The Transfer Pricing Law Review

Seventh Edition

Editors

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PREFACE

It has been a great pleasure to edit this seventh edition of *The Transfer Pricing Law Review*. This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered in the *Review*. Each chapter summarises the country's substantive transfer pricing rules, explains how a transfer pricing dispute is handled, from initial scrutiny through to litigation or settlement, and discusses the interaction between transfer pricing and other parts of the tax code (such as withholding taxes, customs duties and attempts to prevent double taxation).

Other than Brazil, all the countries covered in this *Review* apply an arm's-length standard and adhere, at least to some extent, to the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines); and Brazil itself is moving towards greater alignment of its TP rules with the OECD norm. However, as the chapters make clear, there remains significant divergence, both in countries' interpretation of the arm's-length standard (e.g., the transactions it applies to, the pricing methods preferred and whether secondary adjustments are imposed) and in the administration of the rules (e.g., the documentation requirements imposed and the availability of APAs). Therefore, transfer pricing practitioners cannot simply assume that the OECD Guidelines contain all the answers, but must engage with their detailed application within each country.

Given their economic importance, transfer pricing rules will be high on the corporate tax agenda (and the broader political agenda) for many years to come, and they are continuing to evolve at a rapid pace. Over the next few years, we expect the following to be among the main areas of focus.

First, as many of the chapters make clear, litigation over transfer pricing disputes is becoming ever more common. Some countries have a long record of transfer pricing litigation and have resolved many of the procedural hurdles in asking a court to rule on exactly where value is created in a multinational; for example, the approach to handling (often conflicting) expert evidence and the challenge of developing factual evidence in a proportionate but comprehensive way. However, this clearly results in lengthy – and costly – hearings before the tax tribunals and many other countries will soon find themselves grappling with transfer pricing litigation for the first time.

Second, the fact-heavy nature of transfer pricing disputes means that they often take many years to reach resolution; for example, the US Tax Court judgment in *3M*, published in February 2023, involved an appeal lasting 10 years, and the UK authorities have confirmed that it now takes five years to agree an 'average' advance pricing agreement, compared to under three years in 2018/19. This can make it difficult to ensure that accurate evidence

is available – either because people have left the business or simply due to the vagaries of memory – and make it ever more important that high quality transfer pricing documentation is prepared in real time.

Third, in the *Fiat Chrysler* judgment, published in November 2022, the Court of Justice of the European Union appears to have rejected the European Commission's suggestion that there is an 'autonomous' EU arm's-length standard, holding instead that transfer pricing standards are set at the national level. (We are still waiting, however, for the Court of Justice to confirm whether this means that the €13 billion *Apple* case also needs to be decided against the Commission.) The *Fiat Chrysler* judgment reduces the ability of the European Commission to act as an additional transfer pricing watchdog, but also means that (pending any harmonisation through EU legislation) taxpayers will need to grapple with 27 separate transfer pricing regimes across the European Union.

Finally, the OECD/G20 project to address the tax consequences of digitalisation continues to progress. If it is ever implemented, which looks increasingly unlikely, Pillar One would mark a radical pivot away from the arm's-length standard for large and highly profitable multinationals, so that a portion of their profits (above a 10 per cent hurdle rate) would automatically be reallocated to market jurisdictions. The Pillar Two 'minimum tax' reforms are much more likely to be implemented; for example, the European Union has already adopted a Pillar Two Directive, and the first part of the UK Pillar Two rules is included in the Finance Bill currently before Parliament. Pillar Two, as merely a minimum tax measure, has a less radical impact on transfer pricing than the Pillar One proposals; nevertheless, there will be many issues to work through here in the future. For example, what happens if a transfer pricing adjustment in country A, after several years of debate, finally causes the group's effective tax rate in country A to increase above 15 per cent? Will any countries that have levied Pillar Two tax on the group, through the income inclusion or undertaxed payment rules, be obliged to reverse this Pillar Two charge?

We would like to thank the authors of each of the chapters for their comprehensive and illuminating analysis of each country's transfer pricing rules, and the publishing team at Law Business Research for their diligence and enthusiasm in commissioning, coordinating and compiling this *Review*.

