

**Reportable schemes in Mexico &
other topics to keep in mind at year-end.
How ready are you?**



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Helping companies do business in Latin America®

- Reportable schemes in Mexico, new obligation in 2020.
- Non-Deductible Payments made to related parties abroad in Preferential Tax Regimens (REFIPREs).
- *Materiality* of the operations in tax authorities' reviews.
- Considerations for deduction of interest. Thin capitalization & New limit of net interest rule.
- Trend of "Outsourcing" in Mexico. What's to come?.
- COVID-19 and the effects on Transfer Pricing.
- Summary.
- Q&A.





**Reportable schemes in Mexico.
New obligation in 2020.**



BEPS 15 ACTIONS

Reforming the international tax system
to tackle tax avoidance



- **G20** diagnosis request to the OECD.
- **OECD** “How to solve base erosion and profit shifting” (BEPS).
- **G20** “We are determined to develop measures to solve base erosion and profit shifting, collectively adopt the necessary measures, and we expect the OECD to present a comprehensive plan in July.”
- **OECD** Publication of a 15-action plan (“BEPS”).
- **Action 12** Require taxpayers to reveal their aggressive tax planning mechanisms.

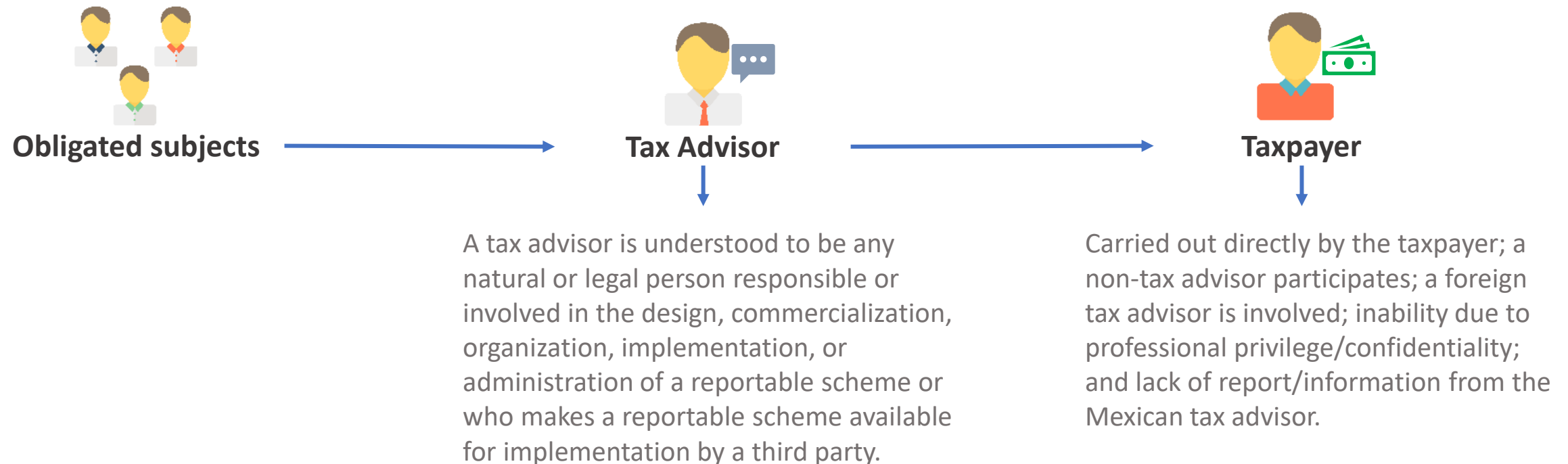


**Final Report of Action
12 of the *BEPS* project.**

The main objective of disclosure regimes is to increase transparency by providing tax administrations with timely information.



Reveal the generalized and personalized reportable schemes that generate or may generate, directly or indirectly, a tax benefit in Mexico regardless of tax residence.



