

Mexico and BEPS

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Abstract

A Premier study on BEPS on Mexico

I. INTRODUCTION

During the 2012's G20 Meeting in Mexico, a growing perception that governments loose substantial amounts of corporate tax revenue to lower income jurisdictions arose which had been addressed by the Organization for Economic Cooperation and Development (OECD).

According with that organization, Base Erosion and Profit Shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS[1].

The initiative seeks to close gaps in international taxation for companies that allegedly avoid taxation or reduce tax burden in their home country by engaging in tax inversions (moving operations) or by migrating intangibles to lower tax jurisdictions.

In this context, OECD has issued fifteen Action Items to address the main areas where they feel companies have been most aggressively accomplishing this shifting of profit addressing the digital economy, treaty abuse, transfer pricing documentation, and more. BEPS Action Item 13, in particular, aims to transform transfer pricing documentation, forcing multinational corporations to reconsider how transfer pricing details are reported to local tax authorities as well as worldwide with country-by-country (CbB) reporting[2].

Broadly speaking corporate tax planning strategies aim at moving profits to where they are taxed at lower rates and expenses to where they are relieved at higher rates. These strategies typically ensure[3]:

1. Minimisation of taxation in a foreign operating or source country,
2. Low or no withholding tax at source,
3. Low or no taxation at the level of the recipient, as well as
4. No current taxation of the low taxed profits (achieved via the first three steps) at the level of the ultimate parent.

The result is a tendency to associate more profit with legal constructs and intangible rights and obligations, thus reducing the share of profits associated with substantive operations involving the interaction of people with one another[3].

As such, BEPS intends to focus on the following key areas[3]:

1. International mismatches in entity and instrument characterization including hybrid mismatch arrangements and arbitrage;
2. Application of treaty concepts to profits derived from the delivery of digital goods and services;
3. The tax treatment of related party debt-financing, captive insurance and other inter-group financial transactions;

4. Transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents;
5. The effectiveness of anti-avoidance measures, in particular GAARs, CFC regimes and thin capitalization rules;
6. The availability of preferential regimes for certain activities.

In 2013, OECD laid out an Action Plan[4] that all jurisdictions signing the treaties have to follow.

II. STATUS ON MEXICO

In this context, Mexico, as member of OECD[5] has initiated the procedures to implement the BEPS initiative. On 17 October 2016, Mexican Tax Authorities published proposed regulations regarding the additional information that could be requested as part of the new transfer pricing obligations, which require Mexican taxpayers to submit a master file, local file and country-by-country (CbC) report[6].

Mexico incorporated BEPS Action 13 in Article 76-A of the Mexican Income Tax Law (MITL) as part of the 2016 tax reform. This provision establishes the obligation for certain Mexican taxpayers to submit three new annual transfer pricing information returns before 31 December of the following year. These new BEPS transfer pricing information returns are the:

1. Master file
2. Local File
3. CbC Report

In general, Mexican resident companies, including subsidiaries of foreign multinational groups (MNE), must submit the master and local files if they reported accruable income greater than Mexican Pesos (MXP)\$644,599,005, approximately US\$34 million. Specific rules apply, for instance,

to government-controlled corporations and residents abroad with a permanent establishment in Mexico. Mexican multinational controlling entities with consolidated income greater than MXP1.2 billion, are required to file the CbC report in addition to other requirements[6].

Next due date is **December 31th, 2017** with non-compliant taxpayers carrying penalties from MXP\$140,540 to MXP\$200,090 and limitations to contract with Government projects[7].

Numerous articles have been published on the topic [8, 9, 6], which shows an increasing interest by stakeholders.

i. Master File

Master files are intended to provide key information about the group's global operations including a high-level overview of a company's business operations along with important information on a company's global transfer pricing policies with respect to intangibles and financing.

The information required for the master file relates to the global operations of the MNE, which is not necessarily available in Mexico to a Mexican subsidiary of a foreign MNE[6].

According with Article 76-A MITL, a company is obligated to file Master File if any of the follow is true[7]:

1. Revenue => MXP\$644,600,000 or public companies
2. Integrated company
3. Government Company
4. Permanent Establishment

The Master File includes:

1. Worldwide companies
 - (a) Description of companies of the multinational around the world
2. Description of multinational
 - (a) Value drivers
 - (b) Supply chain

- (c) Inter-company agreements
 - (d) Geographic markets
 - (e) Functional analysis
 - (f) Restructuring
3. Intangibles
- (a) Strategy for development, ownership and exploitation, management and location.
 - (b) List of intangibles and Company that has the ownership
 - (c) TP policy for Intangible development and RD
 - (d) Transfer of Intellectual Property among companies of the group
4. Financial Funding
- (a) Intra-group financing
 - (b) Cash Pooling companies, including location and management
 - (c) TP Policies and inter-company agreements
5. Tax and Financial Information
- (a) Intra-group financing
 - (b) Consolidated Financial Information
 - (c) APA and other agreements with Tax Authorities
- (a) Intercompany transactions and the economic context
 - (b) Volume of transactions per category
 - (c) Related party and how they are linked
 - (d) Copy of intercompany agreements
 - (e) Functional and comparability analysis
 - (f) TP method selection
 - (g) Selection of tested party
 - (h) Relevant Assumptions
 - (i) Explanation of multi-year analysis
 - (j) Comparable companies and its source of information
 - (k) Adjustments
 - (l) Support on how conclusion was obtained
 - (m) Copy of APAs
3. Financial Information
- (a) Local Entity financial information
 - (b) Financial information used in the analysis
 - (c) Financial information of comparable companies
- iii. Country-by-Country File

ii. Local File

Local files are intended to provide information and support of the inter-company transactions that the local company engages in with related parties. Taxpayers obligated to file the Master File, are also obligated to file the Local file[7].