Steve Edge and Dominic Robertson
Slaughter and May
London
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Chapter 11

MEXICO

Eduardo Michán and Ivonne Montaño[1]

I OVERVIEW

Pursuant to Article 179 of the Mexican Income Tax Law (MITL), Mexican resident individuals and entities that execute related party transactions are required to determine their taxable income and authorised deductions based on the prices, considerations or profit margins, as applicable, which would have been used or obtained in the context of comparable transactions with independent parties.

For such purposes, the MITL establishes that a Mexican resident entity will be a related party of another whenever:

a one party participates, directly or indirectly, in the management, control or capital stock of the other party; or

b a person or group of persons, directly or indirectly, participates in the management, control or capital stock of both parties.

The MITL also provides specific definitions of what should be understood for related parties of Mexican resident individuals, permanent establishment of foreign residents (PE), joint ventures, non-for-profit entities and foreign residents without a PE in Mexico.

Under the MITL, there is no *de minimis* threshold as to the level of participation (in the management, control or capital stock) required for two parties to qualify as related parties. Any level of involvement or participation in the management, control or capital stock, provided by the Mexican tax law, would result in them being defined as related parties.

A transaction is comparable when:

a there are no differences that could have a material effect on the price under the transfer pricing (TP) methods established in the MITL; or

b the taxpayer could make reasonably adjustments to eliminate the material differences.

Depending on the TP method applied, the following aspects must be considered to determine whether such differences exist:

a characteristics of the transaction (e.g., goods' physical characteristics, quality or availability);

b functions, assets and risks assumed by each party;

c the contractual terms;

d economic circumstances; and

e business strategies.

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The MITL provides that the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Guidelines) published in 1977 and any successor guidelines should apply for the construction of domestic TP analysis to the extent that they do not contravene domestic law or Mexican international treaties.

II FILING REQUIREMENTS

Mexican resident taxpayers are required to comply with the following obligations impacting or revealing their TP position.

i TP information

Taxpayers must keep all the documentation evidencing that their controlled transactions complied with the arm's-length principle (which should describe the transaction, assets, functions, risks involved and TP method used) and register it within their accounting records.

ii Multiple informative return

Taxpayers are to submit, by 15 May of each year at the latest, an informative return with the information on the related party transactions of the previous fiscal year.

iii Tax report

Mexican resident individuals and entities that, in the previous fiscal year, had substantial taxable income, assets or personnel can opt to audit their financial statements by a registered accountant (CPA) who will prepare a tax report revealing the compliance, among others, with formal TP obligations and is to submit it by 15 May of each year.

iv Tax situation return

Taxpayers who are related parties of those obliged to file a tax report are to submit the tax situation return (DISIF) by 31 March of each year disclosing their compliance with TP provisions.

v Master file, local file and country-by-country report

As a result of Action 13 of the Base Erosion and Profit Shifting (BEPS) project, Mexico now complies with these reporting obligations. Therefore, taxpayers who are obliged to file the DISIF must file a master file (MF) and local file (LF). In addition, holding companies of a multinational group with income equal to or higher than US$600 million must file a country-by-country report (CbCR).

III PRESENTING THE CASE

i Pricing methods

Mexican taxpayers are required to apply the following TP methods with respect to their related party transactions:

a comparable uncontrolled price method (CUPM);
b resale price method (RPM);
c cost plus method (CPM);

d profit split method (PSM);
e residual profit split method (RPSM); and
f transactional net margin method (TNMM).

Since 2006, taxpayers have been required to prioritise the use of the CUPM. Consequently, the taxpayer may only apply the other TP methods to the extent that the CUPM cannot be used based on the specifics of a given transaction. Furthermore, if the CUPM is deemed inappropriate, RPM or CPM must be first considered over other transactional profit methods. Taxpayers must be able to justify why a given method was discarded and to provide reasons as to why their choice produced the most adequate and reliable results.