Scheme: Any plan, project, proposal, advice, instruction or **recommendation** communicated in an **expressed**¹ or **tacit**² manner in order to materialize a **series*** of legal acts. The performance of a procedure before the authority or the defense of the taxpayer in tax disputes is not considered a scheme.

***Series:** At least two acts, except for the assumptions of 199 Fracc. I, III, VI-c), VIII, XI, and XIII of the Federal Tax Code (FTC).

1 Expressed: When the person declares or manifests personally, or through his legal representative, in writing or by unequivocal signs, his decision to be obligated. Making themselves understood by words or gestures (for example, raising the hand).

2 Tacit: That is not expressed or is not said but is assumed or understood.





Reportable scheme: Any scheme that generates or may generate, directly or indirectly, a tax benefit in Mexico and has any of the following characteristics of art. 199 of the Federal Tax Code (FTC).

Tax benefit: Monetary value derived from any reduction, elimination, or temporary deferral of a contribution.

I

Avoids the exchange of information with foreign authorities.

II

Avoids applications for Preferential Tax Regimens (REFIPRES) or income through foreign entities, figures, or participation.

III

Transmission of tax losses through legal acts.

IV

Through a series of interconnected payments or operations, return all or part of the first payment amount to the person who paid it or to one of its partners, shareholders, or related parties.

V

In any transaction with a foreigner, when a treaty to avoid double taxation is applied on income that is not taxed in the country or jurisdiction where you are tax resident. Or when you apply for a reduced IT rate.



VI

Restructuring of operations between related parties:

- Transference of Intangibles.
- Restructurings, when they reduce their operating income by more than 20%
- Transfer or concession of goods and rights without consideration, or services or functions that are non-remunerated.
- There are no reliable comparatives for Transfer Pricing purposes.
- A unilateral protection regime is used, in terms of foreign laws according to Transfer Pricing guidelines.

VII

Avoids constituting a Permanent Establishment (PE) in Mexico.

VIII

Transmission of a depreciated asset, which allows its depreciation by another related party.

IX

When a hybrid mechanism is involved.

X

The identification of the beneficial owner of income or assets is avoided.

XI

When there are tax losses due to "expire" and operations are carried out to obtain tax profits.

XII

Avoid applying the additional 10% IT w/h rate in Mexico to dividends for 2014 and subsequent years.

XIII

The use of an asset is granted and the lessee, in turn, grants the use of the same asset to the lessor or a related party.

XIV

Involve operations whose accounting and tax records present differences greater than 20%, except for differences due to depreciation calculations.

XV

Others.



- Name, denomination, or company name and Tax ID of the taxpayer.
- Legal representatives' names.
- A detailed description of the scheme and national or foreign legal tax provisions.
- A detailed description of the tax benefit obtained or expected.
- Fiscal years in which it is expected to be implemented or has been implemented.
- Any information that is considered relevant.
- **Identification number of the reportable scheme.**

- **Disclose when:**
 - A tax benefit is obtained when operations are carried out with related parties residing abroad.
 - There are reportable schemes that have been designed, marketed, organized, implemented, or administered before 2020.





- Within 30 days of the day after the first contact is made for commercialization.
- The **reportable schemes that must be disclosed are those who are:**
 - Commercialized,
 - organized
 - implemented
 - managed; and
 - designed
- Any scheme implemented in 2020 or prior, that has any tax implication in 2020.

Infraction	Sanction (Amounts in MXN)
Not disclosing a Reportable Scheme, or reporting it incomplete, with errors or extemporaneous (except when spontaneous.)	\$ 50,000 to \$ 20,000,000
Not revealing a Generalized Reportable Scheme, which has not been implemented.	\$ 50,000 to \$ 20,000
To the Tax Advisor for not providing the Reportable Scheme identification number to taxpayers.	\$ 20,000 to \$ 25,000
Not meeting the requests for additional information on Reportable Schemes.	\$ 100,000 to \$ 300,000
Failure to issue the certificates as per article 197, paragraph seven FTC (Benefit without Reportable Scheme or legal impediment).	\$ 25,000 to \$ 30,000
Failure to report changes after the disclosure of the Reportable Scheme or doing so extemporaneously.	\$ 100,000 to \$ 500,000
Tax Advisor's yearly informative return on tax advice.	\$ 50,000 to \$ 70,000

F I N E



Identify if any of the assumptions of art. 199 FTC scheme is applicable.



