Mexican Income Tax Law – Articles 181-182, referring to transfer pricing in maquila operations

(Unofficial ECS Translation)

Article 181. A foreign resident will not be considered to have a permanent establishment in the country derived from the legal or economic relationships that they maintain with companies that carry out maquila operations, that usually process in the country goods or merchandise maintained in the country by the foreign resident, using assets provided directly or indirectly, by the foreign resident or any related enterprise, as long as Mexico has entered into, with the country of residence of the foreign resident, a treaty to avoid double taxation and the requirements of the treaty are met, including the friendly accords entered into in accordance with the treaty, in the way they have been implemented by the parties to the treaty, so that the foreign resident will not be considered to have a permanent establishment in the country. That established in this article will only be applicable as long as the companies that carry out maquila operations comply with article 182 of the present Law.

For effects of this article, operations that fulfill the following conditions will be maquila operations:

I. That merchandise supplied by the foreign resident in accordance with a maquila contract under the Maquila Program authorized by the Secretary of Economy, that they be subject to a process of transformation or repair, be imported temporarily and returned abroad, including via virtual operations, carried out in accordance with that established in the Customs Law and the general rules issued for such purpose by the Tax Administration Service (SAT). For that established in this section it is not necessary to return scrap and waste abroad.

The merchandise referred to in this section may only be the property of a third resident abroad when this has a commercial manufacturing relationship with the company resident abroad, which has a maquila contract with which it carries out the maquila operation in Mexico, as long as such merchandise is supplied for such commercial relationships.

For effects of this section, in order to be considered transformation, the processes carried out on the merchandise consist of: the dilution in water or in other substances; the washing or cleaning, including removing oxidation, grease, paint or other coverings; the application of preservatives, including lubricants, protective encapsulation or paint for preservation; adjustments, filing or cutting; dosage conditioning; packing, re-packing, wrapping or re-wrapping; conducting tests, and marking, labeling or classifying, as well as the development of a product, except for trademarks, commercial adverts, and commercial names.

II. That the totality of the income for the production activity be exclusively for the maquila operation.

III. That when the companies with the Maquila Program that carry out the transformation or repair processes referred to in section I of this article, incorporate into their productive processes domestic merchandise or foreign merchandise that is not imported temporarily, these should be exported or returned jointly with the merchandise that was imported temporarily.

IV. That the transformation or repair processes referred to in section I of this article be carried out with machinery or equipment that is the property of the foreign resident with which the companies operating with the Maquila Program have entered into the maquila contract, as long as they have not been property of the company that carries out the maquila operation or of another company resident in Mexico that is a related party.

The transformation and repair process may be completed with machinery or equipment property of a third foreign resident, that has a commercial manufacturing relationship with the foreign resident that in turn has a maquila contract with the company that carries out the maquila operation in Mexico, as long as such goods are supplied according to such commercial relationship, or if they are the property of the company that carries out the maquila operation, or with machinery and equipment rented from a third party. In no case may the machinery and equipment indicated be property of another company resident in Mexico of which the company that carries out the maquila operation is a related party.

That established in this section will be applicable as long as the resident abroad with which the maquila contract is entered into is the owner of at least 30% of the machinery and equipment used in the maquila operation. The percentage mentioned will be calculated in accordance with the general rules that for such effect the Tax Administration Service (SAT) may issue.

The transformation or repair of merchandise whose sale is carried out domestically and is not supported by an export request will not be considered a maquila operation, and therefore that established in article 182 of this Law will not be applicable.

Article 182. For effects of article 181 of this Law, it will be considered that the companies that carry out maquila operations comply with that established in articles 179 and 180 of the Law and that the foreign residents for whom they act will not have a permanent establishment in the country, when the maquila companies determine their taxable profits as the greater quantity that results from applying the following:

I. 6.9% of the total value of the assets used in the operation of the maquila during the fiscal year, including those that are property of the entity resident in the country, residents abroad, or any of their related parties, even when they have been provided in temporary use or enjoyment to the maquila.