The Mexican Tax Administration Service (SAT) focuses on comparables, and taxpayers should be able to justify in their TP studies and within documentation, which requests any TP adjustment or settlement, the comparables that were chosen and the rationale behind that choice.

ii Authority scrutiny and evidence gathering

According to the Internal Regulations of the SAT, the General Administration for Large Taxpayers is the authority empowered to:

a interpret and apply tax treaties to determine TP considerations;
b issue opinions on TP methodologies;
c resolve tax rulings on TP methodologies; and
d verify the taxable income and authorised deductions applied on related party transactions, regardless of the revenue, assets or other economic factors.

On the basis of the above, the SAT is vested with the authority to reassess the taxable income and authorised deductions under the conditions that would have been used in uncontrolled transactions, for entities, individuals and foreign residents with PE or activities made through trusts.

For these purposes, taxpayers can review their position and, if the relevant consideration is determined not to comply with the arm's-length principle and has a new TP analysis supporting this conclusion, can change their taxable income or authorised deductions for their current and future operations to be compliant with the new TP analysis.

The SAT considers an undue tax practice and the application of an undue advantage occur when the taxpayer modifies the considerations if they are already within the corresponding TP ranges. Therefore, taxpayers should not change them according to their own discretion, even though such a modification benefits the tax authority. If a taxpayer conflicts with the position adopted by the SAT, the CPA must reveal this position within the tax report to be submitted before the SAT.

If a TP adjustment is needed, the Administrative Tax Resolution for 2023 (ATR 2023) foresees a mechanism under which taxpayers can modify the taxable income or authorised deductions to reflect the economic conditions that they would have used with independent parties in comparable transactions, irrespective of whether an exchange of cash or material resources exist along with the adjustment.

If the adjustment impacts the taxpayer's tax and accounting information, it will be deemed real. However, if it only affects the tax field, the adjustment will be considered virtual. The TP adjustments have the same nature of the transaction, subject to the adjustment.

Regardless of the classification of the relevant adjustment as real or virtual, these adjustments may be:

a voluntary or compensatory: the adjustment is reflected before a taxpayer files his or her annual income tax return, either a regular or amended one; and

b primary: the adjustment results from the SAT's auditing powers, modifying the consideration of a controlled operation executed with a national or foreign-related party to be compliant with the arm's-length principle. This primary adjustment may generate, in turn, a domestic or foreign correlative adjustment for the related counterparty to the transaction:
  - national correlative, which is the adjustment that a Mexican tax resident could apply; and
  - foreign correlative, which is the adjustment that a Mexican tax resident or a foreign resident with a PE could apply as a consequence of a primary adjustment applied to a related foreign party. This adjustment will proceed provided that this foreign party resides in a jurisdiction with a double tax treaty in force with Mexico, and such a treaty foresees the determination and application of TP adjustments.

When the TP analysis results in an increase of the consideration, the taxpayer who has obtained the taxable income will have to increase his or her taxable income within its annual income tax return and the nominal income for his or her monthly advanced income tax return in the month when the adjustment is made. In contrast, the taxpayer who has applied the authorised deductions due to the reviewed operation may increase these deductions by an amount equivalent to the adjustment, provided that certain requirements are met.

On the contrary, if the analysis results in a decrease of the consideration, taxpayers who have obtained the taxable income related to the referred transaction could increase their authorised deductions by an amount equivalent to the adjustment, provided that certain requirements are met. Taxpayers who have applied authorised deductions derived from this transaction are to reduce these deductions by an amount equivalent to the adjustment.

Despite the modification to the taxpayer's tax returns, these changes will also impact several tax attributes (e.g., the after-tax profit account and restarting the statute of limitations term).

IV INTANGIBLE ASSETS

The Mexican tax authorities follow the international standard of identifying and assessing the development, enhancement, maintenance, protection and exploitation (DEMPE) functions within the use of an intangible asset in controlled transactions.

The SAT considers it an undue tax practice when the taxpayer does not recognise within its TP determination:

a the value and unique contribution of an intangible;

b the creation or use of intangibles; and

c the comparability factors provided by such intangible on defining a competitive advantage for the business.