Knowledge of the corporate structure of your Inter company operations.



Attention to compliance dates.




Notice for schemes designed prior to 2020.



Be aware of tax authorities' rules (pending to publish as of today).

A low-angle photograph looking up at a traditional building, possibly a monastery or temple, with numerous colorful prayer flags hanging from the roof and walls. The flags are in various colors including red, yellow, green, blue, and white, and are fluttering in the wind. The building's architecture features stone carvings and a central circular opening. The sky is a clear, pale blue.

**Non-Deductible Payments made to related parties
abroad in Preferential Tax Regimens (REFIPRES).**



Payments that taxpayers make directly to related parties residing abroad, or through a structured agreement, will not be deductible. (REFIPRES)

- The exceptions even when being in the case of REFIPRE ...
 - The recipient of the payment who obtains an income subject to REFIPRES resides in a country with a broad information exchange agreement with Mexico; and
 - The income derives from the exercise of its business activity, provided it is proven that it has the personnel and the necessary assets to carry out the said activity, or when the payment is indirectly taxed for the recipient.

- Payments to a Related Party residing abroad in a REFIPRE country.
- Payments to a Related Party residing abroad in a non-REFIPRE country, and this, in turn, makes deductible payments to another Related Party of the group that is resident in a country considered REFIPRE.
- Payments to Related Parties residing abroad in a REFIPRE country when the payment is characterized differently, and all or part of the payment is not taxed abroad (Hybrid).





How to meet the requirement?

Prepare a defense file containing the following:

- Background and information on the multinational group.
- Functional analysis consisting of a description of the activities, departments or areas, active personnel abroad, description of inter-company operations, description of tangible and intangible assets, and the risks assumed by each of the parties.
- Documental support. Physical evidence of invoices, service orders, and/or comparatives, questionnaires, among others.
- Contractual analysis of Inter companies.



