Simplification of the administration and examination of transfer pricing for small and medium-sized enterprises in Mexico

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Abstract

Tax law in Mexico has established regulations on transfer pricing mainly since the country became a member of the Organisation for Economic Co-operation and Development (OECD). The aim of this study is to outline the effect on small and medium-sized enterprises (SMEs) of the administrative and supervisory simplification measures implemented by the tax authorities on transfer pricing between related parties. The study concludes that the simplification does not enable SMEs to reduce the costs of complying with the transfer-pricing regulation, even these firms represent one of the most dynamic sectors of the Mexican economy.

Keywords

Transfer pricing, small and medium-sized enterprises, SAT, tax administration, examination.
Introduction

The transactions of multinational corporations on the world market have involved, not only intra-group firms, but also small and medium-sized enterprises (SMEs). The aim of this study is to outline the effect on SMEs of the administrative and supervisory simplification measures implemented by the tax authorities on transfer pricing between related parties.

Although compliance with laws and administrative requirements is different for each taxpayer, small, medium-sized or large, in the case of transfer pricing, there is no difference whatsoever between SMEs and large firms. This can create additional burdens for SMEs and generate higher administrative costs in complying with legislative requirements. The tax administration implements the provisions specified by the law, by taxing taxpayers’ profits; and it undertakes site visits to determine whether the taxpayer is fulfilling its tax obligations.

The following documents were reviewed for this study: the Income-Tax Law (Ley del Impuesto Sobre la Renta – LISR), the Federal Tax Code (Código Fiscal de la Federación – CFF) and “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in the OECD”, as well as books and journal articles by various authors that have studied the tax regime governing transfer pricing in Mexico.

1. Aspects of tax policy in Mexico

Small and medium-sized enterprises are a highly dynamic sector of the Mexican economy, providing employment for a large proportion of the economically active population and generating roughly 15% of total tax revenue. Nonetheless, a large proportion of SMEs operate in the informal sector.

The confidential nature tax information has meant that taxation issues have been little studied;\(^1\) and estimating the state and federal taxes paid by a given taxpayer sector using published data is a highly imprecise exercise. Enterprises are normally not public, and they do not publish disaggregated figures in their annual reports; typically they only reveal their consolidated income statements or balance sheets. Consequently, the only source of information on the tax behaviour of industry at the federal level is contained in their tax returns submitted to the Treasury authorities, but these are confidential by law.

In practice this makes it very difficult to measure the revenue efficiency of Mexican tax policy on transfer pricing. Moreover, it is known that 25% of the total revenue from income tax (Impuesto Sobre la Renta – ISR) obtained from corporations (personas morales) and large taxpayers, corresponds to consolidated income segment; and this segment also accounts for 30.8% of taxpayers who avoid paying ISR and the flat-rate business tax (Impuesto Empresarial a Tasa Única – IETU). Nonetheless, it is virtually impossible to ascertain the amount corresponding to tax policy on transfer pricing.

Article 28 of the 2010 Federal Revenue Law (Ley de Ingresos de la Federación) requires the Ministry of Finance and Public Credit (SHCP) to publish the fiscal expenditure budget on its website before 30 June 2010. Under this provision, the budget must identify, in general terms, the amounts of revenue foregone by the Federal Treasury as a result of differentiated rates on various taxes, exemptions, subsidies and tax credits, forgiveness, administrative facilities, tax stimulus, authorised deductions, special treatment and regimes established in the various tax

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\(^1\) Tax returns are confidential under Article 69 of the CFF. Moreover, the Ministry of Finance and Public Credit (SHCP) publishes little information on public sector income, and the information that is available is of a very general nature.
laws applied at the federal level. In 2010 such expenses accounted for 3.21% of GDP. Here again, there is no knowledge of what corresponds to SMEs and large firms in terms of transfer pricing in transactions with related parties.

2. Definition of SMEs

On 30 December 2002, the Official Gazette of the Federation (Diario Oficial de la Federación) published the Law for Development of the Competitiveness of Micro, Small, and Medium-Sized Enterprises (MSMEs) (Ley para el Desarrollo de la Competitividad de la Micro, Pequeña y Mediana Empresa), defining this sector as legally established micro, small and medium-sized enterprises, based on the classification provided by the Ministry of Economic Affairs, in agreement with the SHCP.