Moreover, the tax authorities scrutinise the role of intangibles in the information that the taxpayers must reveal in their MF and LF, including:

a the intangibles used in all the controlled transactions and the main agreements involving intangibles (e.g., cost sharing, research and use);
b policies on research, development, and transfers of rights over intangibles;
c global and local strategy for the DEMPE functions;
d the rationale behind the assets used, functions made, risks assumed and the comparability analysis explaining the DEMPE examination; and
e the group's value generators manifested through intangibles.

Even though these returns should be filed electronically, taxpayers are to keep probatory elements to sustain the information expressed therein in an audit. Finally, the detailed description of the DEMPE functions also plays a key role in the analysis of:

a an advance transfer pricing agreement (APA);
b a bilateral APA (BAPA);
c a mutual agreement procedure (MAP); and
d conclusive agreements before the Mexican Tax Ombudsman Agency.

V SETTLEMENTS

i APA and BAPA

The APA is a unilateral procedure under which the SAT may resolve the taxpayer's queries regarding determining considerations in controlled transactions before an audit. The APA's resolution is valid for the fiscal year in which the taxpayer submitted the tax form, the previous fiscal year and the following three fiscal years to the extent that the same circumstances apply.

The SAT is to issue the APA's resolution within eight months (except when the SAT requires additional information, in which case the term is restarted). However, in practice, the resolution term will depend on how efficiently the information is shared between the SAT and the taxpayer. The assessment carried out by the SAT is made through a TP adjustment mechanism provided by the MITL; however, if a double taxation issue exists, it will remain because the resolution will not impact any other jurisdiction.

The BAPA is similar to the APA, but the difference resides in the simultaneous query made to the SAT and a foreign tax authority under a process set forth by a tax treaty concluded between Mexico and another state. Hence, the tax authorities from both countries will determine the proper TP methodology and the corresponding considerations under a coordinated effort that aims to eliminate any double taxation. The legal time period to resolve a BAPA should be eight months but, given its international nature, its resolution may take longer than two years. In contrast to the validity period of an APA, a BAPA could last more than four fiscal years depending on the agreement reached by the tax authorities.

The APA and BAPA will suspend the verification powers of the SAT to assess a tax liability from the filing date and up to when the final resolution is issued.

ii MAP

The MAP provisions must be followed when seeking to resolve tax disputes derived from applying a tax treaty provision that the taxpayer deems incorrect, which is not exclusive to TP matters. Mexico has included a MAP provision in all its treaties.

In contrast to the APA or BAPA cases, the MAP derives from an act of authority (e.g., an audit or the resolution of an APA or BAPA). The taxpayer is to submit a MAP request before the SAT whenever the disagreement occurs according to the domestic statute of limitations provisions and the rules stated in the relevant tax treaty. Several tax treaties provide that the MAP is admitted if it is filed within three years from the first notification of the action resulting in taxation.

As opposed to an APA or BAPA, the MAP will not suspend the auditing powers of the Mexican tax authorities and taxpayers are required to guarantee the tax liability during the period within which the MAP is reviewed.

According to the SAT, the MAP will not apply in the following cases:

a if it is based on a tax treaty not in force;
b if it is submitted out of the legal time period established by the tax treaty;
c if it does not expressly state what:
- the violation of the treaty is;
- the Article violated; and
- the taxpayer's opinion on the interpretation of the treaty;

d if it is related to taxes not covered by the treaty;
e it comprehends a matter of internal law that does not contravene any provision of a tax treaty;
f a conclusive agreement before the Tax Ombudsman Agency has been reached and signed by the taxpayer and the SAT;
g another MAP has resolved the concern if it relates to the same transaction and circumstances; and
h the matter of the MAP would have been definitively resolved in an appeal before the SAT or a trial before the Federal Tax Court.

The validity of a MAP resolution will depend on each case to the extent that the same circumstances apply in all the fiscal years. When it triggers a change in the TP methodology and the corresponding considerations of a controlled transaction, the taxpayer is to comply with the TP adjustments provisions and file an amended tax return recognising the correlative foreign adjustment, if any.

iii Conclusive agreements

A conclusive agreement procedure is a national mediation mechanism with the tax authorities regarding federal taxes that could involve TP matters and could be requested before the issuance of a final tax assessment. The SAT can accept or reject the taxpayer's remedy proposal but has the legal obligation to participate in the procedure, which should last no more than 12 months. This process suspends the SAT verification powers to assess a tax liability from the filing date and up to when the final resolution is issued.

