

***MEXICO***  
***Efficient Tax Planning***  
***Structures and Related***  
***Considerations in the Wake of a***  
***Transparent World***

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July 28, 2016

# Agenda

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## **A. DOMESTIC ENVIRONMENT**

- 1. OVERVIEW OF EXISTING PROVISIONS**
- 2. NO CHANGE IN MEXICO'S CFC RULES**
- 3. COURT DECISIONS**
- 4. 2016 TAX AMNESTY**

## **B. INTERNATIONAL DEVELOPMENTS**

- 1. BEPS**
- 2. FATCA**
- 3. TRANSPARENCY AND EXCHANGE OF INFORMATION**
- 4. OTHER INTERNATIONAL EVENTS**

## **C. EFFICIENT VS NON-EFFICIENT STRUCTURES**

## **D. THE FUTURE OF PRIVATE BANKING**

# Overview of Existing CFC Provisions

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- Called "preferential tax regime".
- It is an anti-deferral regime.
- Three concerns:
  1. Current recognition of income, even if not actually distributed.
  2. Information returns.
  3. Simulation.

# Current Income Recognition

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- Current recognition of income not effectively taxed at least at **75% of Mexico's tax rates**:
  - 30% corporate tax rate
  - 35% individual tax rate
- Current recognition of income generated through foreign **fiscally transparent vehicles** even if taxed at 75% or more of Mexico's rates.

# Current Income Recognition - Exceptions (1)

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- **Business activities** with less than 20% passive income:
  - Interest, dividends, royalties, sale of shares and other securities or intangibles.
  - Gains from derivatives where the underlying asset is debts or shares.
  - Commissions and mediations.
  - Sale of assets located outside of the vehicle's residence.
  - Services rendered outside the vehicle's residence.

# Current Income Recognition - Exceptions (2)

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- Income generated through **vehicles taxed at 22.5% or higher**, provided:
  - All of their income is taxed.
  - Except for same-country dividends.
  - Deductions actually disbursed (i.e. on a cash basis).
  - Presumption in the law that these conditions are NOT met.

# Current Income Recognition - Exceptions (3)

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- **Royalties** for patents or industrial secrets
  - Developed internally or purchased at FMV.
  - Not deducted in Mexico.
  - Royalties at FMV.
  - Accounting records available to the tax administration.

# Current Income Recognition - Exceptions (4)

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- Passive income generated by **financing entities** duly chartered in their country of residence, provided:
  - Authorization is secured from Mexican tax administration.
  - Income is at FMV.
  - Not deducted in Mexico.



# Current Income Recognition - Exceptions (5)

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- International **intra-group transfers of shares**, including by merger or spin-off, provided:
  - Before-the-fact notice to Mexican tax administration.
  - Valid business and economical purpose other than tax benefits.
  - Notice to tax administration 30 days after the restructuring is completed, with copies of supporting documents.
  - 2-year holding period.

# Current Income Recognition - Exceptions (6)

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- Direct or indirect average daily participation in the vehicle NOT allowing the taxpayer to have **control** over the vehicle or over its management such that he could decide when income, profits or dividends are to be paid out.
- The law sets forth a rebuttable presumption to the effect that does have such control.
- **THIS IS, BY FAR, THE MOST IMPORTANT EXCEPTION ON WHICH THE VAST MAJORITY OF TAX PLANING RELIES.**

# Information Returns

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- **Obligation to report:**
  - Income generated during preceding year through foreign vehicles, **not meeting the 75% taxation threshold.**
  - Income generated from Mexico's **black-listed territories.**
  - Transactions (not income) through foreign **fiscally transparent vehicles.**

# Simulation

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- Tax administration empowered to declare that simulation has taken place in related-party transactions.
- Simulation is:
  - Making something appear different from what actually took place.
  - Making something appear which did not take place.
- Tax Administration must provide legal grounds and reasoning for its decision.
- It must prove the intention to simulate.
- Where simulation is declared, the true transaction is taxed accordingly.
- Can be tantamount to tax fraud.
- Can give rise to criminal penalties.

# No Change in Mexico's CFC Rules

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- Same "preferential tax regimes" rules in effect since 2007.
- Except for broadening definition of passive income in 2004 to include:
  - Income from the sale of real property.
  - Income from granting the temporary use or enjoyment of property.
  - Income received gratuitously.