Micro, small and medium-sized enterprises are defined by the number of persons they employ in carrying out their economic activity, as shown below according to sector:

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<thead>
<tr>
<th>Size</th>
<th>Industry</th>
<th>Commerce</th>
<th>Services</th>
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<tbody>
<tr>
<td>Micro</td>
<td>0-10</td>
<td>0-10</td>
<td>0-10</td>
</tr>
<tr>
<td>Small</td>
<td>11-50</td>
<td>11-30</td>
<td>11-50</td>
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<tr>
<td>Medium-sized</td>
<td>51-250</td>
<td>31-100</td>
<td>51-100</td>
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In this regard, MSMEs are legally required to belong formally to the legal economy, without which they cannot be considered as such under the law.

Microenterprises in Mexico employ between one and 10 people; they generally involve self-employment, and, although there are no serious studies of their lifetime in the market, they generally last less than five years.² In terms of taxation, microenterprises operate under a simplified regime, either as private individuals with business activity under the small-scale taxpayer regime (Personas Físicas con Actividad Empresarial Régimen de Pequeño Contribuyente – REPECO) or as private individuals with business activity under the intermediate regime.

Private individuals engaging in commerce, industry, transport, and crop-farming or livestock activities can pay their taxes under the REPECO regime, provided their sales are not expected to exceed 2 million pesos per year. They have to issue simplified receipts (sales vouchers) to their customers when they sell their goods or services. This facility does not allow them to pass on value-added tax (VAT). If the enterprise has employees, it must fulfil tax and social-security obligations.

A REPECO taxpayer pays a fixed installment covering ISR, VAT and IETU every two months to the federal entity in which it has its tax domicile.

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² Enrique Dussel Peters, a researcher at the Autonomous National University of Mexico, informed the authors that there are no serious studies that precisely indicate the number of years an MSME survives in the market.
A taxpayer entity in this category cannot remain in the simplified regime if it sells merchandise obtained from abroad, and the corresponding sales revenue accounts for over 30% of its total income; if it issues invoices with a VAT breakdown; or if it receives payment through bank transfers or through brokerage firms. If so, it will be transferred to the tax regime covering private individuals with business activities or to the intermediate regime.

A taxpayer in the intermediate regime for private individuals may obtain income exclusively through business activities, such as commerce, industry or services, or from crop-farming, livestock breeding, forestry, or fishing. Entities that pay taxes under this regime include grocery stores, clothes shops, restaurants, pharmacies, hardware stores (tlapalerías), mechanical workshops, beauty parlours, low-cost restaurants (fondas), stationers and kindergartens, among other businesses, provided they have not opted for the general business activities regime or REPECO.

To be eligible to pay taxes under the intermediate tax regime, income obtained from activities may not exceed 4 million pesos per year, and should represent at least 90% of total accumulable income, excluding that received in the form of wages and salaries.

Taxpayers in the intermediate regime are required to maintain a ledger recording income and expenses, and a record of investments and deductions, but they do not have to maintain formal accounting. Private individuals paying taxes under this regime have to file monthly declarations for ISR, VAT and IETU, to the SHCF, in addition to paying a 5% tax rate on account to the federative entity, as an advance on the annual tax assessment.

3. Legal and tax regime governing SMEs

SMEs can undertake their business activities as a private individual or legal entity (persona moral). When they operate as private individuals with business activity, they are taxpayers with the capacity to contract obligations, just like a legal entity formed by a group of private individuals operating with a shared purpose. In Mexico, legal entities are classified as follows: commercial company (sociedad mercantil), civil corporations and associations (sociedades y asociaciones civiles), and partnerships (asociación en participación). Every company has obligations with respect to the administrative authority in legal and tax terms, whether as a private individual or as a legal entity.

The legal system considers the General Law on Commercial Companies (Ley General de Sociedades Mercantiles) and the Law on Cooperatives (Ley de Sociedades Cooperativas) as the set of laws defining how a firm is set up — in other words the legal status under which an enterprise can be established as a legal entity.

The law distinguishes the following categories of commercial company: sociedad en nombre colectivo (general partnership); sociedad en comandita simple (limited partnership); sociedad de responsabilidad limitada (limited liability company); sociedad anónima (joint-stock company); sociedad en comandita por acciones (limited partnership with shares); and sociedad cooperativa (cooperative), irrespective of their corporate purpose. Capital contributions can be made in variable amounts, except in the case of the cooperative company. Companies are established before a notary and are registered in the Public Register of Commerce (Registro Público de Comercio), which accredits their legal status. All commercial companies have a representative (administrador(es)), who approves transactions pertaining to the entity’s corporate purpose, and has special powers established before a notary when the business is set up.

