

# Clients Bulletin

## MEXICO'S NEW TRANSFER PRICING ADJUSTMENTS RULES

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\* Béndiksen, Diedrich, Enríquez, Salazar, Santoyo & Yanar, S. C.

Bld. Tomas Fernández No. 7815, Suite 302

Fraccionamiento Los Parques

32440 Ciudad Juárez, Chihuahua

México

+(52) (656) 648-6500

[www.bendiksenlaw.com](http://www.bendiksenlaw.com)

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On December 23, 2016 the Mexican Tax Administration published in the Federal Official Gazette the so-called 2017 Miscellaneous Tax Resolution, embodying a large number of administrative rules related to Mexico's federal taxes, applicable during 2017.

A new Section 3.9.1 of the resolution –not included in previous resolutions- sets forth rules that enable taxpayers, under certain conditions, to make transfer pricing adjustments after the close of the tax year.

We will discuss these rules in the following paragraphs.

### **Transfer Pricing Adjustments Defined**

For these purposes, transfer pricing adjustments are defined as any modification to the price, consideration or profit margin corresponding to transactions entered into between a Mexican taxpayer and its related parties, done to conform the amount of taxable income or deductions originating from such transactions to the arm's-length standard (i. e. to the prices or consideration independent parties would have used in comparable transactions).

This definition applies whether or not cash or other material resources are transferred between the parties.

### **Same Nature as the Original Transaction**

As is obvious, the rules state that the adjustments we are referring to keep the same nature as the original transaction being adjusted (i.e., interest, royalties, commissions, service fees, etc.).

### **Upward Adjustments**

In those events where a transfer pricing adjustment results in a higher price, consideration or profit margin for the transaction, the following rules apply:

1. Where the original transaction generated taxable income for the Mexican taxpayer, the taxpayer should increase its revenue in an amount equivalent to the adjustment.
2. Conversely, where the original transaction resulted in a deduction, the taxpayer's deductions must be increased in an amount equivalent to the adjustment. This deduction increase is subject to the deduction requirements discussed below.
3. Where the adjustment generates Mexican – source income for a nonresident, the Mexican taxpayer must pay in to the tax administration the corresponding withholding tax. To this end, when the taxpayer is unable to identify the date on which the adjustment was legally due and payable, the taxpayer must consider that it was payable on the last day of the tax year in which the original transaction took place. This determination is relevant to calculate the indexation and late-payment interest payable together with the withholding tax.

## **Downward Adjustments**

Where transfer pricing adjustments result in a lower price, consideration or profit margin for the transaction, then the following rules govern:

1. If the transaction originally generated taxable income for the Mexican taxpayer, the taxpayer may increase its deductions in an amount equivalent to the adjustment. Again, this deduction increase is subject to the deduction requirements discussed below.
2. Where the original transaction generated a deduction for the Mexican taxpayer, the taxpayer must reduce the amount of its deductions in a corresponding amount.

## **Deduction Requirements**

In those events where a transfer pricing adjustment increases the amount of the Mexican taxpayer's deductions under the preceding rules, the taxpayer must comply with the following requirements, in addition to the general deduction requirements set forth in the law, in order to be entitled to the higher deductions:

1. To timely file the following returns or amended returns:

- The information return regarding relevant transactions.
  - The information return regarding the taxpayer's tax situation.
  - The annual tax return.
  - The transfer pricing information return regarding transactions with nonresident related parties.
2. To prepare and keep all documentation and information taken into consideration to determine that the original transactions did not conform to the prices, consideration or profit margins independent parties would have used in comparable transactions.
  3. To prepare and keep a statement, under oath, explaining the reason why the originally agreed prices, consideration or profit margins did not conform to those that independent parties would have used in comparable transactions.
  4. To prepare and keep a statement, under oath, explaining the consistency or inconsistency (i) of the transfer pricing methodologies applied by the taxpayer and (ii) of the search for comparable transactions or entities, both at least with respect to the tax year immediately preceding the year of the transaction being adjusted.
  5. To prepare and keep all documentation and information to allow confirmation that in carrying on the transfer pricing adjustment the adjusted transactions considered the prices, consideration or profit margins independent parties would have used in comparable transactions. This documentation and information must include the arithmetical calculation of the transfer pricing adjustment.
  6. To keep on file the invoices corresponding to the original transaction that was adjusted. This invoice must be the mandatory electronic invoice (CFDI) if the transaction was with a resident of Mexico or an invoice meeting the requirements set forth in Rule 2.7.1.16 of the 2017 Miscellaneous Tax Resolution if the transaction was with a nonresident.
  7. Where the Mexican taxpayer also recognizes accounting book effects for the transfer pricing adjustment, it must, as the case may be, either (i) issue an electronic invoice (CFDI) or (ii) keep the CFDI issued by the related party resident of Mexico or the Rule 2.7.1.16 invoice issued by the nonresident related party, corresponding to the adjustment.