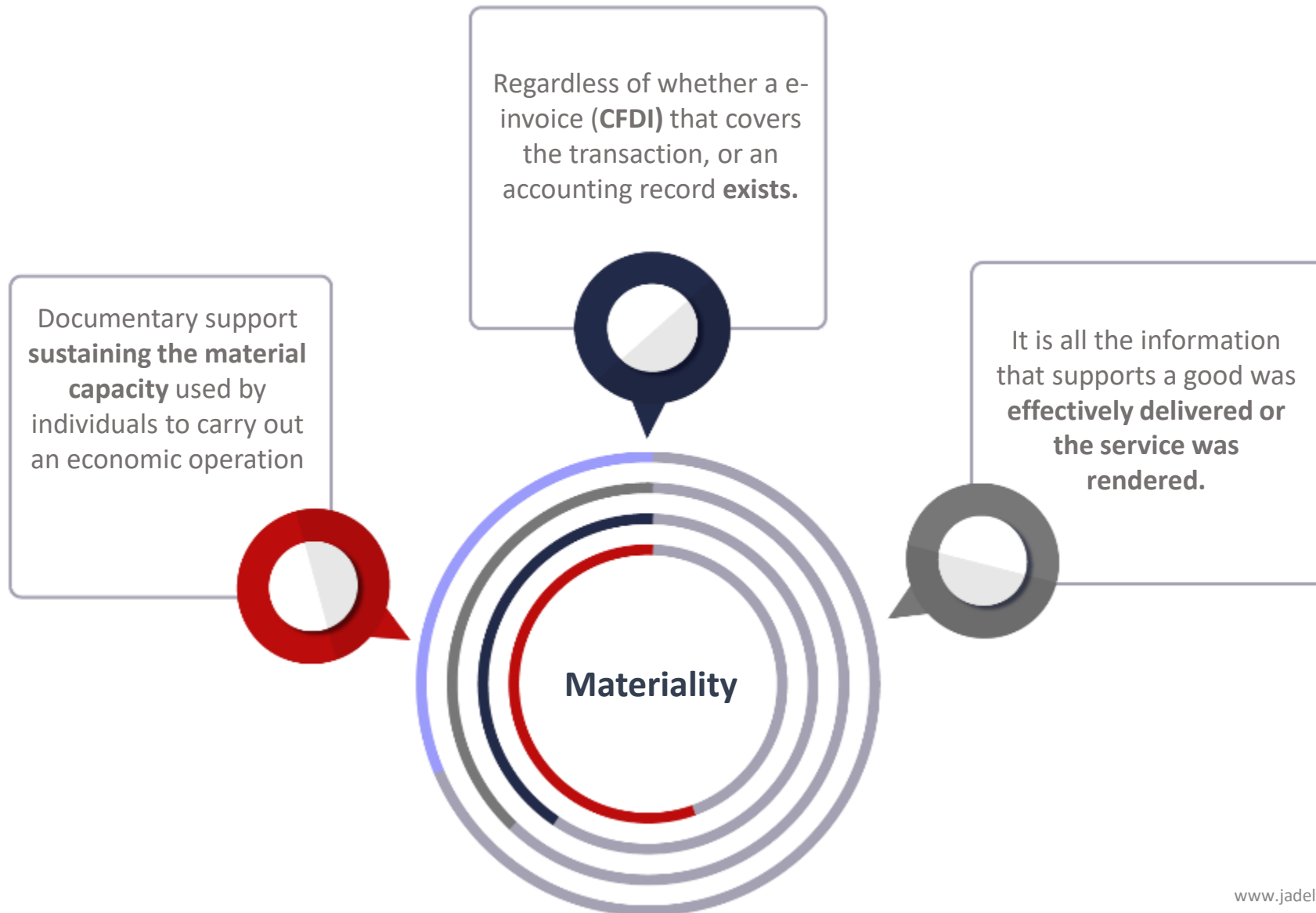
Materiality of the operations in
tax authorities' reviews.

- The authority may question the *materiality* of the operations carried out by taxpayers.
- It applies in income and/or deduction operations, as well as with related & non-related parties.

What happens if the doubts are not resolved before the authority?

- They will not recognize deductions.
- Uncreditable VAT.
- Interpretation of non-existent operations (blacklist in tax authorities data base).







Learn about some validation elements:

General: E-invoice (CFDI) that covers the operation, executed agreement ratified with a notary public, customer selection method, demonstrating employment relationship with the people involved in purchasing processes, etc.

For “sale of products”: the address where goods are stored, the procedure for entry and exit of goods, carriers used with their payment method, warehouse cards, inventory control.

For “services rendered”: Personnel who intervened for its execution with time and hour logs, addresses in which the works were carried out.

Support elements to demonstrate materiality

- Implementation of a comprehensive questionnaire for the validation of operations.
- The taxpayer must provide evidence (defense file).
- Identify transactions that could be questioned by the authority, mainly operations with related parties or rendering of services (intangible assets).
- Have all the support elements to demonstrate that the operation *effectively* took place.
- That the supporting elements (for example, contracts) are updated and reflect the flow of the transaction.



**Considerations for deduction of interest.
Thin capitalization & New limit of net interest rule.**

- This limitation was included within the tax legislation as of fiscal year 2020, which limits the deduction of net interests of a company or a group, if they belong to one.
- An attempt is made to condition the interest deduction according to the proportion of net interest and adjusted tax profit of the companies.
- This limitation will not be applicable to taxpayers whose net interests do not exceed \$ 20,000,000 MXN during the fiscal year.





- In the event that the companies belong to a *group*, the aforementioned amount must be distributed proportionally according to the cumulative income generated from the previous fiscal year.
- Non-deductible interests determined under this rule may be deducted during the next 10 years until they are exhausted (*temporary* effect for Deferred IT purposes).
- Exchange gains and exchange losses will not be considered within the definition of interest.