Civil corporations and associations choose their legal format on the basis of the aims they pursue. A civil association pursues non-commercial purpose. If the main occupation is
commercial, they become commercial entities, because they habitually engage in acts of commerce.

The Law on Cooperatives classifies such entities as production or consumption cooperatives. The Civil Code for the Federal District\(^3\) regulates civil associations and corporations, and contains other provisions affecting all companies on a subsidiary basis. According to the Code, a legal entity (persona moral) must be set up according to the respective founding law.\(^4\)

In contrast, tax legislation provides different tax regimes for the fulfilment of taxpayer obligations, whether as private individuals or legal entities — both cases being considered enterprises for tax purposes. The tax regime governing private individuals is classified according to the activity and amount of income in question. The tax regime for legal entities distinguishes between profit or non-profit entities.

A commercial, industrial, or service-providing SME pays tax in the business activities regime if its estimated income for the year is more than 4 million pesos. Its tax obligations under this regime are greater than in the intermediate or small-scale regimes, such as: maintaining accounts in journals and control ledgers; filing the annual tax return no later than April each year; preparing a statement of the financial position of the business at 31 December each year; undertaking a physical inventory at 31 December; submitting declarations, information on transactions with third parties in respect of value added tax (VAT); withholding income tax on the wages paid to its workers and paying it on to the Tax Administration (Servicio de Administración Tributaria – SAT\(^5\) on a monthly basis (any amount in respect of the employment subsidy must be delivered in cash); providing workers with a summary of payments and withholding made on their behalf, among other items, in February each year. Tax obligations for firms under this fiscal regime are very similar to those pertaining to a legal entity (persona moral).

The tax regime for legal entities covers commercial companies, civil associations of professionals engaging in profit-making activities, production cooperatives,\(^6\) as well as lending institutions (banks and brokerage houses) and decentralised organisations that sell goods or services.

\(^3\) The Civil Code of the Federative Entity corresponding to the region in question will be applied.

\(^4\) For the purpose of the LISR, non-profit legal entities are defined as welfare or charity institutions: civil associations or corporations that exist for political or sporting purposes; religious associations; employer associations; worker unions; chambers of commerce and industry; civil associations or corporations providing officially recognised teaching; scientific or technological research; consumer cooperatives, or mutual companies; professional associations; political parties; parents associations; civil associations of local inhabitants or persons who manage property in condominium. All of these are legal entities that are not subject to ISR, but nonetheless have tax obligations with respect to third parties. Depending on the type of taxpayer, non-profit legal entities are recognized differently before the SAT.

\(^5\) The SAT is a deconcentrated agency of the SHCP which is responsible for implementing tax and customs legislation. Its functions include ensuring that taxpayers contribute proportionately and fairly to public expenditure; inspecting (examining) and assisting the taxpayer, and designing and evaluating tax policy.

\(^6\) The law requires the following legal entities to pay taxes under the simplified regime: those engaging exclusively in freight or passenger transport by road; those that work exclusively in crop farming, livestock, forestry or fishery activities; and those established as “integrator firms” (empresas integradoras). This is a tax regime with a specialisation-based treatment, because private individuals or legal entities (for this tax regime referred to as members (integrantes)), can fulfil their tax obligations through the integrator, or several coordinated integrator firms, when their income is obtained exclusively from freight or passenger road transport.
The law defines the following tax obligations of legal entities that are subject to ISR:

1. Maintain organised accounting;
2. Control transactions in foreign currencies;
3. Issue tax vouchers for its activities;
4. Issue vouchers recording payments made to establishments abroad;
5. Submit information on the persons for whom tax has been withheld;
6. Prepare a financial statement and perform an stock inventory of merchandise, raw materials, products in process, and finished products;
7. File a statement of the taxable earnings of the period or the taxable profit, and the amount of the tax, within three months following the end of the period in question;
8. Calculate the workers’ share of the firm’s profits;
9. Provide information on customers and suppliers, or, as the case may be, a statement of transactions with third parties (DIOT);
10. Provide information on persons to whom donations have been made;
11. Maintain a specific record of investments for which the immediate deduction was taken, among other items.
12. Maintain a record of transactions undertaken with sequentially-numbered vouchers.
13. Obtain and conserve documentary evidence on taxpayers who engage in transactions with related parties abroad, to demonstrate that the amount of their income and deductions were made consonant with the prices or amounts of consideration that would have been paid by independent parties in comparable transactions.