The Local File includes:

1. Local company
 - (a) Local structure and management
 - (b) Description of business and strategy
 - (c) Main competitors
2. Controlled transactions

CbC is intended to provide key financial information on all group members on an aggregate country basis with an activity code for each member.

According with Article 76-A MITL, a company has to file CbC returns if its revenue is over MXP\$12,000,000,000 and any of the following is true[7]:

1. Multinational Controlling company
2. Permanent Establishment

iv. International Exchange of Country-by-Country Reports

According with OECD[10], the Convention on Mutual Administrative Assistance in Tax Matters, by virtue of its Article 6, requires

Definitionimages/CbCEXample1.bb

Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued - Current Year	Stated capital	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Figure 1: CbC table

Definitionimages/CbCEXample2.bb

Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organization or incorporation if different from Tax Jurisdiction of Residence	Main business activity(ies)														
			Research and Development	Holding or Managing Subsidiaries	Real Estate	Pharmaceutical Production	Manufacturing or Production	Production of Electricity or Distribution	Administration	Management or Support Services	Provision of Services to unrelated parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Domest	Other ¹
1																	
2																	

Figure 2: CbC table - Continued

the Competent Authorities of the Parties to the Convention to mutually agree on the scope of the automatic exchange of information and the procedure to be complied with. Against that background, the Multilateral Competent Authority Agreement on the Exchange of CbC Reports (the "CbC MCAA")^[11] has been developed, based on the Convention. In addition, two further model competent authority agreements have been developed for exchanges of CbC Reports, one for exchanges under Double Tax Conventions and one for exchanges under Tax Information Exchange Agreements.

The purpose of the CbC MCAA is to set forth rules and procedures as may be necessary for Competent Authorities of jurisdictions implementing BEPS Action 13 to automatically exchange CbC Reports prepared by the Reporting Entity of an MNE Group and filed on an annual basis with the tax authorities of the jurisdiction of tax residence of that entity with the tax authorities of all jurisdictions in which the MNE Group operates.

A dedicated XML Schema and User Guide^[12] have also been developed to provide structured feedback on received CbC information. The CbCR Status Message XML Schema will allow tax administrations to provide structured feedback to the sender on frequent errors encountered, with a view to improving overall data quality and receiving corrected information, where necessary.

III. PROPOSED SOLUTION

Due to the imminent due date (December 31st, 2017) and the amount of information required a fast response should be provided. This is because MNEs would have to have time to compile and file the files prescribed by the MITL, in observance of OECD rules and procedures.

In general, it can be said that the procedure should rely as much as possible on SAT infrastructure, while at the same time be compliant with all regulations made by the competent organizations. A full assessment should be conducted to see how to implement it in the SAT context. Having as much information in a standardized and electronic form from source (that is, from filing time) may ease the following areas of work. As such, the provider should work as close as possible with SAT to make the project effective in the shortest time possible and with the least cost, with the added benefit of reducing human intervention.

In fact, the issue can be decomposed on the following areas:

i. Filing

The prescribed taxpayers should file on time using the methods indicated by SAT. Ideally, it would entail that a standardized electronic filing system is in place (even with an XML Schema similar to that proposed by OECD in order to rule out formal errors), and that an obligation vector is monitoring all filers in order to detect non-compliance in the shortest time possible¹.

Returns should be developed (or at least explored), processes should be put in place before any MNE has the chance to file.

This area poses one of the biggest challenges as it relies on information that is external to SAT, needing the control of obligations and the imposition of fines and penalties to those who do not file.

¹An example system can be provided in order to show the functionality, developed by the signer

ii. Compilation

Once taxpayers have filed the files and those are accepted, probably running an assessment against the information already inside SAT (for example, Corporate Income Tax returns), the tax administration compiles the information and produces the XML used in the message interchange.

All information has to be cross checked before transmission and - due to the fact that 2017 will be the first time - it may need the creation and training of a team inside SAT in order to detect errors and missing gaps. It may be expected that inconsistencies may appear, so procedures should be in place to properly solve them.

iii. Transmission

The Tax Administration transmits the XML to member jurisdictions. In this case, the system takes care of securing the transmission and makes sure that the recipients receive the resulting message.

From the system stand point of view, due to the nature of the information contained in the message and its consequences if it falls into the wrong hands, security poses the biggest issues. Hard encryption and ensuring the identity of both the emitter and the receiver are the cornerstone of this work area.

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