- Analyze the impact of non-deductible interest as a general rule of thin capitalization. (3 to 1 debt capital).
- If non-deductible interests correspond to the new rule on adjusted net tax profit, the higher amount determined in both calculations will be considered non-deductible.
- The calculations regarding the interest limitation are annual.
- The provisions of said limitations shall not apply to interest derived from debts for projects of exploration, extraction, transportation, storage, distribution of oil, hydrocarbons or electricity storage, or those corresponding to members of the financial system.



Trend of "Outsourcing" in Mexico.
What's to come?.

Operating company

It is the one that does not have directly hired employees.

Service providing company

Has employees directly hired.

There is a service agreement between them in place.

Insourcing

- Is part of the corporate group.
- Income is calculated based on transfer pricing.
- Limits risks in strikes (by not having their own employees).
- Limits risks of high-value assets.
- Specialization of activities.

Outsourcing

- Savings in personnel recruitment costs.
- Ease of replacing employees.
- The contracting company does not have labor liability obligations.
- Limits risks in strikes (by not having their own employees).
- Limits risks of high-value assets.
- Specialization of activities.

- The current Mexican president proposes to eliminate them in 2021.
- Tax authorities presumes that there are abusive practices:
 - No VAT payment
 - Incorrect Social Security contributions
- Tax authorities wants companies to have their own employees directly hired.
- Authority trend in 2020
 - Frequent audits and requirements in labor matters.

NOTE:

This can trigger economic problems for the country (loss of jobs, discouragement of foreign investment, among others).

AMLO anuncia iniciativa para desaparecer el outsourcing





What can we expect?

- Seeks that the requirements of Article 15-A of the Federal Labor Law are met. Otherwise, there will be implications for the hiring company:
 - Non-deductible expenses (wages paid without payroll digital stamps),
 - Non-creditable VAT,
 - Exposure of having to distribute the 10% of Profit Sharing (PTU) of the contracting company.
- Seeks that the contractor company has "economic capacity" to face the payment of contributions:
 - Have assets
 - Business reason / economic substance,
 - Be up to date with tax and labor obligations.