On this point, the law provides that taxpayers engaging in business activities whose income in the immediately preceding year did not exceed $13,000,000.00, and taxpayers whose income from the provision of professional services did not exceed $3,000,000.00 in that period, shall be exempt from the obligation specified in this section, except for those engaging in transactions between related parties, in which the prices and amounts of consideration are not consistent with those that would have been paid between independent parties in comparable transactions. The documentation in question should be recorded in the accounts, identifying the fact that it relates to transactions with related parties resident abroad.

14. Submit information on transactions undertaken with related parties abroad.
15. Legal entities that distribute dividends to private individuals or other legal entities must make the corresponding payments through bearer-named checks, and provide the corresponding documentation.
16. Legal entities engaging in transactions with related parties should calculate their accumulable income and authorised deductions, considering, for such transactions, the prices and amounts of consideration that would have been agreed between independent parties in comparable transactions, pursuant to the valuation methods established in the law.
17. Submit the declaration providing information on transactions undertaken through trust funds used as a vehicle for their business activities.
18. Perform an inventory of merchandise, raw materials, products in process and finished products.
19. Taxpayers selected for audit must provide the Ordinary General Shareholders meeting with a report on compliance with tax obligations payable during the fiscal year corresponding to the audit.
### 4. Tax regime on transfer pricing

The regulations on transfer pricing in Mexico are the same for SMEs and large firms. Without making distinctions, the regulations state that prices in all transactions between related parties must be comparable with those that would have been agreed between independent parties; in other words, all transactions must be carried out at market value. Transactions between related parties are classified as “controlled transactions”, while transactions with an independent third party are classified as “uncontrolled transactions” (Table 3).

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**Source:** Prepared by the authors on the basis of legislation.
The LISR requires related parties to undertake a “functional analysis” of the assets used in the transaction, and an evaluation of the risk assumed by each related party (the taxpayer that participated in the transaction). The functional analysis includes the contractual clauses agreed upon in relation to controlled transactions, specifying the responsibilities of the parties, and the direct and indirect participation of the firms in the transaction, as well as the transactions agreed upon and their amounts.

The analysis of two or more similar (tangible or intangible) goods, services or enterprises reveals affinities and similarities between the transfer price set by the related parties compared to the prices agreed upon by them in uncontrolled transactions. According to the OECD, “being comparable means that none of the differences between the transactions could materially affect the factor being examined in the methodology (e.g. price or margin), or if reasonably accurate adjustments can be made to eliminate the material effects of any such differences.” (OECD, 1995).

For LISR purposes, transactions are comparable when there are no differences between them that significantly affect the price or consideration or profit margin to which the traditional or transactional methods refer; or, where such differences do exist, they can be eliminated through reasonable adjustments. The arm’s-length principle is useful because it compares the prices of controlled transactions with those of uncontrolled transactions.

In Mexico two valuation methods are used to determine transfer prices: traditional methods and transactional methods. Traditional methods are direct and reliable. Sometimes, the transaction is not established directly, because comparable transactions are not always available. The methods are applied to transactions successively to identify the alternative best adapted to the market value of the transaction. The alternatives are “methods that examine the profits arising from particular transactions among associated enterprises (OECD, 1995), e.g. the Profit-Split Method (PSM), the Residual Profit-Split Method (RPSR), and the Transaction Net Margin Profits Method, (TNMM).

The taxpayer needs internal comparables, and if the information needed to determine the transfer price is not available, databases of transactions between third parties are used as a reference to document the functional and economic study.

The databases provide daily information on thousands of firms and “makes it possible to use information from companies that may be functionally comparable” (IMCP 2008:89) Databases are useful for setting a transfer price. Nonetheless, in Mexico there are no databases yet for such purposes.

In Mexico, the SHCP “tends to reject the use of information from private firms on the grounds that it is impossible to corroborate the data at source, as can be done with financial data from public firms” (Miranda 2008:36). Nonetheless, private databases identify the countries in which the compared companies are based, along with the macroeconomy of the region, and specific events that could affect the company’s financial situation, in addition to evaluating the different risks and the technique of its financial regulations, to ensure an approximation to the scenario of the related party.

