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The Mexican Tax Authorities Man Up –

The new tax audit tools now available to the Mexican government

Abel Francisco Mejia Cosenza

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New Tools for International Tax Enforcement

1. Relevant Issues of the 2014 Mexican Tax Reform 2014.

2. Current trends in Mexico tax enforcement efforts.

3. General comments on Mexico´s Network of International Tax and Information Exchange Treaties.

4. Specific comments on the Intergovernmental Agreements between the US and Mexico to improve international tax compliance including with respect to FATCA (IGAs).

Relevant Issues of the 2014 Mexican Tax Reform

- Base Erosion and Profit Sharing based provisions introduced:
  - Non-deductibility for certain interest, royalties and technical assistance payments made to disregarded or transparent entities.
  - Requirement that foreign resident receiving payments from Mexico prove the existence of juridical double taxation to claim treaty benefits.

- A new 10% tax on dividends was introduced including for payments to foreign holding companies, subject to lower treaty rates.

- The maximum tax rate of the income tax for Resident individual's was increased from 30% to 35%. Corporate tax rate remains at 30%.

- The Flat Business Tax (*Impuesto Empresarial a Tasa Unica*) and the Tax on Cash Deposits (*Impuesto a los Depositos en Efectivo*) were eliminated.

- The preferential Value Added Tax rate of 11% for the border area was eliminated, and the general tax rate of 16% applies to all transactions.

Relevant Issues of the 2014 Mexican Tax Reform

- The preferential Value Added Tax rate of 11% for the border area was eliminated, and the general tax rate of 16% now applies to all transactions.
- All deductible expenses must now be reflected in digital invoices issued by the corresponding provider of services or supplier of goods.
- A new electronic system for direct communication (the “tax mailbox”) between the authorities and tax payers is established, allowing for real-time uploading of the taxpayer´s tax information.
    - Allows immediate cross-checking of deductible expenses with corresponding income accrual.

Current trends in Mexico tax enforcement efforts

Elimination of the Confidential tax payment

- This was a mechanism that allowed individuals obtaining foreign-sourced income from interests, dividends and profits, to confidentially pay the income tax due through a Mexican financial institution.
  - The aforementioned institution did not have to disclose the taxpayer's identity.
  - All formal income tax obligations regarding interests, dividends and profits from foreign-sourced income were considered duly complied, including the obligation to file an informative return for investments in "tax havens" or transparent entities.
  - The confidential payment now only applies to income generated prior to January 1, 2014. Income obtained after that date must be paid and disclosed in the annual tax return.

Current trends in Mexico tax enforcement efforts

- There is great uncertainty as to the final date to apply the confidential tax payment.
  - Current provisions do not set forth a final date for paying taxes for 2013 and prior years.
  - Tax authorities may effectively revoke the validity of the tax payment through an administrative ruling.
- What are the options left for Mexican taxpayers with offshore structures and income???
  A) STATUS QUO. Stay the same and risk non-compliance penalties.
  B) FULL DISCLOSURE. Reporting everything in ordinary tax return.
  C) MIGRATION TO COMPLIANT STRUCTURES. Obtain legitimate deferral.

Current trends in Mexico tax enforcement efforts

Tax Digital Era

- Mexico has effectively migrated to a digital-base tax system. All invoices must be in digital format and sent to the taxpayer's email and immediately reported to the tax authorities.
  - Audits can now be conducted through digital communications.
  - Authorities can cross-check invoices with income as well as with information of third parties.

Public List of Entities issuing false and fraudulent invoices

  - The list is on the tax authorities website and open to the general public.
  - Taxpayers are informed that any invoice issued by said entities will not be valid and thus is non-deductible. It is very likely that taxpayers dealing with these entities will be audited themselves.

Current trends in Mexico tax enforcement efforts

Use of Criminal Prosecution Capacities

- During 2013 and 2014, at least 33 warrant for the arrest of individuals for tax fraud.

Combo of Tax & Anti-Money Laundering Measures

- A new Anti-Money Laundering law came into effect in 2013. The law requires all service providers to obtain certain personal and economic information from the individuals and entities contracting and paying for their services.

Greater use of the information of the financial system

- The modernization and growth of the banking and credit system in Mexico has placed a wide array of information in the hands of the Mexican financial system.
- Authorities are working closely with the financial institutions to monitor flows of money and used of consumer credit such as mortgages, credit cards and prepaid cards.

Current trends in Mexico tax enforcement efforts

Public Statements by Mexican Tax Authorities in Private Forums

- Have pointed out that those taxpayers using aggressive tax planning structures are challenging Mexico and the SAT will do anything to fight against them.
- Have indicated that it is not possible to increase the taxes even more, so it is time to look for "gaps" in the law.
- In those cases where there is clear aggressiveness, the SAT will be there.

Mexico´s Treaty Network and International Documents

-Convention on Mutual Administrative Assistance in Tax Matters done at Strasbourg on January 25, 1988.

- Article 27 of the Convention between the U.S. and Mexico done at Washington on September 18, 1992.

- Article 4 of the Agreement between the U.S. and Mexico for the Exchange of Information with respect to Taxes, done at Washington on November 9, 1989.

- Protocol that amends the Strasbourg Convention on Mutual Administrative Assistance in Tax Matters done at Paris on May 27, 2010.

- Standard for Automatic Exchange of Financial Account Information.

-Treaty between the U.S. and Mexico to Improve International Tax Compliance including with respect to FATCA done at Washington, D.C. on November 2012 and amendment done on Mexico City on April 9, 2014.