It is understood that the assets are used in the maquila operation when they are located in Mexico and are used entirely or partly for such operation.

The assets referred to in this section may be considered only in the proportion in which they are being used as long as authorization is obtained from the tax authorities.

a) The entity resident in the country may exclude from the calculation referred to in this section the value of the assets that have been rented from related parties resident in Mexico or unrelated parties resident abroad, as long as the rented goods have not been their property or that of their related parties resident abroad, except when the sale of which has been established in accordance with articles 179 and 180 of this Law.

The value of the assets used in the maquila operation, property of the entity resident in Mexico, will be calculated according to the process established by the Tax Administration Service (SAT) via general rules.

The value of the fixed assets and inventories that are the property of residents abroad, used in the operation in question, will be calculated according to the following:

1. The value of inventories of raw materials, semi-finished goods and finished goods, using the sum of the monthly average of such inventories, corresponding to all months in the year and dividing the total by the number of months included in the year. The monthly average of the inventories will be determined using the sum of such inventories at the beginning and at the end of the month and dividing the result by two. The inventories at the beginning and at the end of the month should be valued according to the method that the entity resident in Mexico uses based on the value that for such inventories would have been assigned in the accounting of the owner of the inventories at the time they are imported to Mexico. Such inventories will be valued according to the generally accepted accounting principles in the United States of America or the international generally accepted accounting principles when the owner of the goods resides in a country that is not the United States of America. For the case of the value of semi-finished or finished

products, processed by the entity resident in Mexico, the value will be calculated considering only the value of the raw materials.

When the monthly averages referred to in the previous paragraph are denominated in U.S. dollars, the entity resident in Mexico should convert them to the domestic currency, using the exchange rate published in the Official Gazette current the last day of the corresponding month. If the Bank of Mexico has not published such rate, the last rate published in the Official Gazette before the last day of the month will be applied. When the quantities referred to are denominated in a foreign currency different from the U.S. dollar, the aforementioned exchange rate should be multiplied by the equivalent in U.S. dollars of the relevant currency, according to the table published by the Bank of Mexico in the month immediately following that which corresponds to the importation.

2. The value of the fixed assets will be the amount pending to be deducted, calculated according to the following:

   i) The amount of the acquisition of such goods by the resident abroad will be considered the amount of the original acquisition.

   ii) The amount pending to be deducted will be calculated by subtracting from the original amount of the investment, determined according to that established in the preceding point, the amount that results from applying to this last amount the maximum percentages authorized established in articles 34, 35, 36, 37 and others applicable from this Law, as corresponds to the good in question, without in any case being able to apply that established in article 51 of the Mexican Income Tax Law in force until 1998 or in article 220 of the cited Law in force until December 31 2013. For effects of this section, the deduction for complete months should be considered, from the date on which they were acquired until the last month of the first half of the year for which the taxable profit is being determined. When the good has been acquired during such year, the deduction will be considered for complete months, from the date of acquisition of the good until the last month of the first half of the period in which the good has been destined to the operation in question in the referred to year.

   In the case of the first and last year in which the good is used, the average value of the same will be determined by dividing the result mentioned before by twelve and the quotient will

be multiplied by the number of months the good has been used in such years.

The amount pending to be deducted calculated according to this section of the goods denominated in U.S. dollars will be converted to the domestic currency using the exchange rate published in the Official Gazette as of the last day of the last month corresponding to the first half of the year in which the good has been used. In the case that the Bank of Mexico has not published such exchange rate, the last published exchange rate will be used. The conversion to U.S. dollars referred to in this paragraph, of the values denominated in other foreign currencies, will be carried out using the equivalent in U.S. dollars of this last currency according to the table published monthly by the Bank of Mexico during the first week of the month immediately following the corresponding month.

iii) In no case will the amount pending to be deducted be lower than 10% of the amount of the acquisition of the goods.