# Court Decisions

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- **75%** threshold refers to taxes actually paid outside of Mexico (i.e. effective tax rate).
- \*\*CFC rules do not apply where the taxpayers have **no control** over the timing of income, profits or dividend distributions.\*\*
- Taxpayers must keep **accounting records** at the disposition of the tax administration and file information returns to be entitled to claim deductions or losses from CFC investments.
- CFC income, deductions and losses from CFC investments should be **computed separately** from other income, deductions and losses.

# 2016 Tax Amnesty

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- Applied to income from direct and indirect investments held outside of Mexico up to December 31, 2014.
- Benefit was to pay all taxes, with indexation but with no interest or penalty. And to claim foreign tax credits for taxes paid outside of Mexico.
- June 30, 2016 deadline.

# 2016 Tax Amnesty (2)

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- **Conditions:**
  - Income and investments were to be repatriated.
  - Investments themselves should also pay tax if they were originally subject to Mexican taxation.
  - Repatriated income and investments were to be invested in fixed assets to be held for at least 3 years, R&D, payment of non-related party liabilities, certain investments through the Mexican financial system.



## 2016 Tax Amnesty (3)

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- As of May 31, repatriation was of only 478 million pesos. Taxes collected amounted to only 92 million pesos.
- Tax expectations were between 300 to 400 million.
- The Mexican tax administration has stated that there are 174,000 Mexicans with bank accounts in the US.
- Further information will be received under tax exchange of information agreements.
- **SAT has stated that taxpayers who did not take advantage of the amnesty will be audited.**

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# Base Erosion and Profit Shifting

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- BEPS refers to tax avoidance strategies that exploit **gaps and mismatches** in tax rules to artificially shift profits to low or no-tax locations.
- 85 members in the BEPS Project, with a further 19 countries and jurisdictions likely to join by year end
- BEPS establishes a modern international tax framework under which profits are taxed where **economic activity and value creation** occur.

# BEPS 15 Action Plans

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- **Action 1. Addressing the Tax Challenges of the Digital Economy**
- **Action 2. Neutralising the Effects of Hybrid Mismatch Arrangements**
- **Action 3. Designing Effective Controlled Foreign Company Rules**
- **Action 4 . Limiting Base Erosion Involving Interest Deductions and Other Financial Payments**
- **Action 5 . Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance**

# BEPS 15 Action Plans (2)

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- Action 6 . Preventing the Granting of **Treaty Benefits** in Inappropriate Circumstances
- Action 7 . Preventing the Artificial Avoidance of Permanent Establishment Status
- **Actions 8-10. Aligning Transfer Pricing Outcomes with Value Creation**
- Action 11. Measuring and Monitoring BEPS
- **Action 12. Mandatory Disclosure Rules**
- Action 13 . Transfer Pricing Documentation and Country-by-Country Reporting

# BEPS 15 Action Plans (3)

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- **Action 14. Making Dispute Resolution Mechanisms More Effective**
- **Action 15 . Developing a Multilateral Instrument to Modify Bilateral Tax Treaties**

# Foreign Account Tax Compliance Act

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- Mexico and the US entered into an agreement to improve international tax compliance including with respect to FATCA, effective July 1, 2014.
- The United States informs Mexico, with respect to each Mexican reportable account of each reporting U.S. financial institution:
  - (1) the name, address, and Mexican TIN of any person that is a resident of Mexico and is an Account Holder of the account;
  - (2) the account number (or the functional equivalent in the absence of an account number);

# FATCA (cont)

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- (3) the name and identifying number of the Reporting U.S. Financial Institution;
  - (4) the gross amount of interest paid on a Depository Account;
  - (5) the gross amount of U.S. source dividends paid or credited to the account; and
  - (6) the gross amount of other U.S. source income paid or credited to the account, to the extent subject to reporting under chapter 3 or 61 of subtitle A of the U.S. Internal Revenue Code.
- The first exchange took place at the end of October 2015. The second exchange shall take place in September 2016.



# Transparency, Exchange of Information

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- OECD Global Forum on Transparency and Exchange of Information.
- Premier international body for ensuring the implementation of the **internationally agreed standards of transparency and exchange of information** in the tax area.
- In-depth **peer review process** to monitor that its members fully implement the standard of transparency and exchange of information they have committed to implement.