Mexico-US legal framework

Mexico-US Tax Treaty

- The Mexico-US Tax Treaty establishes the obligation of Contracting States to exchange information under the Tax Exchange Information Agreement executed on November 9, 1989.

- Authorizes the exchange of information with respect to any tax covered in the treaty.

Tax Exchange Information Agreement:

- Tax authorities must exchange information for the administration and execution of domestic law, including such information needed for the determination, assessment, and collection of tax, the recovery and enforcement of tax claims, or the investigation or prosecution of tax crimes or crimes involving the contravention of tax administration.

Mexico-US legal framework

Tax Exchange Information Agreement:

- Taxes covered include those imposed by a state, municipality, or other political subdivisions or local authorities of a Contracting State.

- The competent authorities of the Contracting States shall automatically transmit information. Contracting States shall spontaneously transmit important information to the other.

- In addition, the requested State shall provide information upon request by the applicant State. If the information available in the tax files of the requested State is not sufficient to enable compliance with the request, that State shall take all relevant measures to provide the applicant State with the information requested.

- No information shall be denied by arguing banking secrecy.

Mexico-US Reciprocal IGA

Foreign Account Tax Compliance Act (FATCA)

- Enacted on March 18, 2010. Included in Chapter 4 of the US Tax Code.
- Aimed at avoiding tax evasion by US citizens with funds in foreign accounts.
- Unilateral.

Intergovernmental Agreement (IGA) to improve international tax compliance including with respect to FATCA

- Entered by Mexico and the US on November 19, 2012, following the Reciprocal Model for IGAs. Provides for the rules under which FATCA is applied with respect to Mexico. The IGA was updated on April 9th, 2014. The update was largely the result of the "most-favored- nation" provision contained in the original version of the IGA and Notices 2013-43 and .

Mexico-US Reciprocal IGA

- The "most-favored-nation" provision sets for that if the U.S. agrees at a later date to an IGA that has better terms than the IGA just signed, the IGA just signed will be automatically updated to reflect those better terms.

- Notice 2013-43 states that the US Treasury Department and U.S. Internal Revenue Service will postpone by six months, to July 1, 2014, the start of withholding required under FATCA.

- Significant differences between U.S. reportable account and Mexican reportable account.
  - There is no concept of entities controlled by Mexican persons.
  - Special attention to typical deferral vehicles for Mexican residents, like life insurance with a cash value and foreign trusts.

Mexico-US Reciprocal IGA

- **News Analysis: Will U.S. Hypocrisy on Information Sharing Continue? (Article in Tax Analysts by Lee Sheppard).**
  - Mexico got a cheerleader promise.
  - Mexico is believed to have lost $872 billion in dubious outbound transfers over four decades, some of which is transfer pricing. Most of the money is believed to have ended up in the United States.
  - Mexico also got a most favored nation clause. The IGA requires consultation if implementation is a problem. This same provision is in the British and Danish IGAs.
  - This is a ticket to putting the accounts in third-country corporate shells -- again displaying the inefficacy of bilateral agreements. The Mexican IGA might effectively be a nonreciprocal agreement disguised as reciprocal.

Mexico-US Reciprocal IGA

US information exchange obligations under IGA

Bank Account Information
Name
Address
Tax ID (RFC in Mexico)
Account number
Gross amount of paid or credited dividends
Gross amount of other reportable income
Concerning depository accounts, gross amount of paid interest

Information must be exchanged within the nine months following the calendar year to which that information pertains.

Mexico-US Reciprocal IGA

In terms of the IGA reportable accounts are:

- Depositary Accounts (held by individuals generating more than USD 10 on interest paid); and
- Custodial Accounts (corporate or individual investments on bonds and equities when generating US sourced income).

In particular, the information to be collected from the accountholders of "Mexican Reportable Accounts" is the following:

(i) Name, address and tax identification number (or date of birth);
(ii) Account number and name of the U.S. Financial Institution where the account is held;
(iii) Interest paid on Depository Accounts;
(iv) U.S. source dividends paid or credited to Mexican Reportable Accounts; and
(v) Other U.S. source income paid or credited to such accounts.

OECD's Automatic Exchange of Financial Information

On January 2014 the OECD issued the "Standard for Automatic Exchange of Financial Account Information" with the scope to prevent international tax evasion.

The mentioned Standard contains the Model Competent Authority Agreement (CAA) and the Common Reporting and Due Diligence Standard (CRS).

The CRS, contains the reporting and due diligence rules and the Model CAA, contains the detailed rules on the exchange of information.

Countries that enter into the CAA, will obtain information from the other countries' financial institutions on an annual basis.

OECD's Automatic Exchange of Financial Information

The key information that will be subject to exchange according to the CAA and the CRS will be the following:

- All types of investment income including interest, dividends, income from certain insurance contracts and other similar types of income along with account balances and sales proceeds from financial assets.
- The report obligation will not only include bank sand custodians but also other financial institutions such as brokers, certain collective investment vehicles and certain insurance companies.
- Information of accounts held by individuals and entities which includes trusts and foundations.
- The CRS includes a requirement for the financial institutions to look through passive entities and report on the individuals that ultimately control these entities.

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Firma la Diferencia

México DF
T. +(52) (55) 5029.8500

Monterrey
T. +(52) (81) 8153.3900

www.sanchezdevanny.com

Lic. Abel Mejia Cosenza
amejia@sanchezdevanny.com