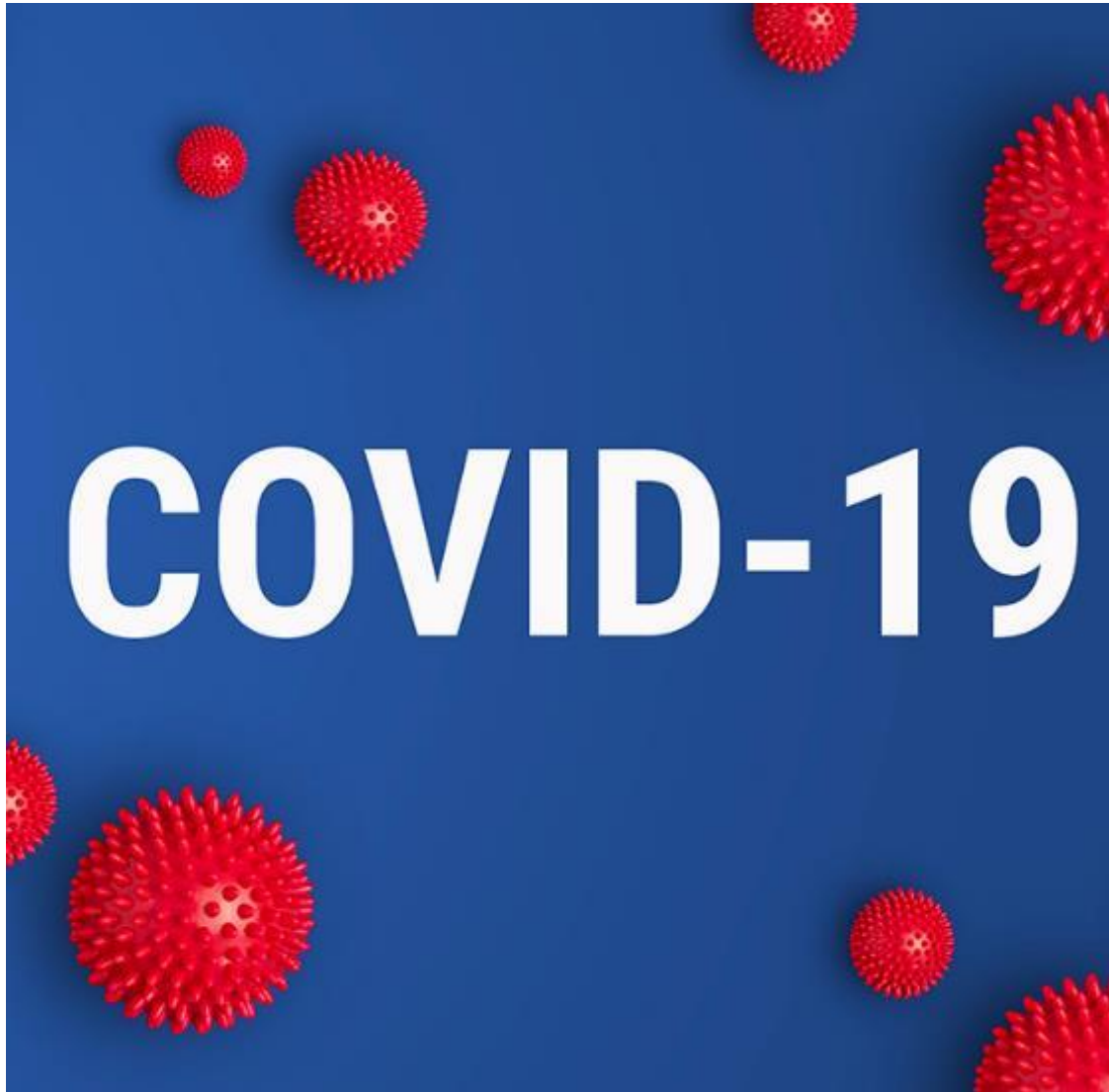
Does this mean that we must immediately eliminate dual company structures in 2021?

- Validate the correct compliance with art. 15-A.
- In the event of insourcing, validate that the operations are carried out as independent entities, demonstrating substance and materiality.
- Feasibility of incorporating employees into the operating company under the analysis of risks and functions.



A low-angle photograph looking up at a Tibetan Buddhist monastery. Numerous colorful prayer flags (red, yellow, green, blue, white) are strung across the frame, flying against a clear blue sky. The flags are attached to thin poles and are in motion, creating a sense of dynamic energy. In the background, the dark, ornate stone architecture of the monastery is visible, featuring traditional Tibetan design elements. The overall scene is bright and vibrant, with the colors of the flags contrasting sharply with the blue sky and the dark stone of the building.

COVID-19 and the effects on Transfer Pricing.



Consequences in the medium & long term?

- Immediate consequences for companies:
 - Reduction of consumer demand;
 - The impact on supply chains; and
 - The impact on financial markets.
- Businesses continue to hold the idle capacity and operating costs.

- Review of current transfer pricing documentation.
- The results of comparable companies may have affectations. There are temporary effects on financial information.
- The companies' income is determined considering the functions performed, the risks assumed, and their assets.
- Restructuring and changes in transfer pricing policies for business continuity and activities will be unavoidable for many.
- Assess each entity/section of the supply chain and identify where the restructuring will add value.
- Request the application of force majeure clauses or the alteration of the terms of the contract.

- Analyzing the possibility of a loan restructuring.
- Favoring shorter-term debts.
- Fixed-rate vs. variable rate?
- Real expectations of the payment of the principal.
- Country risk.





Measures to consider:



Analyzing the payment conditions and accrual of royalties derived from the current economic situation and the benefit obtained from said payments.



Staggered approach to royalties based on sales.



Natural reduction of royalty payments based on decreased income.



Comparable royalty rate analysis.

Topics



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Q & A