# Transparency, Exchange of Information

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- It also works to establish a level playing field, even among countries that have not joined the Global Forum.
- The implementation of the international standard significantly contributes to the **fight against tax evasion**, as well as achieving greater international co-operation and enhanced transparency of corporate bodies, arrangements and financial information.
- It is increasingly **difficult** for taxpayers and financial institutions **to benefit from secretive structures and related planning**. The **difficulty of concealing money offshore** will increase enormously.

# Transparency - Exchange of Information

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- Two internationally agreed standards:
  - **Automatic** exchange of information.
  - Exchange of information **on request**.
- 54 jurisdictions have committed to undertake first **automatic** exchanges by 2017.
- 47 jurisdictions have committed to undertake first **automatic** exchanges by 2018.
- The Global Forum has 135 member countries. **All** have committed to implementing the **on request** standard.

# Transparency - Automatic Exchange

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- Takes an important step towards greater transparency and **putting an end to banking secrecy** in tax matters
- Calls on jurisdictions to obtain **information from their financial institutions** and **automatically exchange** that information with other jurisdictions on an annual basis, including balances, interest, dividends, and sales proceeds from financial assets, reported to governments by financial institutions and covering accounts held by individuals and entities, **including trusts and foundations.**

# Transparency - Automatic Exchange

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## JURISDICTIONS UNDERTAKING FIRST EXCHANGES BY 2017 (54)

Anguilla, Argentina, Barbados, Belgium, Bermuda, British Virgin Islands, Bulgaria, Cayman Islands, Colombia, Croatia, Curaçao, Cyprus, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Jersey, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Montserrat, Netherlands, Niue, Norway, Poland, Portugal, Romania, San Marino, Seychelles, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Trinidad and Tobago, Turks and Caicos Islands, United Kingdom



# Transparency - Automatic Exchange

## JURISDICTIONS UNDERTAKING FIRST EXCHANGES BY 2018 (47)

Albania, Andorra, Antigua and Barbuda, Aruba, Australia, Austria, The Bahamas, Bahrain, Belize, Brazil, Brunei Darussalam, Canada, Chile, China, Cook Islands, Costa Rica, Dominica, Ghana, Grenada, Hong Kong (China), Indonesia, Israel, Japan, Kuwait, Lebanon, Marshall Islands, Macao (China), Malaysia, Mauritius, Monaco, Nauru, New Zealand, Panama, Qatar, Russia, Saint Kitts and Nevis, Samoa, Saint Lucia, Saint Vincent and the Grenadines, Saudi Arabia, Singapore, Sint Maarten, Switzerland, Turkey, United Arab Emirates, Uruguay, Vanuatu

# Transparency – On-Request Exchange

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- The internationally agreed tax standard on exchange of information provides for **full exchange of information on request** in all tax matters.
- **No restrictions on exchange caused by bank secrecy** or domestic tax interest requirements.
- Information held by **banks, other financial institutions**, and any person acting in an **agency or fiduciary capacity** including **nominees and trustees**:
  - Account, financial, and transactional information and information on the identity or legal structure of account holders and parties to financial transactions.

# Transparency – On-request Exchange

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- The term **“agency”** is very broad and includes all forms of corporate service providers (e.g., **company formation agents, trust companies, registered agents, lawyers**).
- Information regarding the **ownership** of companies, partnerships, and other persons or contractual arrangements, including ownership information in an **ownership chain**. Not only legal ownership but also on other person(s) who may be the **beneficial owner(s)**.



## Transparency – On-Request Exchange

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- Where jurisdictions permit the issuance of **bearer shares** they should have appropriate mechanisms in place that allow the **owners of such shares to be identified**. One possibility among others is a custodial arrangement with a recognized custodian or other similar arrangement to immobilize such shares.
- In the case of **trusts**, information should be supplied on **settlers, trustees and beneficiaries**. Also information on persons who are in a position to **direct how assets of the trust are to be dealt with**.

# Transparency – On-Request Exchange

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- Regarding **foundations**, information on the **founders, members of the foundation council and beneficiaries**. “Foundation council” interpreted very broadly to include **any person or body of persons managing the foundation** as well as persons who are in a position to **direct how assets of the foundation are to be dealt with**.

# Transparency - Mexico

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- Mexico exchanges information with the United States, (i) automatically, (ii) upon request and also (iii) spontaneously, since 1994.
- It now also exchanges information under FATCA.
- Mexico has rapidly been increasing its exchange of information treaties.
- It is expected to exchange information with around 146 countries in 2017.

