



## Mexico publishes final master file, local file, and CbC report rules

### Global Transfer Pricing Alert 2017-017

Mexico's Tax Administration Service (SAT) on April 12 published on its website the final compliance rules regulating the contents and filing of the master file, local file, and country-by-country (CbC) report, as well as a report on the public consultation conducted by the Taxpayer's Ombudsman Office (*Procuraduría de la Defensa del Contribuyente* or PRODECON), concluding a process that began in October 2016. These rules are considered official under the terms of Rule 1.8 of the Fiscal Miscellaneous Resolution.

Article 76-A of the Mexican Income Tax Law (MITL) requires that for fiscal year 2016, companies that enter into transactions with related parties (in Mexico or abroad) and receive revenue<sup>1</sup> equivalent to or greater than MXN 686,252,580 (approximately USD 37 million) must file a master file and a local file. In addition, Mexican multinational enterprise (MNE) groups that receive revenue equal to or higher than MXN 12,000 million (approximately USD 648 million) also must file a CbC report.

The published rules simplify the fulfillment of the filing obligations by concluding that taxpayers are not obligated to provide certain documentation, and in some specific cases by allowing the filing of the information in English or Spanish, rather than just Spanish under the previous rules.

<sup>1</sup>The direct translation from Spanish is "taxable income," but the term refers to revenue determined under Mexico's Income Tax Law.

## **Master file**

Under the final rules, if a master file is completed outside of Mexico in accordance with the guidance in the Organisation for Economic Cooperation and Development (OECD)'s final report on Action 13 of the base erosion and profit shifting (BEPS) project, it will be accepted in Mexico in English or Spanish.

The final rules regarding the Mexican master file also provide as follows:

- The SAT has accepted the guidance in the Action 13 final report regarding the inclusion in the master file of information on the taxpayer's five principal products or services, as well as products or services representing 5 percent of the MNE's total revenues. Prior rules required taxpayers to provide data on their main products, but did not specify how many products had to be included.
- The information required in the master file may be presented in foreign currencies, and if the taxpayer so wishes, by line of business.
- Definitions for the following terms were included in the final rules:
  - Business restructuring
  - Multinational business group
  - Intangible assets
  - Transfer pricing policies

For filing the master file, one entity can file a single master file on behalf of all Mexican taxpayers that meet the master file requirement. The names and taxpayer ID numbers of the companies resident in Mexico that are part of the group and are obligated to file a master file should be listed in the filing.

## **Local file**

The local file rules require that the Mexican taxpayer provide the following information:

- A detailed description of the taxpayer's organizational structure, strategic and business activities, intercompany transactions, and the transfer pricing policy for each intercompany transaction. Information on intercompany transactions must be grouped by the type of transaction.
- A description of the MNE group's supply chain, indicating the taxpayer's participation and location; whether the activities at each point of the supply chain are routine or value added; and the transfer pricing policies used to allocate profits to the portion of the supply chain to which the Mexican taxpayer belongs.
- A list of the taxpayer's principal competitors.
- A description of the MNE group's strategy for the development, enhancement, maintenance, protection, and exploitation of intangibles (DEMPE activities).
- A copy of the Mexican taxpayer's contracts with related parties (may be submitted in English or Spanish.)

- A functional analysis for each individual intercompany transaction
- A detailed description of and justification for the transfer pricing method selected
- A description of the search process used to identify potentially comparable companies or transactions, the profit level indicator selected, and the application of comparability adjustments.
- For each intercompany transaction, a justification of the selection of the tested party and the reasons for rejection of the counterparty.
- A business description of comparables (may be submitted in English or Spanish).
- A detailed explanation and justification for performing a multiyear analysis.
- Financial information (segmented, if that's the case) of the tested party (taxpayer or related party) and the comparable companies, including arithmetical calculation of profits.
- Certain financial and tax information of foreign related parties (current assets, fixed assets, sales, costs, operating expenses, net income, taxable base, and tax payments, specifying which currency was used).
- A list of any advance pricing agreements and other tax rulings related to the transactions entered into by the taxpayer with related parties during the fiscal year to which the Mexican tax authority is not a party. Copies of these agreements the Mexican taxpayer has in its possession must also be submitted with the local file.

The final rules clarify that the information contained in the local file is evidence of compliance with the arm's length principle in accordance with Articles 179 and 180 of the MITL.

The local file is a separate document from the traditional transfer pricing documentation report that large multinational companies typically prepare by June 30. Under the final rules, the SAT does not require the submission of the transfer pricing documentation study together with the local file. However, taxpayers should continue to prepare their transfer pricing documentation report contemporaneously in order to receive penalty protection. The regulations governing the June 30 transfer pricing documentation report have not changed. For a more detailed discussion, see the "Transfer Pricing Information Report" section below.

### **Country-by-country report**

Under the final rules, Mexican multinational business groups do not have to file several CbC reports; rather, only one report is filed per Mexican ultimate parent entity.

The final rules also provide that the CbC report may be filed using foreign currencies.