The agreement that is reached is binding and unchallengeable for both parties, and what is agreed upon in one fiscal year does not constitute a precedent for other years. In the event of a partial agreement, the SAT can issue a formal tax assessment, considering what was not agreed upon, and the taxpayer is able to challenge the assessment.

VI INVESTIGATIONS

Under an APA, BAPA or MAP procedure, the SAT may initiate a functional analysis at the tax address of the taxpayer to obtain qualitative and quantitative information and documentation to prove the facts, circumstances and elements involved in these procedures. This functional analysis should be carried out in no more than 10 business days from the date it began and may include visual inspections, interviews and working groups with the taxpayer's personnel. This technical analysis does not imply the exercising of auditing powers by the SAT.

Moreover, tax authorities can issue non-official invitations (including queries on TP matters), which do not constitute a formal audit. However, the consequences of not replying or clarifying the taxpayer's situation can result in a further review or the cancellation of its digital seal to issue tax invoices.

Moving to formal auditing powers, the SAT could verify the compliance of TP obligations through an *in-situ* tax audit carried out in the taxpayer's tax domicile, a desk review performed by requesting taxpayers to submit information and documents at the tax authority's offices, or an electronic review through an examination of information already in possession of the SAT. The SAT's ability to impose sanctions or determine a tax assessment is limited to five years, which, under exceptional circumstances, could be extended to 10 years.

The authorities are bound to communicate the period and tax subject to review. Generally, audits must conclude in a one-year period, subject to certain exceptions. Additionally, the tax authority can request information from third parties, as well as from any joint obligors.

Once a taxpayer has been notified of a tax assessment, it has the option to file an administrative appeal directly with the SAT's legal branch. Within this appeal, the taxpayer has the right to exhibit further evidence not provided during the audit (this is the last procedural stage to do this) and is relieved from the obligation to provide a guarantee of the tax liability. This procedure should last 90 days; however, in practice, it can take from one to two years. If taxpayers obtain an unfavourable resolution, they can challenge both the resolution and the tax assessment in court.

VII LITIGATION

i Procedure

If taxpayers choose not to file an administrative appeal or they have obtained an unfavourable resolution, taxpayers can file a nullity claim before the Federal Tax Court where they can raise new arguments. In court, taxpayers are obliged to guarantee the tax liability (except under the substance over form trial) and they should submit the claim before the Federal Tax Court no later than 30 days after the challenged resolution has been issued. The process should last 190 days but, in practice, it could take from two to four years.

The Federal Tax Court is entitled to request, by the taxpayer's solicitation, the information that the SAT has in its possession. Either the SAT or the taxpayers have the right to offer expert reports. If the experts' opinions differ, a third expert witness, whose opinion will prevail over those appointed by the parties, can be appointed. Such opinions are commonly used in accounting and TP analysis.

Once the Federal Tax Court issues its resolution, taxpayers have the right to file a constitutional claim to challenge an unfavourable decision no later than 15 days after this decision, which should be theoretically solved by a federal court in 240 days (even when this process may take from one to three years).

If the constitutional trial is unfavourably resolved, taxpayers may file a last appeal before the Supreme Court of Justice. However, such appeals are only limited to constitutional matters and should be under exceptional circumstances.

ii Recent cases

During 2017 and 2018, several constitutional trials were filed in federal courts by taxpayers claiming that the MF, LF and CbCR violated the principles of territoriality, reasonableness and ability to pay because they imposed obligations that resulted in additional costs and disproportionate charges. In the first case, the courts sustained that these obligations derived from an international commitment of Mexico that they should not represent an extraordinary burden, due to the fact that the multinational group to which the taxpayer belonged should have already been in possession of the information. Hence, the taxpayers should not have been required to carry out an exhaustive search, making it impossible for them to comply with these obligations. Moreover, the reasonableness standards were not exceeded because these obligations are related to the attribution of the tax authority to:

a verify compliance with the arm's-length principle; and
b allow the identification of any tax avoidance or evasion risk.