The CFDI or Rule 2.7.1.16 invoice documenting the transfer pricing

adjustment must include, at a minimum, the following:

- A cross-reference to the invoices issued for the original transaction.
  - A description of the adjusted transaction.
  - The amount of the original transaction.
  - Tax year in which the original transaction was reported as income or as a deduction.
  - A description of the transfer pricing adjustment, within the line items labeled "concepts" and "description".
  - The invoice must be dated in the year in which the tax return was filed or should have been filed for the tax year in which the original transaction was reported as income or as a deduction.
8. Where the transfer pricing adjustment is for tax purposes only (and not for accounting purposes), the adjustment must be recorded in the books of account in a memorandum account and it must be recognized in the book-to-tax reconciliation.
9. To evidence that the related party with who the adjusted transaction took place recognized income or reduced its deductions, as the case may be, in the same tax year in which it was deducted by the Mexican taxpayer and in the same adjusted amount.
10. The taxpayer should also evidence that the adjustment does not represent income subject to Mexico's preferential tax regime.
11. To withhold and pay in the withholding tax corresponding to the transfer pricing adjustment. As mentioned earlier, when the taxpayer is unable to identify the date on which the adjustment was legally due and payable, the taxpayer must consider that it was payable on the last day of the tax year in which the original transaction took place.

### **Deduction of Adjustment Limited to Original Transaction Tax Year**

Note that deduction of the transfer pricing adjustment is possible only for the tax year in which the income or deductions corresponding to the original transactions were reported for income tax purposes.

### **Timing Limitations**

Although the language is not clear, we read the rules to provide that the transfer pricing

adjustments **giving rise to deductions** must be reflected in the corresponding tax return or tax report no later than on the following dates:

- March 31, in the regular tax return, for taxpayers who did not elect to file a tax report and who are not under an obligation to file the tax situation information return called for under Article 32-H of the Federal Fiscal Code.
- July 15, in the tax report, in the case of taxpayers electing to file a tax report. If necessary, these taxpayers must file an amended tax return reflecting the transfer pricing adjustment.
- June 30, in the ordinary or amended tax return, as the case may be, for all other taxpayers.

No time limitation is set in the rules regarding adjustments **increasing revenues**. We understand this to mean that these adjustments must be recognized at any time, without regards to the above dates.

### **Deduction of Transfer Pricing Adjustments Resulting from Advanced Pricing Agreements with the Tax Administration**

Taxpayers making transfer pricing adjustments as a result of an advance pricing agreement (“APA”) with the Mexican tax administration or of a corresponding adjustment under Mexico's tax treaties are not subject to the above rules.

Further, the amended tax returns filed by these taxpayers to reflect the APA adjustments are not computed for purposes of the rule limiting to three times the right to file amended tax returns for each tax year.

The corresponding APA may provide that the transfer pricing adjustment takes place in tax years other than the year in which the effects of the original transaction were reported for tax purposes. In such an event, the APA may specify which of the requirements discussed above are to be complied with.

### **Qualifying Tax Years**

Although nothing is mentioned in the rules to the effect, it would appear that the adjustments contemplated in the rules apply for tax year 2016 only.

### **Examination Authority**

The tax administration expressly reserves the right –already included in their broad

examination powers under the Federal Fiscal Code- to examine these adjustments and related information.

### Further Guidance

Further guidance and clarifications are expected from the tax administration. We will keep you abreast of developments.

### BéndiksenLaw is Here to Assist You

Should you have any questions on the above or should you wish to implement one or more transfer pricing adjustments, or Transfer Pricing Area is prepared to be of assistance.

## CONTACT INFORMATION

For further information and questions, please feel free to contact us.

Jaime G Bendiksen [jbendiksen@bendiksenlaw.com](mailto:jbendiksen@bendiksenlaw.com)

Alejandro Enríquez-Mariscal [aenriquez@bendiksenlaw.com](mailto:aenriquez@bendiksenlaw.com)

Daniel Rangel Flores [drangel@bendiksenlaw.com](mailto:drangel@bendiksenlaw.com)

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