# Other International Events

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- Lux leaks – tax rulings.
- Swiss leaks – bank account holders.
- Panama papers – offshore structures.
- They all show that in this new world no secret is well kept.
- Advisors are also at risk: reputational risk and investigations.

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# Typical Wealth Management Products

## Typical Wealth Management Products



# Wealth Planning Components



# Efficient Structures

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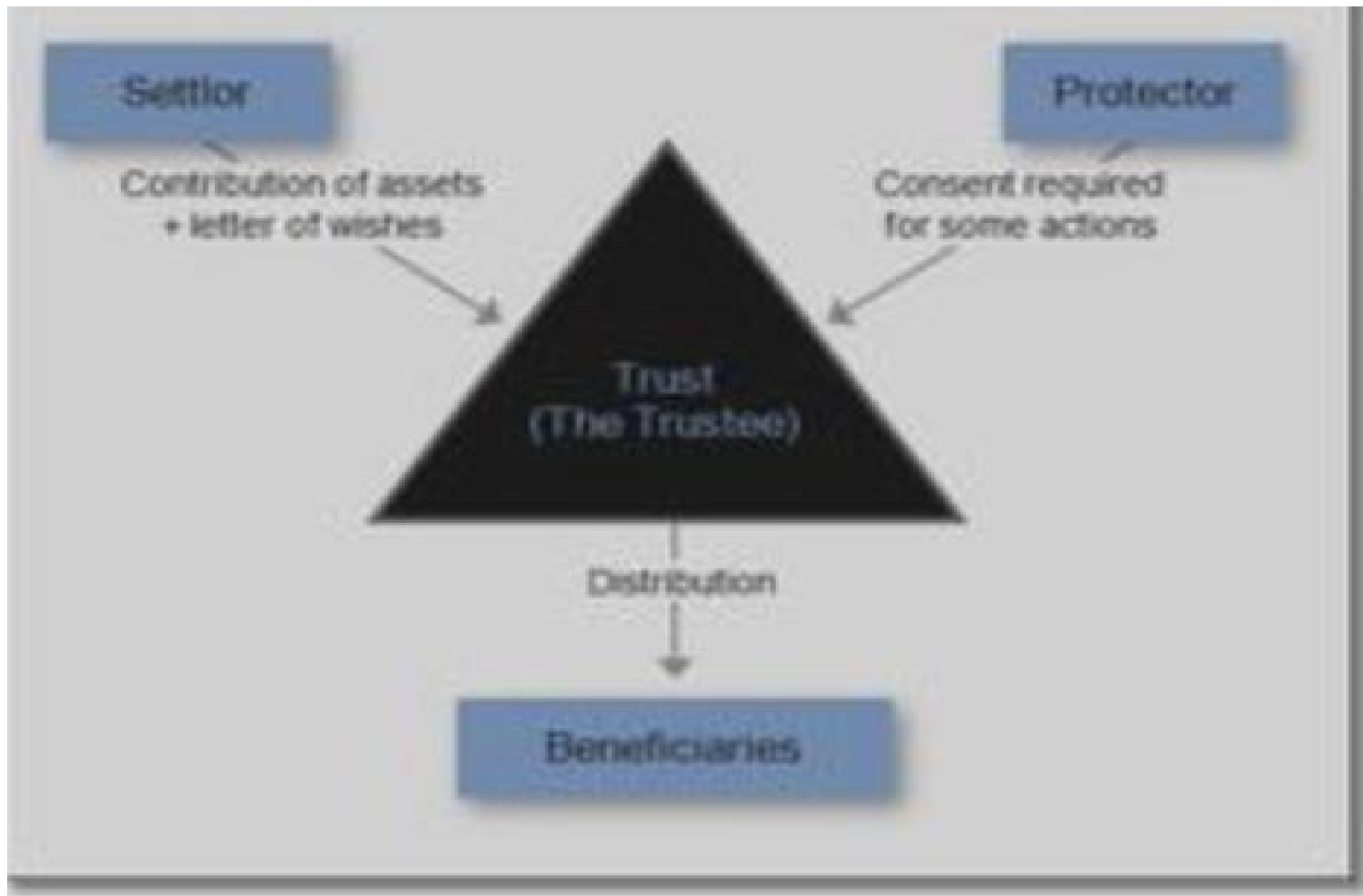
- Efficient structures:
  - Multiple structures still available:
    - Mexican taxpayer should have **no direct or indirect control** over timing of distributions from top vehicle.
    - Ideally top vehicle **not in a blacklisted country**, to avoid reporting.
    - Ideally top vehicle **not fiscally transparent**, to avoid reporting.
  - No limitations on second and subsequent tier investments or vehicles. May be transparent (not subject to taxation) or located in listed countries.



