer. The SAT has the authority to make physical visits to the taxpayer's premises to review and better understand the facts and business description presented in the APA request. No special permission is required for these visits (eg, court orders or warrants), however written notification must be given to the taxpayer beforehand.

25 How long does it typically take to obtain a unilateral and a bilateral APA?

This depends on the complexity of each case. A unilateral APA can take from 10 to 24 months. A bilateral APA can take from 18 to 30 months depending on the amount of information submitted, the timely response to additional requests from the SAT and also on the level of communication between authorities.

26 How many years can an APA cover prospectively? Are rollbacks available?

The APA may cover transactions conducted in the fiscal year in which the request is filed, the prior year and three years following that of the request.

The duration of the APA can be extended if it results from a competent authority procedure under a double tax treaty.

27 What types of related-party transactions or issues can be covered by APAs?

There is no limitation. Any related-party transaction subject to transfer pricing rules can be covered in an APA.

28 Is the APA programme widely used?

Unilateral APAs were mandatory in the *maquiladora* industry during 2000 through 2002. As from 2003, the *maquiladora* industry was allowed to comply with transfer pricing rules by using safe-harbour thresholds, by securing an APA, or by following arm's-length values under general transfer pricing methods. As of 2014, the industry is required to comply with transfer pricing provisions pursuant to safe-harbour thresholds or by an APA. The SAT has initiated a programme to conduct 'fast track' APAs by using methodologies and benchmarks previously discussed and negotiated with the US Internal Revenue Service. With this, APAs requested from years 2014 and 2015 will entitled to benefit from this process, through formal agreement with the SAT or they can elect to continue their APA without adhering to the expedited process.

Other industries in Mexico are also entitled to APAs. Multinational groups with bilateral or multilateral APAs are normally interested in having their transfer pricing policies accepted by the Mexican SAT. Unilateral APAs are consequently requested supported by information secured in other countries. The SAT will decide whether to elevate the case bilaterally or multilaterally.

Because of the recent decision by the SCJ regarding deductible cost-sharing arrangements, APAs dealing with pro rata allocation of expenses or cost sharing of investments made abroad will increase. Based on the legal uncertainty that results from the lack of express legal provisions allowing a deductible cost-sharing, an APA will become strongly advisable to allow a tax deduction upon negotiated terms, conditions and transactional documentation.

There is no official information published as to the number of bilateral APAs executed by the Mexican SAT, but they are still limited in number. They will become more common to the extent that the number of double tax conventions executed by Mexico is constantly increasing, as well as the different sources of foreign investment into Mexico.

Recent constitutional and legal reforms in Mexico opining opportunities to energy (oil and gas) and telecommunication industries should increase the use of APAs for the purpose of having multinational transfer pricing policies accepted in Mexico, as well as to the need for having major projects financed by debt without compromising interest deductibility under thin capitalisation rules.

29 Is the APA programme independent from the tax authority's examination function? Is it independent from the competent authority staff that handle other double tax cases?

The CAT controls four different areas responsible for the management and administration of the transfer pricing rules in Mexico. Four administrators report to the central administrator; one of them is responsible of all kinds of APAs and everything related to the *maquiladora* industry, while the other three are engaged in audit procedures.

Positive considerations relate to the internal level of communication that exists between the four administrators and the central administrator. SAT officials have shown to be open to discussions and to find business-motivated solutions.

Conversely, there is no provision in the statute that obligates Chinese walls must be in place with respect to information that an APA administrator has and may share with a CAT audit administrator or with any other area in the SAT. The CAT does not hold this information confidentially. The different central administrations under the General Administrator of Large Taxpayers are constantly in contact, sharing information related to taxpayers (domestic and non-resident), common structures to industries or commercial activities, aggressive tax planning, cross-border reorganisations, etc.

With the increasing number of Exchange of Information Agreements and the tax and financial cooperation policy adopted among countries in the OECD and European Community, sharing of information internally within the SAT and between governments will become natural.