In the second case, in January 2023, the Federal Tax Court issued a precedent stating that when the SAT audits, it is to recharacterise a transaction for tax purposes when:

a the economic essence of the operation differs from its form; or
b the agreements related to a transaction diverge from those that would have been adopted in an uncontrolled transaction even if form and substance do not differ.

Hence, for a correct TP assessment, the SAT can ignore the contractual operation and determine the economic substance and the TP effects of the underlying transaction.

VIII SECONDARY ADJUSTMENT AND PENALTIES

i Secondary adjustments

Secondary adjustments seek to align the effects derived from a TP adjustment to the economic or accounting reality between the parties that implemented the adjustments. The secondary adjustment implies recognising certain tax effects to a subsequent act of the transaction that was adjusted. In certain cases, secondary adjustments could be characterised as a deemed dividend, capital contribution or loan.

According to the ATR 2023, these adjustments result from applying a contribution after a voluntary or primary TP adjustment has been determined, which is generally considered as a deemed dividend. Under the ATR 2023 and Mexican tax law, the tax effects given as a deemed dividend to the following will be considered secondary adjustments:

a non-deductible interest if they were not determined at arm's length;
b certain profits paid to bondholders and other creditors;
c certain loans in favour of shareholders;
d non-deductible expenses benefitting the shareholders of an entity;
e income omissions or purchases not made and improperly registered;
f the profit modification carried out through a TP adjustment process; or
g the profit presumptively determined by the tax authorities.

ii Penalties

If any tax that has resulted from the omission to recognise any income or for applying non-allowed deductions under an incorrect TP determination, unpaid taxes are subject to inflationary adjustments and to monthly surcharges (i.e., 1.47 per cent in 2023) for a maximum of five years as a general rule.

Additionally, tax authorities may impose fines that range from 55 per cent to 75 per cent of the unpaid tax. Under certain circumstances, the fines can be increased due to aggravating conducts, thus increasing the fines for an additional 50 per cent to 75 per cent of the historic amount of tax due and the fines could also be subject to inflationary adjustments. If the same act is subject to multiple fines, the taxpayer is only obligated to pay the fine with the highest value.

Moreover, failure to comply with the formal obligations for TP purposes will also imply the imposition of a wide range of fines. For these cases, the taxpayers could follow the same defence pathway that was described for tax assessments (i.e., administrative appeal, nullity claim and constitutional trial).

IX BROADER TAXATION ISSUES

i Diverted profits tax, digital sales taxes and other supplementary measures

Mexico does not have a diverted profit tax in force, and even though Mexico has imposed value-added tax (VAT) and income tax obligations to foreign platforms selling goods and rendering services within Mexican territory since 1 June 2020, it does not have an interaction with TP rules. However, the Mexican government has implemented other measures to review and control the taxpayers' transactions that may impact their TP position.

One procedure that could supplement TP measures is the general anti-avoidance rule (GAAR) according to which the SAT could perform a legal restatement for transactions lacking business reasons. The tax authorities use two presumptions unless proven otherwise. A presumable lack of business reason shall exist when:

a the reasonably expected economic benefit is lower than the tax benefit; or
b upon performing a series of transactions, the taxpayer could have obtained the same reasonable expected economic benefit through fewer steps, and the tax effect thereof would have resulted in a higher tax burden.

Furthermore, a reasonably expected economic benefit may arise from transactions seeking to maximise income, reduce costs, increase the value of goods and strengthen a market position. The tax authorities analyse contemporary documentation (including projected economic benefits if they are supported and reasonable) to quantify the expected economic benefit for which TP rules could be useful.

Another measure is the simulation test to be performed by the tax authorities under which they could determine the simulation of acts from a tax perspective in a related party transaction. Upon determining a tax simulation, the authorities must:

a identify the simulated act and the one executed;
b quantify the tax benefit obtained because of the simulation; and
c identify the elements used by the tax authority to determine the existence of the tax simulation, including the party's intention to simulate.