### **Deadlines**

The deadline for submitting the local file is 12 months after the end of the fiscal year.

For MNE groups with a calendar year end, the deadline for submitting the CbC report for Mexican MNEs and the master file is December of the following year. For foreign MNEs whose fiscal year end does not follow the calendar year, the final rules made the following clarifications regarding the deadline to submit the master file or the CbC report under the secondary filing mechanism:

- When the fiscal year ends in June, July, August, September, October, November, or December, the deadline is 31 December of the year immediately following the declared fiscal year
- When the fiscal year ends in January, the deadline is 31 January of the year immediately following the declared fiscal year
- When the fiscal year ends in February, the deadline is the last day of February of the year immediately following the declared fiscal year
- When the fiscal year ends in March, the deadline is 31 March of the year immediately following the declared fiscal year
- When the fiscal year ends in April, the deadline is 30 April of the year immediately following the declared fiscal year
- When the fiscal year ends in May, the deadline is 31 May of the year immediately following the declared fiscal year

## **Comments**

The draft rules published by the SAT through PRODECON in October 2016 required information that exceeded what Action 13 of the BEPS Action Plan contemplated. After a six-month process that involved technical analysis by PRODECON and practitioners, as well as technical opinions from the public in general and discussions with the SAT, the new master file and CbC report requirements are in line with the principles in BEPS Action 13.

As to the local file, the final rules include some items that differ from the BEPS Action 13 format:

- Companies that enter into transactions only with domestic related parties but pass the taxable income threshold must also file a master file and a local file.
- The Mexican local file requires the testing of all transactions with domestic related parties, whereas the OECD's guidance under Action 13 relates only to transactions with related parties resident abroad.
- The local file requires the disclosure of whether activities in each part of the supply chain are routine or value added, and the allocation of profits within the supply chain when relevant to the Mexican taxpayer.
- In the case of intangibles, the local file may require additional DEMPE activities of the MNE in comparison to what is already required under an OECD master file.

- Functional and economic analyses must be prepared on a transaction-by-transaction basis.
- Certain financial and tax data must be disclosed. Nevertheless, the previous requirement of filing full financial statements and tax returns of foreign related parties was eliminated.
- The preparation date, as well as the tax ID number of the preparer of the transfer pricing study (and that of the transfer pricing advisor, if different) must be included.
- The local file requires confirmation that transactions with related parties were entered into at arm's length values and whether transfer pricing adjustments were applied to comply with the arm's length principle.
- The local file must be prepared in Spanish.

Taxpayers that have entered into an APA covering one or several intercompany transactions and maquiladoras that opted for an APA are not required to submit the local file.

Now that the final rules have been published, the tax authorities must release the electronic platform for the filing of the master file, local file, and CbC report. Time is of the essence in this regard, given the 31 December 2017 filing deadline.

### **Transfer Pricing Information Returns**

The general rule is that Mexican taxpayers must submit a transfer pricing informative return (Appendix 9, "Operations with Foreign Related Parties") with their annual tax return, which is due March 31. However, most international taxpayers will qualify for a three-month extension. Companies submitting a Dictamen Fiscal, filed by the auditor, or DISIF, filed by the taxpayer, can file Appendix 9 on 30 June, three months after the general due date of the pertinent year.

As a practical matter, most taxpayers will need to have prepared Mexican transfer pricing documentation by the time the Dictamen Fiscal or DISIF and Appendix 9 need to be submitted, because Appendix 9 asks taxpayers to disclose information contained in an economic analysis, such as the interquartile range and results, the number of comparables used in the economic analysis, and the SIC code selected. Furthermore, taxpayers or the external auditor need to disclose in the Dictamen Fiscal or DISIF whether the entity has a transfer pricing study, along with other information such as method applied in the transfer pricing study.

### **Transfer Pricing Documentation**

Taxpayers engaged in business activities whose revenue in the preceding fiscal year exceeded MXN 13 million (approximately USD 650,000) or taxpayers whose revenue related to the rendering of professional services in the preceding fiscal year exceeded MXN 3 million (approximately USD 150,000) must prepare TP documentation to receive partial relief from TP penalties in the event of an adjustment.

In practice, documentation is required by the later of the tax return due date or the date of submission of the Dictamen Fiscal and DISIF. In most cases, an OECD local file report would not substantially comply with Mexico's TP

documentation requirements, because Mexican rules require analyzing transactions entered into with domestic and foreign related parties on a transaction-by-transaction basis. In addition, in selecting the best method, taxpayers are required to analyze the methods in the traditional hierarchy, that is, CUP, resale price, cost plus, etc. Moreover, the Dictamen Fiscal and DISIF require information regarding the Mexican Tax ID number of the preparer of the transfer pricing documentation and the transfer pricing advisor (if different).

Mexico's official language is Spanish, and in accordance with current legislation, all information considered part of the accounting records (including transfer pricing documentation) must be prepared in Spanish. If the report is not prepared contemporaneously in Spanish, there is a risk the SAT may conclude that contemporaneous TP documentation is nonexistent.

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