taxnotes® international

Volume 87, Number 12 ■ September 18, 2017

Mexico's CbC Reporting Requirements Are Part of a Larger Trade Strategy

by George L. Salis

Reprinted from *Tax Notes Int'l*, September 18, 2017, p. 1193

© 2017 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes International* content, please visit www.taxnotes.com.

© 2017 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Mexico's CbC Reporting Requirements Are Part of a Larger Trade Strategy

by George L. Salis

George L. Salis is a principal senior tax compliance, tax lawyer, and certified business economist (CBE) with Vertex Inc. He is based in Pennsylvania.

In this article, the author discusses Mexico's implementation of country-by-country reporting and new trade positioning.

The OECD's country-by-country reporting template requires corporations to demonstrate an unprecedented level of transparency when furnishing tax data. Mexico's adoption of the CbC reporting template reflects important economic and trade issues that are not readily apparent. Mexico incorporated into domestic law the requirements of action 13 of the base erosion and profit-shifting action plan by enacting article 76-A of the Mexican Income Tax Law (Ley de Impuesto Sobre la Renta), with the tax authority issuing final rules on May 15.

Although Mexico's final CbC rules (Declaracion Informativa Pais por Pais, or DCIPxP) appear straightforward on the surface, taxpayers should be aware that there are some added requirements that extend beyond action 13's stated requisites. Like many other countries, Mexico adopted the OECD's recommended CbC reporting template with some important adjustments. Mexico's local file (Declaracion Informativa Local) requires significant additional information that may or may not be available to the Mexican subsidiary operating abroad, depending on the foreign jurisdiction involved. Accordingly, article 76-A, Section III, paragraph C of the Mexican Income Tax Law states that embedded in the general rules of the tax authority (SAT) is the ability of the SAT to solicit and require additional information not present or obvious within the CbC. The added requirements may pose an interesting legal and compliance dilemma for the Mexican parent company that may call for a constitutional legal challenge.

Under the new Mexican Income Tax Law, the CbC report must be filed by a Mexican multinational company or another group-related designated company. A local Mexican operating entity can also be designated a "surrogate parent entity" and thus may be compelled to furnish a CbC report within 120 days if the SAT does not receive one from the foreign company's controlled group's parent entity — whether through a bilateral tax treaty or a tax information exchange agreement.

The additional information demanded is not necessarily required to conform to the recommended prerequisites of the OECD's action 13. It is the conformity to or parity with Mexican tax law and its constitutional alignment that can give rise to the legal challenge known as the *amparo*, or, in this case, a protective order. This can occur if the information required is not readily available or is not in line with the applicable multilateral competent authority agreement (MCAA) provisions for the exchange of information with Mexico, such as CbC, as signed on January 27, 2016, and later incorporated into domestic law.

Article 76-A took effect in January 2016, and the initial filing date for Mexico CbC reports is December 31 of this year, when companies submit their 2016 tax returns. Setting economic and trade issues aside for a moment, Mexico's CbC reporting requirements pose some of the same types of tax management and data management challenges as other countries' CbC reporting templates, with the exception of the concerns discussed above. Tax managers within companies that conduct business in Mexico should recognize and address these issues and be aware of the specific

For more *Tax Notes International* content, please visit www.taxnotes.com.

subsidiary information required in each group-related entity that may trigger certain local reporting and legal difficulties.

While those challenges can be substantial, chief tax officers and their executive colleagues should also understand how Mexico's swift and comprehensive adoption of CbC reporting rules and related OECD guidelines reflects a larger, long-term drive to burnish its reputation throughout Latin America as a regional trade leader. Further, Mexico's embrace of CbC reporting — along with its adoption of the OECD's transfer pricing rules and the BEPS initiative — signals that it is committed to the expansion of free trade around the world, at a time when its relationships with its largest trading partner, the United States, remains uncertain.

CbC Reporting Adoption

The CbC reporting requirements, which were finalized by the OECD in late 2015, are part of the organization's ongoing BEPS initiative. The OECD's final BEPS report includes 15 action items, which were created to eliminate the gaps in international tax rules that enabled multinational corporations (MNCs) to legally, but artificially, shift profits to low-tax or no-tax jurisdictions. The CbC reporting template is a component of BEPS action 13 (which also includes master file and local file documentation) and requires the aggregation of high-level financial data of an MNC and its entities within the country. These data include revenue, before-tax profits, taxes paid and accrued, number of employees, stated capital, accumulated earnings, tangible assets, and more.

Since its finalization by the OECD two years ago, the CbC reporting template has been adopted by most member countries, including Mexico, with varying levels of changes. Mexico moved quickly to adopt the CbC template — so quickly, in fact, that the country's tax authorities began mobilizing even before the OECD had finalized its template and action 13. The CbC reporting template is very much in line with the Mexican government's long-standing effort to prevent companies from taking advantage of differing tax treatments and to increase tax transparency.

On January 1, 2016, article 76-A of Mexico's Income Tax Law took effect. These rules contain Mexico's CbC reporting requirements as well as other requirements from the OECD's BEPS action 13 that cover transfer pricing documentation and Chapter VI of the transfer pricing guidelines. In April of this year, PRODECON, Mexico's tax ombudsman (the country's consumer and taxpayer protection overseer), finalized the rules concerning the tax returns that, starting at the end of this year, MNCs must file to comply with its CbC reporting requirements. These rules are consistent with the OECD's recommendations concerning action 13, according to the PwC bulletin "Mexico: PRODECON Publishes Final Rules for Country-by-Country Reporting." MNCs are required to prepare three returns in accordance with action 13 and its CbC reporting requirements. These are:

- a master file;
- a local file; and
- the CbC report.

