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EY TAX Flash

Non-binding criteria for transfer pricing

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On November 30, 2018, the following two non binding criteria for transfer pricing were published in the Official Gazette as part of the Fourth Resolution of Changes to the Miscellaneous Tax Resolutions for 2018.

- **39/ISR/NV** **Recognition of unique and valuable contributions. Unique and valuable contributions must be recognized in transfer pricing studies in order to demonstrate that the taxable income and authorized deductions recognized for related party transactions correspond to the consideration prices and amounts that would have been used by independent parties in comparable transactions.**

In accordance with the transfer pricing rules established in the Mexican Income Tax Law (MITL) and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by the Organization for Economic Cooperation and Development Council, taxpayers that carry out transactions with related parties must identify and consider any valuable contributions as part of the analysis of functions, assets and risks (functional analysis). In this context, valuable contributions are understood as those that generate a significant value and that are a key source of potential economic benefits such as:

a) Intangibles created or used; or
b) Comparability factors that determine a competitive advantage for the business, including DEMPE activities[1]

If as a result of the functional analysis performed and the application of the selected transfer pricing method there are determined to be differences in the comparability aspects between the analyzed transaction or entity and the potentially comparable transaction(s) or company(ies) on account of unique and valuable contributions, such differences will affect the arm's-length prices, consideration amounts or profit margins, and it is therefore necessary to review the comparable transaction(s) or company(ies) to ensure their comparability with regard to the analyzed transaction or entity.

In order to achieve symmetry in the comparison between the analyzed transaction or entity and the potentially comparable transaction(s) or company(ies), taxpayers must consider unique and valuable contributions both in the evaluated intercompany transaction and the potentially comparable transaction(s) or company(ies) in accordance with articles 179 and 180 of the MITL. Based on the above, the tax authority considers the following to be incorrect tax practices:

I. Failure to recognize the taxpayer's own unique and valuable contributions or those of the comparable companies in its transfer pricing studies.
II. Considering transactions or companies to be comparable when there are significant differences between the analyzed party or transaction and the potentially comparable transactions or companies as a result of unique and valuable contributions.
III. Aiding, advising, providing services or participating in the execution or implementation of the aforementioned practices.

40/ISR/NV Changes to the value of related party transactions within the interquartile range.

The tax authority considers it to be an incorrect practice for taxpayers to make any changes to the prices, consideration amounts or profit margins agreed for transactions carried out with related parties when these amounts are already within the interquartile range.

The authority considers that the transfer pricing adjustment referred to in rule 3.9.1.1. of the Miscellaneous Tax Resolutions for 2018 is only applicable when the prices, consideration amounts or profit margins are outside the transfer pricing range indicated in article 180 of the MITL.

Transfer pricing adjustments are only appropriate when they result from a ruling on a transfer pricing consultation in accordance with article 34-A of the Federal Tax Code or from an agreement between the competent authorities under the framework of the applicable international treaties, meaning, in the case of specific resolutions.

[1] DEMPE = development, enhancement, maintenance, protection and exploitation of intangibles.

For transfer pricing purposes, the tax authority considers the following to be incorrect tax practices:

I. Modifying in any way the prices, consideration amounts or profit margins of the transactions carried out by the taxpayer with related parties when these amounts are already within the adjusted interquartile range of the comparable transactions, meaning, when they fall between the lower and upper limit of the aforementioned range, since the purpose of making a change of this kind would not be to comply with applicable tax laws, but to obtain an undue benefit by increasing the taxpayer's deductions or reducing its revenue.
II. Aiding, advising, providing services or participating in the execution or implementation of the aforementioned practices.

In light of these additions to Exhibit 3 of the Miscellaneous Tax Resolutions, we recommend that taxpayers evaluate with their tax advisors: (i) the existence of any unique and valuable contributions in the transactions carried out with their related parties and in the transactions and/or companies selected as comparables, as part of the functional analysis performed for the transaction; and (ii) any change or adjustment to the prices, consideration amounts and/or profit margins agreed for transactions with related parties.

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