When setting a transfer price, the taxpayer takes account of events, evaluations, market comparisons, financial information and industries. Given the precise information needed, however, the taxpayer may make mistakes. On this point, the OECD urges tax examiners, when reviewing transfer pricing, to be “flexible in their approach and not demand from taxpayers in their transfer pricing a precision that is unrealistic under all the facts and circumstances […] tak[ing] into account the taxpayer’s commercial judgment about the application of the arm’s length principle, so that the transfer pricing analysis is tied to business realities.” (OECD, 1995).
5. Administrative simplification: documentation alternative to the audit report on the financial statements

On 30 June 2010, the Official Gazette of the Federation published a decree granting administrative facilities for taxpayers that were required to have their financial statements audited. They may now avoid this provided they submit information by the deadlines and using the media specified in general rules issued by the corresponding tax authorities.

The information alternative to the audit opinion is specified in Annex 21 of the Second Miscellaneous Tax Resolution (*Segunda Resolución Miscelánea Fiscal*) for 2010 and consists essentially of 19 annexes, of which three concern the transfer-pricing regime:

1. Annex 11: Transactions in financial derivatives contracted with residents abroad;
2. Annex 15: Transactions with related parties; and
3. Annex 16: Information on the taxpayer and on its transactions with related parties.

This information replaces the tax diagnostic and questionnaire on transfer pricing, which were previously compulsory.
Presentation of the questionnaires and tax diagnostic assessment in terms of transfer pricing (reviewed by the public accountant) was a requirement until the current administrative simplification, which represents a lighter administrative burden in relation to transfer pricing because there are fewer annexes to submit. Nonetheless, the alternative information will be the exclusive responsibility of the taxpayer and will not be reviewed by the Registered Public Accountant (CPR). Moreover, the authority in exercising its verification faculties, will request this directly from the taxpayer, very likely forcing the latter to seek specialist assistance.

6. Tax audits for transfer pricing

The Tax Administration Service (SAT) introduced administrative changes aimed at making inspection more effective. The Administration contains the General Transfer Pricing Department, which is attached to the General Large Taxpayers Department, which, under SAT internal regulations is authorized to perform audits or back-desk reviews and examine transfer pricing. The SAT is mandated to issue resolutions and opinions on transfer-pricing matters.

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<tr>
<th>Tax Audit 2009</th>
<th>Information alternative to 2010 Audit</th>
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<tr>
<td>Annex 5.- Segmented income statement</td>
<td>Requirement suppressed</td>
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<tr>
<td>Annex 15.- Transactions with residents abroad</td>
<td>Requirement suppressed</td>
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<tr>
<td>Annex 25.- Transactions in financial derivatives contracted with residents abroad</td>
<td>Annex 11.- Transactions in financial derivatives contracted with residents abroad</td>
</tr>
<tr>
<td>Annex 26.- Accounts and documents receivable and payable in foreign currency</td>
<td>Requirement suppressed</td>
</tr>
<tr>
<td>Annex 27.- Foreign loans. Obligation suppressed</td>
<td>Requirement suppressed</td>
</tr>
<tr>
<td>Annex 34.- Transactions with related parties</td>
<td>Annex 15.- Transactions with related parties</td>
</tr>
<tr>
<td>Annex 34.- Information from the taxpayer on its transactions with related parties</td>
<td>Annex 16.- Information from the taxpayer on its transactions with related parties</td>
</tr>
<tr>
<td>Questionnaire on transfer pricing</td>
<td>Requirement suppressed</td>
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</tbody>
</table>

Source: Prepared by the authors from information published in the Official Gazette of the Federation, 29 January 2009.
Large taxpayers resident in Mexico are defined as the group of firms involved in the global trade of transnational corporations. The tax authority defined clear rules for controlling this taxpayer sector (which at December 2005 represented roughly 0.1% of the total number of taxpayers and 75% of total revenue)” and for safeguarding revenue; and it defined criteria for selecting taxpayers for site visits (Zubiria, 2006:7).

The definition of large taxpayers contained in the SAT internal regulation includes the following entities:
1. Lending institutions and certain other institutions in the Mexican financial system.
2. Holding companies.
3. Enterprises in a holding company group
4. Taxpayers in the general ISR regime that earned at least 500 million pesos in the previous fiscal year.
5. Any private individual or legal entity engaging in transactions with related parties and investments under preferential tax regimes.

In relation to domestic taxes, and given their revenue importance, the General Federal Tax Audit Department (Administración General de Auditoría Fiscal Federal – AGAFF) can exercise the faculties granted by the legislation, either on its own or in conjunction with the General Large Taxpayer Department (Administración General de Grandes Contribuyentes).