With the energy reform in Mexico that opened the oil and gas industry to the private sector, the SAT created a General Administration of Hydrocarbons, which is responsible for verifying tax compliance in Mexico by companies engaged in that industry. The General Administration of Hydrocarbons is empowered to review all transfer pricing related issues to the oil and gas industry.

30 What are the key advantages and disadvantages to obtaining an APA with the tax authority?

Securing an APA from the Mexican SAT presents different advantages. Taxpayers can be certain that their transfer pricing policy is valid and already accepted by the authorities, which will have full effects for a period of five fiscal years.

Mexico lacks relevant transfer pricing experience, mostly in the judicial area. Different criteria from the Federal Tax Court and from the federal judiciary exist that reflect the lack of full understanding of the rationale behind a legal tax system that relies on economic considerations. There are cases where a taxpayer is audited for two fiscal years, operating under a similar transfer pricing policy, and tax deficiencies are assessed by the SAT pursuant to transfer pricing adjustments. Ultimately, litigation and, because of legal procedural rules, contradictory decisions are rendered by federal courts; that is, upholding both a transfer pricing corporate policy for one year and a transfer pricing adjustment made by the SAT for the second year. No legal certainty is granted to the taxpayer for future years.

Special topics

31 Is the tax authority generally required to respect the form of related-party transactions as actually structured? In what circumstances can the tax authority disregard or recharacterise related-party transactions?

The 2014 tax reform in Mexico introduced a number of anti-abuse, BEPS countermeasures, particularly pertaining to interest, royalties and technical assistance. Also, cross-border transactions are subject to tax authority recharacterisation if they are deemed to be transactions lacking substance or construed as abusive. In practice, the tax authorities have been actively challenging aggressive structures, forcing taxpayers to negotiate settlement as the judiciary has also taken an economic substance approach in its rulings.

Special attention will be given to functional analysis and value creation because the SAT will be following the transfer pricing rules and interpretation resulting from the BEPS initiative.

32 What are some of the important factors that the tax authority takes into account in selecting and evaluating comparables? In particular, does the tax authority require the use of country-specific comparable companies, or are comparables from several jurisdictions acceptable?

Access to public comparables tends to favour US and Canadian comparables, albeit not exclusively. To the extent that substantive elements are available to demonstrate the eligibility to use a given comparable, and that such comparables can be reasonably adjusted to accommodate to the realities of the Mexican market, the comparable should be accepted by the tax authority.

33 What is the tax authority's position and practice with respect to secret comparables? If secret comparables are ever used, what procedures are in place to allow a taxpayer to defend its own transfer pricing position against the tax authority's position based on secret comparables?

The tax authorities cannot use secret comparables. In the event that the tax authorities assess a determination against a taxpayer using confidential information, the taxpayer is entitled to gain access to said comparable information through up to two representatives during a 45-day term. The representatives can only take notes from the information used by the tax authorities, without being able to copy the documentation or information reviewed.

34 Are secondary transfer pricing adjustments required? What form do they take and what are their tax consequences? Are procedures available to obtain relief from the adverse tax consequences of certain secondary adjustments?

As of December 2016, tax guidelines for secondary adjustments applicable to transactions that occur as of fiscal year 2017. Adjustments are intended to reflect a logical consequence of adjusting a determined transfer price with different implications, such as accounting, tax

sánchez devanny®

Ricardo León **rls@sanchezdevanny.com**
Guillermo Villaseñor **gvillasenor@sanchezdevanny.com**

Paseo de las Palmas 525 Piso 6
Lomas de Chapultepec
11000 Mexico City
Mexico

Tel: +52 55 5029 8500
Fax: +52 55 5029 8501
www.sanchezdevanny.com

and documentary. Transfer price adjustments may produce different income results by increasing or reducing taxable revenues or allowed deductions. Indirect tax and potential import duty implications must also be observed, while no rules have been created to that effect. Another effect could be an increase in mandatory profit sharing in the event of an adjustment of the taxable result of a taxpayer.

