

Relevant Excerpts from the Mexican Income Tax Law as published in the Official Gazette on December 11, 2013 regarding Transfer Pricing

Unofficial translation by ECS

Title II: Entities

Chapter IX: On the Obligations of Entities

Article 76. The taxpayers which obtain income of the type indicated in this Title, in addition to the obligations established in other articles of the Law, will have the following:

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IX. Regarding taxpayers that carry out transactions with related parties resident abroad, obtain and maintain the corroborating documentation, with which they demonstrate that the amount of their income and deductions were determined in accordance with the prices or amounts of considerations that would have been used by independent parties in comparable transactions, which should contain the following information:

- a) The name, business name or denomination, domicile and tax residence, of the related parties with which it carried out transactions, as well as the documentation which shows the direct and indirect participation between the related parties.
- b) Information regarding the functions or activities, assets used and risks assumed by the taxpayer for each type of transaction.
- c) Information and documentation on the transactions with related parties and their amounts, for each related party and for each type of transaction in accordance with the classification and with the information established in article 179 of this Law.
- d) The method applied in accordance with article 180 of this Law, including the information and documentation on comparable transactions or companies for each type of transaction.

The taxpayers that carry out business activities whose income in the tax year immediately prior did not exceed \$13,000,000.00, as well as the taxpayers whose income derived from the provision of professional services have not exceeded in such year \$3,000,000.00 are not obliged to comply with the obligation established in this section, except those that are in the situation referred to in the penultimate paragraph of article 179 of this Law.

The exercise of the powers of inspection regarding the obligation established in this section may only be carried out for completed tax years.

The documentation and information referred to in this section should be recorded in the accounting, identifying in the same that it refers to transactions with related parties resident abroad.

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XII. Regarding entities that carry out transactions with related parties , these should determine their income and authorized deductions considering for these transactions the prices and amounts of considerations that would have been used with or between independent parties in comparable transactions. For such effects, the methods established in Article 180 of this Law will be applicable, in the order established in such article.

Title VI: On Preferential Tax Regimes and Multinational Enterprises

Chapter II: On Multinational Enterprises

Article 179. The taxpayers of Title II of this Law that carry out transactions with related parties resident abroad are obliged, for effects of this Law, to determine their income and authorized deductions considering for these transactions the prices and amounts of considerations that would have been used with or between independent parties in comparable transactions.

To the contrary, the tax authorities may determine the income and authorized deductions of the taxpayers, by means of the determination of the price or amount of the consideration in transactions carried out between related parties, considering for these transactions the prices and amounts of considerations that would have been used by independent parties in comparable transactions, whether these are entities resident in the country or abroad, individuals or permanent establishments in the country of foreign entities, as well as in the case that the activities are carried out by way of trusts.

For effects of this Law, it is understood that the transactions or the enterprises are comparable when there are no differences between these that significantly affect the price or amount of the consideration or the profit margin to which the methods established in article 180 of this Law, and when such differences exist, they may be eliminated using reasonable adjustments. To determine such differences, the pertinent necessary elements should be considered, in accordance with the method applied, considering, among others, the following elements:

- I. The characteristics of the transactions, including:
 - a. Regarding financing transactions, elements such as the amount of principal, term, guarantees, solvency of the debtor, and the interest rate.
 - b. Regarding the provision of services, elements such as the nature of the service, whether the service involves experience or technical knowledge, or not.
 - c. Regarding the use, enjoyment or sale of tangible goods, elements such as the physical characteristics, quality and availability of the good.
 - d. Regarding the sale of shares, elements such as the updated shareholder's equity of the issuer, the present value of the profit or projected cash flows or the last stock market quote on the day of the sale of the issuer.
- II. The functions or activities, including the assets used and risks assumed in the transactions, of each of the parties involved in the transaction.
- III. The contractual terms.
- IV. The economic circumstances.
- V. The business strategies, including those related to market penetration, permanence or growth.

When the business cycles or commercial acceptance of a taxpayer's product covers more than one year, comparable transactions corresponding to two or more years, prior or subsequent, may be used.

It is considered that two or more entities are related parties when one participates directly or indirectly in the administration, control or capital of the other, or when an entity or group of entities participate directly or indirectly in the administration, control or capital of such entities. Regarding associations in participation, the participants are considered related parties, as well as the entities which in accordance with this paragraph are considered related parties to such participant.