The authority fulfils its verification duties by requesting specific information from the taxpayer for examination. The first question addressed is whether the taxpayer submitted the functional analysis study or the analysis of inter-company transactions. The economic study is analysed jointly, to provide a tool using statistical methods for issuing an opinion on the fulfilment or otherwise of the market-value principle. The Treasury authority studies the transactions of related parties and the method used according to the LISR; and, if there are comparable internal or external transactions, the description of uncontrolled comparable transactions for similar operations. The authority then certifies the financial and tax data from the audited firm in accordance with the financial reporting standards and legislation in force during the fiscal year in relation to the examination of comparable firms. Lastly it compares the results obtained with the statistical tools used.

The taxpayer is required to undertake a transfer pricing study to show that the valuation of the price of its transactions is consistent with the arms-length principle. For that purpose, the SAT examines a study of transfer pricing for affiliated firms, so “the first step is to identify which directly or indirectly affiliated parties exist” (CIAT 2003:190).

In order to verify that taxpayers, the persons collectively responsible, or related third parties have fulfilled their tax obligations; identify omitted tax payments or tax credits; check whether any tax offence has been committed, and provide information to other tax administrations, the authorities are empowered to visit the taxpayer’s premises, or those of persons collectively responsible or related third parties, to examine their accounts, goods and merchandise. The authorities have power to examine the opinions on the taxpayer’s financial statements issued by public accountants, and its compliance with tax regulations.

The working papers examined by the authority are included with the financial statements, the firm’s articles of association, minute book, shareholder map, study of the main clauses of contracts signed between related parties, business strategies (innovation, new product development, degree of diversification), political issues, applicable legislation and information on comparable transactions, in addition to factors affecting the entity’s businesses, and the tax declarations and tax audit report (dictamen fiscal) if the taxpayer was audited.
If the taxpayer has been audited, the *dictamen fiscal* issued by the auditors is requested. The latter furnishes the authority with a questionnaire on transfer pricing relating to the period under audit, containing general information and knowledge about the businesses.

In exercising their verification powers in relation to transfer pricing, the tax authorities generally start with large taxpayers — mainly those with controlled transactions, in other words enterprises that have intra-group transactions.

The authority examines the functional analysis undertaken, focusing mainly on the treatment of intangible assets (commercial names and trademarks, marketing value, corporate image, quality of the organisation and staff, technical knowledge, software, databases, distribution channels, licences, patents, etc.), since these are often not recorded separately in account books and registers, yet their functions are important and add value (CIAT 2003:196-198).

When related parties engage in controlled transactions, the authority studies the group’s influence on the price, volumes and allocation of costs, the risks being assumed, the costs being incurred, and how these costs and risks are compensated (CIAT, 2003), bearing in mind that the risks firms assume include those relating to efficiency and calculation, inventory, price, uncollectible and foreign-exchange debts, development, responsibility, market, guarantee; and the risk of the physical environment. The related party that is best able to bear such risks should do so.

The authority’s verification actions start with a visit order — a notification in writing received in person by the taxpayer, requesting its presence on the following day, for the purpose of informing it that a documentary audit will be performed at its tax domicile, and requesting that the auditors be admitted to its offices and be allowed to examine documents supporting transactions, particularly the functional analysis, and the valuation method used to set a transfer price. The visit order should indicate the specific taxable event to be examined by the authority.

The visit order shall be in writing and shall indicate the authority issuing it and the place and date of issuance, at least. It should also contain a justification and motivation and express the resolution, object or purpose involved; and it should be signed by the competent official, and bear the name or names, as the case may be, of the person(s) to whom it is addressed. When the name of the person to whom it is addressed is unknown, sufficient information will be indicated to permit the necessary identification.

The visit order shall indicate the place or places to be visited. If the number of sites to be visited is subsequently increased, the audited party shall be notified, indicating the name(s) of the person(s) who will make the visit, which may be replaced, increased or reduced in number, at any time by the competent authority.

The audited parties (taxpayers) must grant the auditors appointed by the tax authorities (i.e. the SAT auditors) access to the premises selected for the visit, and keep available accounts and other papers accrediting the fulfillment of tax obligations, of which the auditors may make copies. Then, having been compared with the originals, these are certified as authentic and attached to the final or partial minutes generated by the visit. Taxpayers being audited must also allow goods and merchandise to be verified, as well as documents, disk, tapes, or any other processable data-storage media held by the taxpayer in the sites visited. In this case they must make computer equipment and their operators available to the auditors, to facilitate the visit.