3. The entity resident in Mexico may opt to include expenses and deferred charges in the value of the assets used in the maquila operation.

   The entities resident in Mexico should have at the disposition of the tax authorities the corresponding documentation in which, in such case, the values described in numbers 1 and 2 of section I of this article. It will be considered that the obligation to have at the disposition of the tax authorities the documentation referred to previously when, in such case, such documentation is provided to the authorities within the term provided in the tax regulations.

II. 6.5% of the total costs and expenses of the operation in question, incurred by the entity resident in Mexico, determined in accordance with the financial information regulations, including those incurred by the resident abroad, except for the following:

1. The value corresponding to the acquisition of the merchandise will not be included, nor will raw materials, semi-finished or finished product, used in the maquila operation, carried out independently by residents abroad.

2. The deduction of investments in fixed assets, expenses and deferred charges property of the maquila company, destined for the maquila operation, will be calculated applying that established in this Law.

3. The effects of inflation considered in the financial information regulations should not be considered.
4. Financial expenses should not be considered.

5. Extraordinary or non-recurring expenses of the operation in accordance with the financial information regulations should not be considered. Those expenses for which, in accordance with the financial information regulations, reserves and provisions have been established and for which the maquila company has liquid funds expressly destined for such payment, will not be considered extraordinary expenses. When the taxpayers have not created such reserves and provisions and for which the maquila company has liquid funds expressly for such payment, the payments that are carried out for concepts regarding which such reserves and provisions should have been created will not be considered extraordinary expenses.

   The concepts referred to in this number should be considered in their historical value, without actualization for inflation, except for that established in number 2 of this section.

For effects of this section only expenses carried out abroad by residents abroad for the concept of services directly related with the maquila operation for expenditures carried out on behalf of the entity resident in Mexico to cover its own obligations contracted domestically, or expenditures of expenses incurred by residents abroad for personal services provided in the maquila operation, when the stay of the service provider in Mexico is more than 183 days, consecutive or not, in the last 12 months, in terms of article 154 of this Law.

For effects of the calculation referred to in the previous paragraph, the amount of the expenses incurred by residents abroad for personal subordinate services related with the maquila operation, that are provided or taken advantage of in Mexico, should consist of the total of the salary paid during the tax year in question, including any of the benefits indicated in the general rules that for this purpose are issued by the Tax Administration Service (SAT), granted to the person.

When the person providing the personal subordinate service is a resident abroad, the place for applying that established in the previous paragraph may be considered proportionately, regarding the expenses referred to in the cited paragraph. To obtain this proportion the total amount of the salary received by the physical person during the tax year in question should be multiplied by the quotient that results from dividing the number of days that the person has stayed in Mexico by 365. The number of days that the person has remained in Mexico will be those where the person was

physically present in the country, as well as the Saturdays and Sundays for each 5 working days within the country, vacation days when the person has remained in Mexico for more than 183 days in a period of 12 months, short term interruptions of labor, as well as sick days.

The entities resident in Mexico that opt to apply that established in this section will provide to the tax authorities a document in which they show that the taxable profits of the year represented at least the greater quantity that results from applying that established in sections I and II of this article, at the latest within the 3 months following the date at which such tax year ends.

The companies with a maquila program that apply that established in this article, should provide to the tax authorities annually, at the latest in the month of June of the year in question, an informative declaration of its maquila operations in the terms established by the Tax Administration Service (SAT) via general rules.

The entity resident in Mexico may obtain an individual resolution in terms of article 34-A of the Federal Tax Code in which it is confirmed that it complies with articles 179 and 180 of this law. Such individual resolution will not be needed to satisfy the requirements of this article.

The entities resident in Mexico that may have opted to apply that established in this article will be excepted from the obligation of presenting the informative declaration indicated in section X of article 76 of this Law, only for the maquila operation.

The entities resident in Mexico that carry out, in addition to the maquila operation referred to in article 181 of the present Law, activities other than that, may apply that established in this article only for the maquila operation.