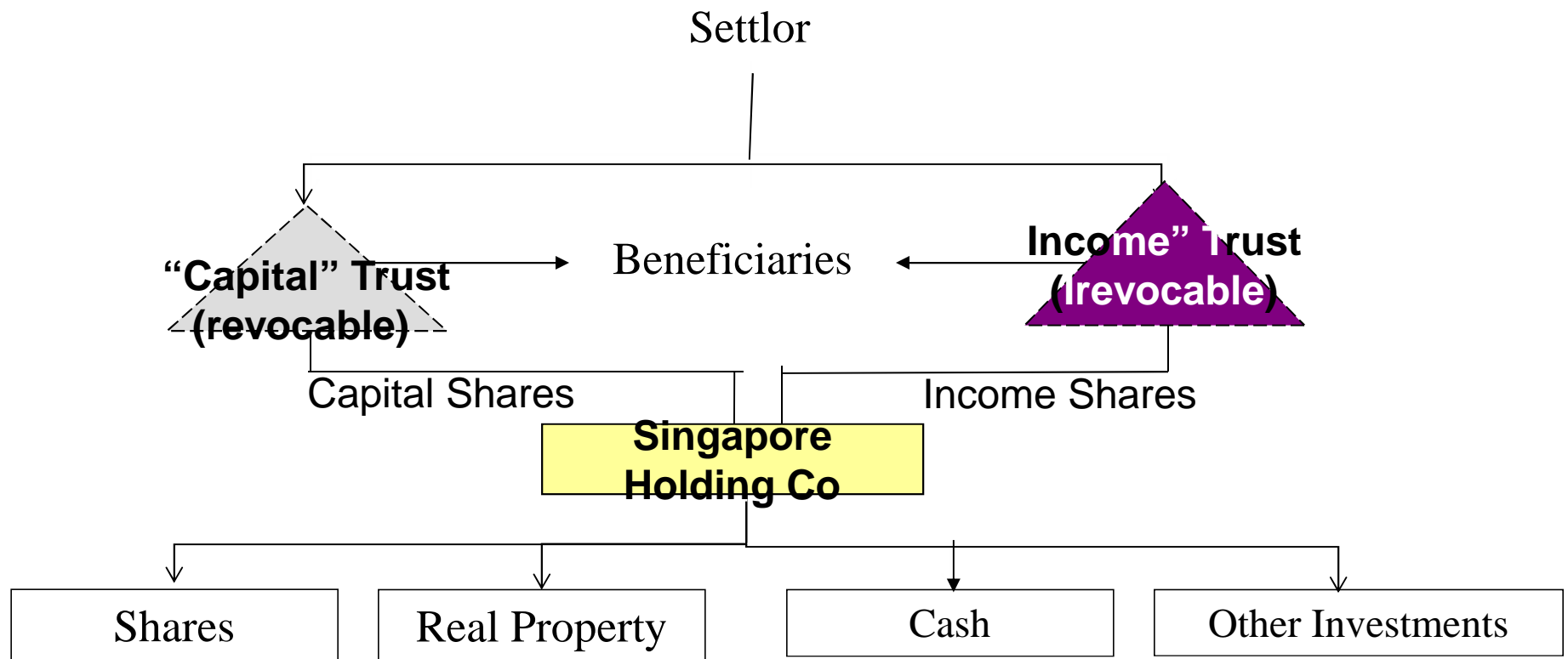
# Trusts



# Trusts



# Dual-Trust Structure

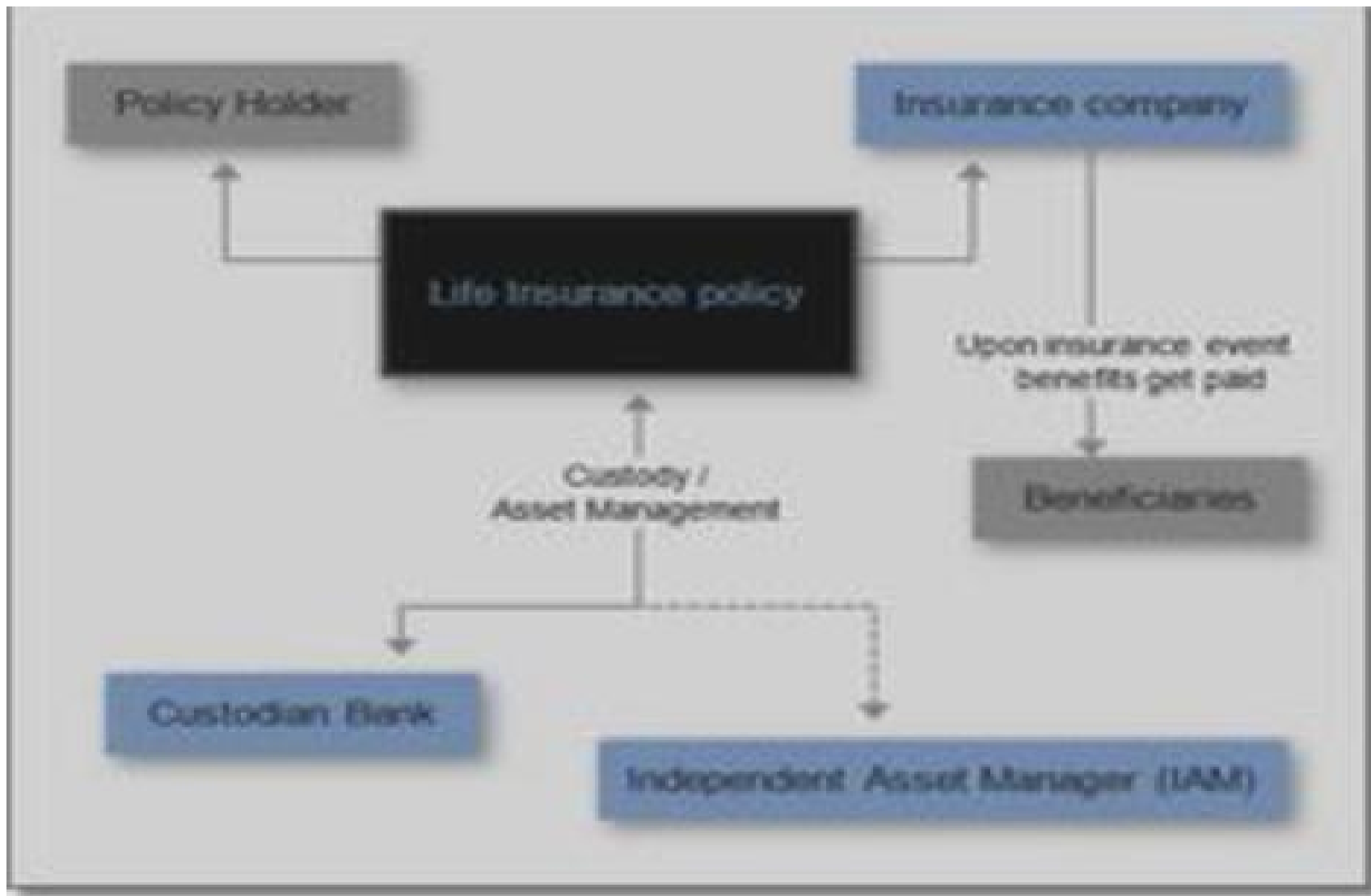