35 Are any categories of intercompany payments non-deductible?

Payments deriving from cost-sharing arrangements or, in general, any payment computed pursuant to a pro rata method, is not deductible in Mexico (consider, however, the existence of new administrative guidelines previously described). New tax legislation prevents a tax deduction in Mexico in case of double deductions, or when the payment is non-existent in the country or jurisdiction of residence of the beneficial party. Such rules are a reflection of the position adopted and publicly expressed by the Mexican government with respect to BEPS implementation.

36 How are location savings and other location-specific attributes treated under the applicable transfer pricing rules? How are they treated by the tax authority in practice?

Such location savings are no longer applicable, as the accelerated depreciation regime was repealed as part of the 2014 tax reform.

37 How are profits attributed to a branch or permanent establishment (PE)? Does the tax authority treat the branch or PE as a functionally separate enterprise and apply arm's-length principles? If not, what other approach is applied?

Yes, branches or PEs are deemed to be independent bodies and must comply with arm's-length pricing, including transfer pricing studies to support the value at which transactions take place among related entities.

38 Are any exit charges imposed on restructurings? How are they determined?

If an entity relocates outside of Mexico, such relocation is construed as liquidation and taxed as such. Essentially, it is subject to tax on the excess of paid-in capital and retained pre-taxed earnings. Excess is subject to corporate income tax.

39 Are temporary special tax exemptions or rate reductions provided through government bodies such as local industrial development boards?

No.

Getting the Deal Through

Acquisition Finance
Advertising & Marketing
Agribusiness
Air Transport
Anti-Corruption Regulation
Anti-Money Laundering
Appeals
Arbitration
Art Law
Asset Recovery
Automotive
Aviation Finance & Leasing
Aviation Liability
Banking Regulation
Cartel Regulation
Class Actions
Cloud Computing
Commercial Contracts
Competition Compliance
Complex Commercial Litigation
Construction
Copyright
Corporate Governance
Corporate Immigration
Corporate Reorganisations
Cybersecurity
Data Protection & Privacy
Debt Capital Markets
Dispute Resolution
Distribution & Agency
Domains & Domain Names
Dominance
e-Commerce
Electricity Regulation
Energy Disputes
Enforcement of Foreign Judgments
Environment & Climate Regulation
Equity Derivatives
Executive Compensation & Employee Benefits
Financial Services Compliance
Financial Services Litigation
Fintech
Foreign Investment Review
Franchise
Fund Management
Gaming
Gas Regulation
Government Investigations
Government Relations
Healthcare Enforcement & Litigation
High-Yield Debt
Initial Public Offerings
Insurance & Reinsurance
Insurance Litigation
Intellectual Property & Antitrust
Investment Treaty Arbitration
Islamic Finance & Markets
Joint Ventures
Labour & Employment
Legal Privilege & Professional Secrecy
Licensing
Life Sciences
Loans & Secured Financing
Mediation
Merger Control
Mining
Oil Regulation
Outsourcing
Patents
Pensions & Retirement Plans
Pharmaceutical Antitrust
Ports & Terminals
Private Antitrust Litigation
Private Banking & Wealth Management
Private Client
Private Equity
Private M&A
Product Liability
Product Recall
Project Finance
Public M&A
Public-Private Partnerships
Public Procurement
Real Estate
Real Estate M&A
Renewable Energy
Restructuring & Insolvency
Right of Publicity
Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
Ship Finance
Shipbuilding
Shipping
Sovereign Immunity
State Aid
Structured Finance & Securitisation
Tax Controversy
Tax on Inbound Investment
Telecoms & Media
Trade & Customs
Trademarks
Transfer Pricing
Vertical Agreements

Also available digitally

Online

www.gettingthedealthrough.com

ISBN 978-1-78915-079-7