For a permanent establishment, the headquarters or other permanent establishments of the same, as well as the entities indicated in the previous paragraph and their permanent establishments, are considered related parties.

Unless proven otherwise, it is presumed that the transactions between Mexican residents and associations or entities subject to preferential tax regimes, are between related parties in which the prices and amounts of the considerations are not established according to those that would have been used by independent parties in comparable transactions.

For the interpretation of that established in this Chapter, the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, approved by the Committee of the Organization for Economic Cooperation and Development in 1995, or those which substitute them, to the extent that they are consistent with that established in this Law and the treaties entered into by Mexico.

Article 180. For effects of that established in article 179 of this Law, taxpayers should apply the following methods:

- I. Comparable uncontrolled price method, which consists in considering the price of the amount of the considerations that would have been established with or between independent parties in comparable transactions.
- II. Resale price method, which consists in determining the price of acquisition of a good, the provision of a service or the consideration for any other transaction between related parties, multiplying the resale price, or for the provision of the service or the transaction in question, by the result of subtracting from 1 the percentage of gross profit that would have been established with or between independent parties in comparable transactions. For effects of this section, the percentage of gross profit will be calculated dividing the gross profit by the net sales.
- III. Cost plus method, which consists in determining the sales price of a good, of the provision of a service or of the consideration of any other transaction, between related parties, multiplying the cost of the good, the service or the transaction in question by the result of adding to 1 the percentage of gross profit that would have been established with or between independent parties in comparable transactions. For effects of this section, the percentage of the gross profit will be calculated by dividing the gross profit by the cost of sales.
- IV. Profit split method, which consists in assigning the operating profit obtained by related parties, in the proportion that would have been assigned with or between independent parties, in accordance with the following:
 - a. The profit of the global transaction will be determined with the sum of the operating profit obtained by each of the related parties involved in the transaction.

- b. The global operating profit will be assigned to each of the related parties considering elements such as assets, costs and expenses of each of the related parties, regarding the transactions between such related parties.
- V. Residual profit split method, which consists in assigning the operating profit obtained by related parties, in the proportion that would have been assigned with or between independent parties in accordance with the following:
 - a. The profit of the global transaction will be determined with the sum of the operating profit obtained by each of the related parties involved in the transaction.
 - b. The global operating profit will be assigned as follows:
 - 1. The minimum profit that corresponds to each of the related parties will be determined by way of the application of any of the methods to which sections I, II, III, IV, and VI of this article refer, without considering the use of significant intangibles.
 - 2. The residual profit will be determined, which will be obtained by subtracting the minimum profit referred to in part 1 above from the global operating profit. This residual profit will be distributed between the related parties involved in the transaction considering, among other elements, the significant intangibles used by each of them, in the proportion in which they would have been distributed with or between independent parties in comparable transactions.
- VI. Transactional net margin method, which consists in determining in transactions between related parties, the operating profit comparable companies or independent parties would have obtained in comparable transactions, based on the profitability factors that consider variables such as assets, sales, costs, expenses or cash flows.

From the application of any of the methods indicated in this article, a range of prices, amounts of considerations or profit margins may be obtained, when two or more comparable transactions exist. These ranges will be adjusted by the application of statistical methods. If the taxpayer's price, amount of the consideration or profit margin are within these ranges, such prices amounts or margins will be considered as established or used between independent parties. If the taxpayer is outside of the adjusted range, it will be considered that the amount of the consideration that would have been used by independent parties is the median of such range.

Taxpayers should use in the first place the method established in section I of this article, and may only use the methods indicated in sections II, III, IV, V, and VI of the same, when the method established in the cited section I is not appropriate to determine that the transactions carried out are at arm's length in accordance with the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations referred to in the last paragraph of article 179 of this Law.

For effects of the application of the methods established in sections II, III, IV and VI of this article, it will be considered that the methodology is correct as long as it is shown that the cost and the sales price are at market prices. For these effects, market prices will be understood as the prices and amounts of considerations that would have been used with or between independent parties in comparable transactions or when the taxpayer has received a favorable resolution in the terms of article 34-A of the Federal Fiscal Code. It should be demonstrated that the method used is the most appropriate or the most reliable according to the information available, giving preference to the methods established in sections II and III of this article.

For effects of this article and article 179 of this Law, the income, costs, gross profit, net sales, expenses, operating profit, assets and liabilities, will be determined based on the financial information norms.