# Life Insurance

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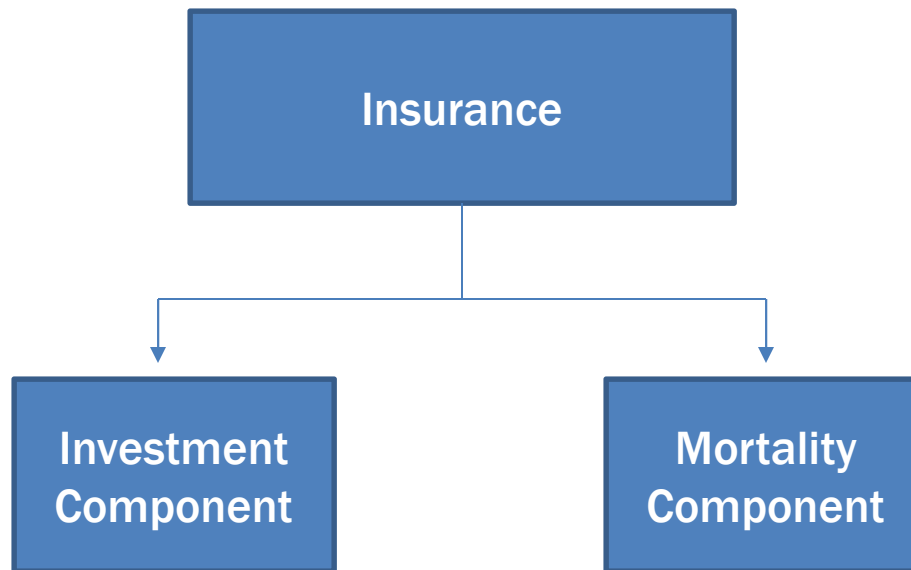