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The auditors may make copies of the accounts and other papers relating to tax compliance in the following situations: when the audited party refuses to receive the visit order; when systems of accounting, records or corporate ledgers exist that are not registered with the authorities; when there are more than two accounting systems in existence with different content; when there are several (more than one) corporate ledgers that are similar but of different content; when not all of the periodic declarations required by the tax regulations have been filed for the period to which the visit relates; when the data recorded in the accounts cannot be reconciled with the figures shown in the declarations or notices submitted, or when the documents supporting the act or activities of the audited party do not appear in those accounts within the period indicated by the tax regulations, or when they are false or relate to nonexistent transactions; when the seals or official stamps affixed by the auditors are removed, altered, or destroyed, either wholly or partially, without legal authorisation; or the auditors are prevented from fulfilling their purpose by a ploy of any type.

Should the audited party be subject to strike action or a suspension of labour, the accounting documents can only be obtained within 48 hours prior to the date set for the start of the strike or suspension of labour. For this purpose, the accounts are understood to include, among other things, papers, discs and tapes, and any other type of processable data-storage medium.

At the start of the visit to the taxpayer’s tax domicile, a minute is created for the purpose of recording in detail any actions or omissions identified by the auditor. This minute has evidence value in respect of any of the contributions payable by the audited party during the period under examination.

If the visit occurs simultaneously at two or more sites, partial minutes shall be prepared for each one; and these will be appended to the final minute of the visit, which can be produced at either of the sites. In such cases, two witnesses are needed in each establishment visited to be able to produce the partial minute. If the audited party or its representative is not present at the site to be visited when the auditors arrive, a notice will be left requesting presence on the following day. If the person in question is then not present, the visit will start with whoever is present at the visited site.

To secure accounting documents, correspondence, or goods that are not registered the accounts during the period of the site visit, the auditors may affix seals or stamps on the said documents or goods, or on the furniture, filing cabinets or offices in which they are located, and leave them on deposit with the audited party, or the person to whom this task is entrusted, having previously performed an inventory for that purpose, and provided this does not hinder the activities of the audited party, unless related to securing the activities of the current or two previous months. If any sealed document contained in the furniture, filing cabinets or offices is needed to enable the audited party to carry out its activities, the latter shall be permitted to remove the document in the presence of the auditors, who may make a photocopy thereof.

During the audit, partial or complementary minutes may be kept to record specific events, omissions or circumstances that come light during the visit. Once the final minute has been prepared, no complementary minutes may be produced without a new visit order.

When, during an audit, the tax authorities discover acts or omissions that could involve non-compliance with tax regulations, these will be described in detail in partial minutes. Such minutes will also include known acts or omissions by third parties. The final partial minute of this type will explicitly indicate that it is the last such, and at least 20 days must elapse between this and the final minute, during which the taxpayer may present the documents, account books or records to disavow the aforementioned acts or omissions, or may decide to rectify the corresponding tax situation. If more than one fiscal year, or fraction thereof, is being examined,
the aforementioned deadline will be extended for a further 15 days, provided the taxpayer gives notice during the initial 20-day period.

The acts recorded in the minutes will be considered agreed to, if, prior to finalization of the final minute, the taxpayer does not submit the said documents, account books or records, or does not indicate their location, if this is the tax domicile or place authorised to produce the accounts, or else does not provide evidence that the documents in question are already in the possession of an authority.

In the case of visits to examine transfer pricing, at least two months may elapse between the date of the final partial minute and the final minute of the audit, which may be extended once for a period of one month, at the taxpayer’s request.

Within a maximum of 15 working days from the date of the final partial minute, and exclusively in transfer-pricing audits, the taxpayer may designate up to two representatives, to have access to the confidential information supplied by or obtained from independent third parties, with respect to comparable transactions that affect the competitive position of those third parties. The appointment of such representatives must be made in writing and submitted to the competent tax authority.

The confidential information provided by or obtained from third parties shall be deemed agreed to if the taxpayer fails to designate the aforementioned representatives by the stated deadline. Taxpayers who are private individuals may have direct access to the confidential information referred to in this paragraph.

The taxpayer and its representatives will be responsible for a period of up to five years from the date on which access to the confidential information was granted, or from the date of the written appointment, respectively, for any disclosure or personal or improper use, for any purpose and through any medium, of the confidential information to which they were given access in relation to the audit actions by the tax authorities. The taxpayer will also be collectively liable for any damage resulting from the disclosure or personal or improper use of the information, by the representatives referred to in this paragraph.

Cancellation of the appointment of the representative authorised to have access to confidential information provided by third parties does not exonerate the representative or taxpayer from any collective responsibility incurred as a result of the disclosure or personal or improper use made of that confidential information.