A third measure is that of the mandatory reportable schemes rules. For these purposes, tax advisers and taxpayers should reveal a transaction that derives from a project, plan or advice for materialising a series of legal acts that have one of 14 reportable features, generating a tax benefit. One of the reportable arrangements applies in certain related party transaction.

ii Tax challenges arising from digitalisation

As a member of the OECD Inclusive Framework, Mexico has expressed its political commitment to incorporate the provisions relating to Pillars One and Two within the Mexican law. However, neither Pillar One nor Two-related provisions (except for certain deductibility limitations on payments to foreign taxpayer related parties effective since 2020) have been formally introduced.

The impact foreseen due to the implementation of these provisions will be of great importance on TP matters, particularly when Amount B must be determined within the Pillar One proposal or in the determination of the considerations that must be taxed under the global minimum tax of Pillar Two.

An element that was aligned with this commitment is the ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) by the Senate and its deposit before the OECD in March 2023, which gives a particular emphasis to the dispute resolution mechanisms that will be essential in the implementation of both Pillars.

iii Transfer pricing implications of covid-19

Even though there have been no tax bills, TP or tax measures arising from the covid-19 pandemic in Mexico, the auditing procedures performed by the SAT have intensified.

According to the Inspection Master Plan for 2023 published by the SAT, a key verification action for 2023 will be the analysis and programming of atypical items of income and expenses. Additionally, international business restructurings, operations with shareholders and related companies, and payment to foreign parties will be subject to significant scrutiny continuing with the trend observed in recent years.

iv Double taxation

Under the MAP Peer Review,[2] almost half of Mexico's tax treaties provide that the MAP is to be implemented no later than four and a half years after the tax return containing the concern was filed or due to be filed. Notwithstanding, under the MLI provisions, most of these treaties should adopt the current provisions of Article 25(2) of the Model Tax Convention on Income and on Capital (2017), which states that any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the states.

Notably, the SAT is not bound to a legal time period to resolve a MAP because the resolution depends on the capabilities and efficiency of both tax authorities to share information. Moreover, tax authorities are not obliged to achieve a positive outcome in the MAP, and in the event of an unsuccessful outcome for the taxpayer, it may invoke the national judicial protection through a claim or a constitutional trial, depending on the arguments sustained and on the time constraints related to this judicial stage.

2 Making Dispute Resolution More Effective – MAP Peer Review Report, Mexico (Stage 2) published by the OECD on 15 April 2021.

Alternatively, the taxpayer may turn to arbitration, which is covered by 11 of more than 60 Mexican tax treaties, to achieve an agreement in the event of an unsatisfactory MAP resolution. Taxpayers are not allowed to choose arbitration if they have already initiated a national judicial procedure. Even in the event that the arbitration is followed, the resolution could be unfavourable to the taxpayer, resulting in double taxation that cannot be resolved.

v Consequential impact for other taxes

When the taxpayer modifies his or her taxable income or authorised deductions from a TP adjustment, the VAT and excise tax (if any), which is triggered on the relevant transaction, will also be modified. When the taxable income increases, the value of the acts or activities subject to VAT also increases, and when taxpayers reduce their deductions, the creditable VAT considered initially also diminishes by applying a factor (resulting from dividing the adjustment amount between the total amount of the operation without any adjustment) to the creditable VAT or excise tax amount reflected in the corresponding return.

X OUTLOOK AND CONCLUSIONS

Mexico is committed to implementing TP formal and substantive rules seeking compliance with the arm's-length principle. Moreover, Mexico has adopted international standards on TP matters, such as the methods, adjustment mechanisms and rules on intangibles.

In addition to the regulation, Mexican tax authorities carefully audit and scrutinise the taxpayers' position on TP matters by applying regular auditing procedures and consequential and supplementary measures, in line with their anti-avoidance or anti-abuse objectives. As a result, tax authorities can assess penalties and tax liabilities for income tax that may impact other taxes.

Despite these broad auditing powers, taxpayers can challenge the assessments through a diverse set of judicial and extra-judicial procedures in the domestic or international arena.

The current circumstances that impact global economies or the continuous and evolving international tax regulations can only guarantee the development of new TP legislation. Nevertheless, it is also foreseeable that Mexico will adopt these measures to ensure due compliance with the arm's-length principle.