"Multinational groups that have not yet conducted preliminary reporting exercises," the PwC report asserted, "should do so as soon as possible in order to determine criteria for filing, not only in Mexico, but also in other jurisdictions where they do business."

Questions of Readiness

CbC reporting requirements inject another dose of complexity into tax data management activities within MNCs. These requirements in all countries, including Mexico, change how data will need to be controlled, sourced, and reported. The following sets of questions can help tax managers determine the extent to which their organizations are prepared to report financial data by tax jurisdiction and legal entity:

- Can your organization aggregate financial data by country?
- Can your organization convert business-unit financial data into legal entity data?
- Can your organization separate the data by country?
- Can your organization reconcile to local statutory statements and local tax returns?

Data Control and Other Challenges

Preliminary reporting run-throughs can help tax managers pinpoint which facets of the CbC reporting requirements are likely to pose the

For more *Tax Notes International* content, please visit www.taxnotes.com.

© 2017 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

greatest difficulties. While each company will experience unique reporting challenges based on internal procedural and technological factors, the following steps can help tax managers understand and address the most common CbC reporting issues that will arise in all countries complying with BEPS actions:

- *Assess enterprise resource planning (ERP) and/or accounting systems.* Accounting and ERP systems may not necessarily support the aggregation of data on a CbC basis, as CbC reporting requires. Tax managers, often in collaboration with their finance and accounting and IT colleagues, should find out if the current system collects and organizes data according to business lines only or if the system can also collect information by legal entity and/or geographic location. If the former is true, manual work likely is required. For example, business unit financial information would need to be converted to the legal entity, and then the legal entity information would need to be organized by country before reconciling it with Mexico's statutory statements and tax returns.
- *Evaluate data access and control.* The more manual work required to complete the CbC reporting template, the higher the risk of reporting errors. While most of the required CbC data can be sourced at the trial balance level, tax managers should determine the extent to which the data can be accessed in an automated fashion. It is crucial to clearly determine and document the CbC reporting process. This includes identifying who will prepare the template (for example, a corporate controller or tax manager, someone in Mexico if the company is based elsewhere, or a small team). It is also important to recognize that local legal entity statutory financial statements often contain data that reside beyond the control of corporate tax departments. This can create data control issues in cases when a corporate tax or finance manager (based outside Mexico or another local country) is responsible for preparing the template.
- *Evaluate the ease of data reconciliation.* As is the case with other countries, Mexico does not require MNCs to reconcile CbC reporting disclosures with: the company's audited financial statements; legal entity books on both a worldwide consolidated financial basis and local statutory basis; local country tax returns; or transfer pricing documentation. However, MNCs may elect to perform these reconciliations on their own as a form of leading practice. In these cases, finance and tax managers should recognize that these reconciliations quickly become complicated, particularly when merger and acquisition activities and intercompany transactions occur, as well as when global expansion, operational changes, and changes to tax planning structures have taken place.
- *Assess what changes will improve future CbC reporting activities.* Most MNCs will need to implement new data collection processes to supplement data delivered by existing accounting systems. Technology upgrades may also make sense. Technology that comprehensively manages data for income tax purposes with an audit trail and record retention can help with template filing and the reconciliation of financial data as well as with tax returns.

Data Control Determinations

The effectiveness and efficiency of CbC reporting processes hinge on the level of control that tax, finance and accounting, and IT managers can exert over the CbC data. The following steps can help strengthen the level of data control while highlighting areas in need of improvement:

- Determine if the current ERP system and configuration maintains trial balances by legal entity or by country; and determine if the system supports local statutory reporting as well as consolidated reporting on relevant accounting rules.
- Determine the identity and location of the individual or individuals responsible for preparing the CbC reporting templates.
- Determine if needed CbC reporting data are sourced from more than one ERP system. If so, identify ways to mitigate the risks associated with data being sourced outside of the corporate tax department's control.

Boosting Mexico's Trade Hand

As tax leaders and their executive colleagues within MNCs address CbC reporting

© 2017 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes International* content, please visit www.taxnotes.com.

requirements, they should recognize how Mexico's adoption of these requirements fits into the country's regional and global trade intentions.

Mexico's adoption of the OECD's recommended CbC reporting template is notable for its speed and comprehensive nature. Rather than adopting CbC reporting requirements alone, Mexico incorporated all of action 13, which includes transfer pricing documentation requirements, by amending its Income Tax Law. This effort also began before the OECD finalized its BEPS action items — and well before last year's U.S. presidential elections. This strong embrace of the OECD's drive for tax transparency seems intended to send an equally strong signal to Mexico's current and future trading partners that the country intends to operate as a leader in international trade.

As *The Economist* recently indicated, "There has never been a better time for Latin American integration" on trade.[1] The publication reported on a growing desire for the convergence of Mercosur (a customs arrangement among Brazil, Paraguay, and Uruguay) and the Pacific Alliance (a free-trade group that counts Mexico, Chile, Colombia, and Peru as members).

Although the new U.S. president officially scotched the Trans-Pacific Partnership by withdrawing, Mexico and its Pacific Alliance partners have been exploring ways to bring the Trans-Pacific Partnership back without U.S. participation. Furthermore, while the drawn-out uncertainty put forth by President Trump around the North American Free Trade Agreement's potential renegotiation or abolishment poses difficulties for Mexico, the way the country adopted the OECD's CbC requirements demonstrates Mexico's commitment to its sustained leadership position in Latin American trade and beyond. ■

[1] "Bello: There Has Never Been a Better Time for Latin American Integration," *The Economist*, Mar. 23, 2017.

For more *Tax Notes International* content, please visit www.taxnotes.com.

© 2017 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.