When a review of the minutes of the audit and other related documentation shows that the procedure did not follow the applicable norms, thus potentially affecting the legality of the conclusions reached, the authority may automatically repeat the procedure once only. Once the site visit has ended, a new order is needed to initiate another visit to the same taxpayer. If the verification faculties concern the same tax payments, operations and periods, a new examination may only be undertaken following identification of acts other than those already reviewed.

The identification of different acts must be based on information, data or documents from third parties; an examination of specific issues not reviewed previously; data provided by private individuals in supplementary submissions; or documentation provided by taxpayers in any appeal they may file which had not been presented to the tax authorities when implementing the verification procedures specified in the tax regulations — unless, in this latter case, the authority has not rejected as “false” the corresponding appeal document and could have done so, or else, having objected to it, the incident in question has been declared inadmissible.
Table No. 7 Procedure for a visit order

Source: Prepared by the authors on the basis of Articles 40 3, 46 and 76 of the Tax Code of the Federation.
Accounting Ledgers No. 29 (forthcoming).
Universidad Javeriana, Colombia.

The tax authorities must complete the audit within 12 months from the date on which taxpayers are notified of the start of verification procedures, except in the case of taxpayers from whom the tax authority requests information to verify compliance with the obligations defined in Article 86, fraction XII and Articles 250 and 216 of the LISR, the deadline being two years from the date on which the taxpayers were notified of the start of verification procedures.

The deadlines for completing site visits or desk reviews referred to in the first paragraph of this article, shall be suspended the event of:

I. A strike causing temporary withdrawal of labour, and until the strike ends.
II. The death of the taxpayer, until the legal representative of the succession is appointed.
III. When the taxpayer leaves the tax domicile without having submitted the corresponding notice, or when the taxpayer cannot be found in the place indicated, and until located.
IV. When the taxpayer does not respond to requests for information, reports or documents from the tax authorities to verify compliance with tax obligations, during the period between the expiry of the deadline granted in the request and the day on which the request is responded to or fulfilled. Any such suspension may not last longer than six months. In the case of two or more information requests, the two suspension period will be added together, and in no case may a suspension period exceed one year.
V. In the procedure has to be repeated, the deadline will be suspended as from the date on which the authority notifies the taxpayer thereof.
VI. When the authority is prevented from fulfilling its verification duties as a result of fortuitous events or force majeure, and until the cause thereof disappears, which must be published in the Official Gazette of the Federation and on the Internet site of the SAT.

If during the period for concluding the site visit, or examination of the taxpayer’s accounts in the authorities’ offices, the taxpayer files an appeal in Mexico or abroad against the act or activities arising from the exercise of verification procedures, the deadlines in question shall be suspended from the date on which such appeals are filed and until they are definitively resolved,
If the authorities do not produce the final minute of the visit or fail to disseminate the observations report, or, as the case may be, complete the examination by the aforementioned deadlines, the audit will be deemed completed on that date, and the order and actions arising during the visit or examination shall be cancelled.

The tax authorities shall bring any site visits they have ordered to an early conclusion, when the audited party is required to have its financial statements audited.

If the legal, economic and financial considerations for determining the tax claim proposed by the authority are valid, and if the adjustment corresponds to transactions with a resident of a foreign country with which Mexico has a tax treaty, the taxpayer may accept the amount of the tax claim and pay it, along with any adjustment, surcharge and corresponding fines, or else it may invoke the procedure of the competent authority to request the corresponding payment of the difference with respect to the tax as imposed in Mexico.

Final comments

In Mexico SMEs do not receive special tax treatment in relation to transfer pricing; and the documentation and information requirements put this type of firm at a disadvantage.

Since 1997, when transfer pricing was first included in Mexican legislation, no administrative simplification has been introduced that enables SMEs to reduce the costs of complying with the transfer-pricing regulations. Moreover, the changes made in terms of examination procedures apply to SMEs and large taxpayers alike.

The tax administration simplification facilities applicable to fiscal 2010 allow taxpayers to submit information alternative to the tax audit, involving a lighter administrative burden in terms of transfer pricing. Nonetheless, in the case of an examination by the tax authorities, it is the taxpayer that has to provide all the information requested by the tax authorities — a situation that will very likely force it to hire external assistance.

Lastly, it is important to draw attention to the lack of disaggregated data on transfer pricing between related parties, which makes it difficult to gauge the effectiveness of the tax measures adopted.

Bibliography


**Items published in the Official Gazette of the Federation.**