# Life Insurance



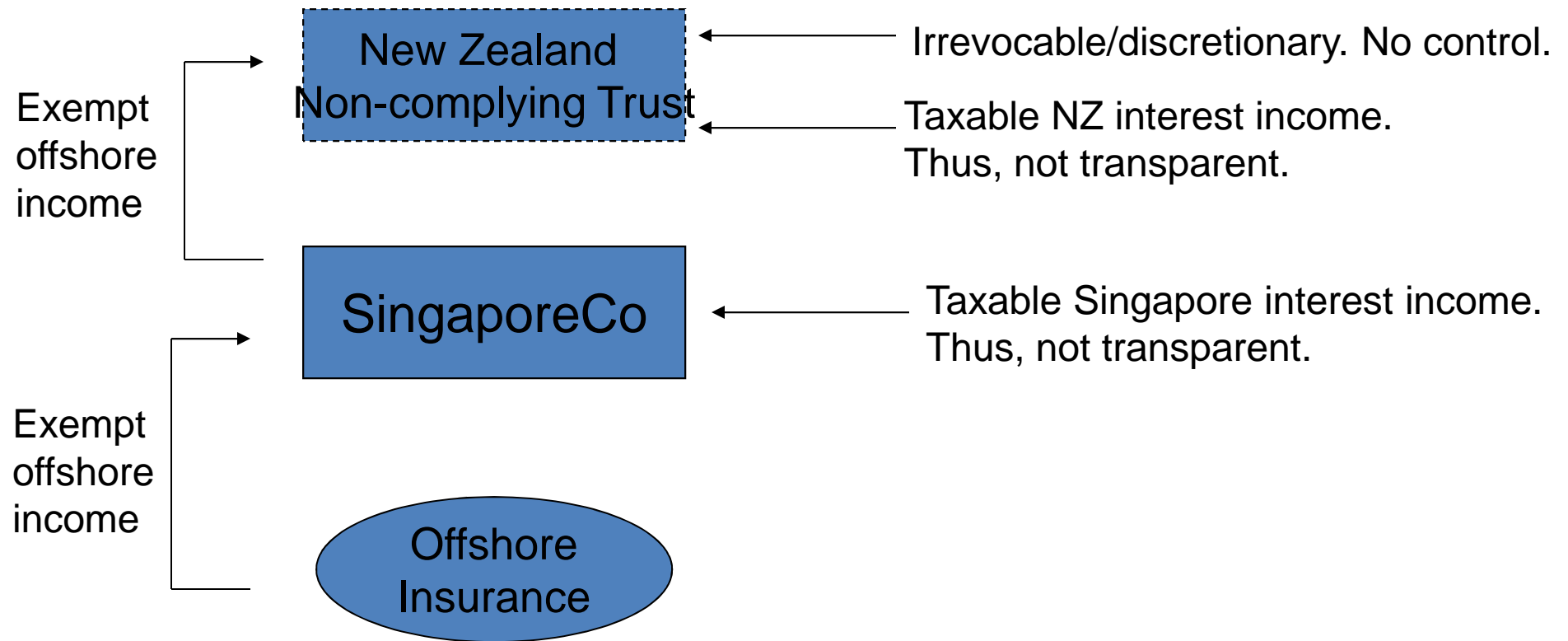
# Life Insurance – Components

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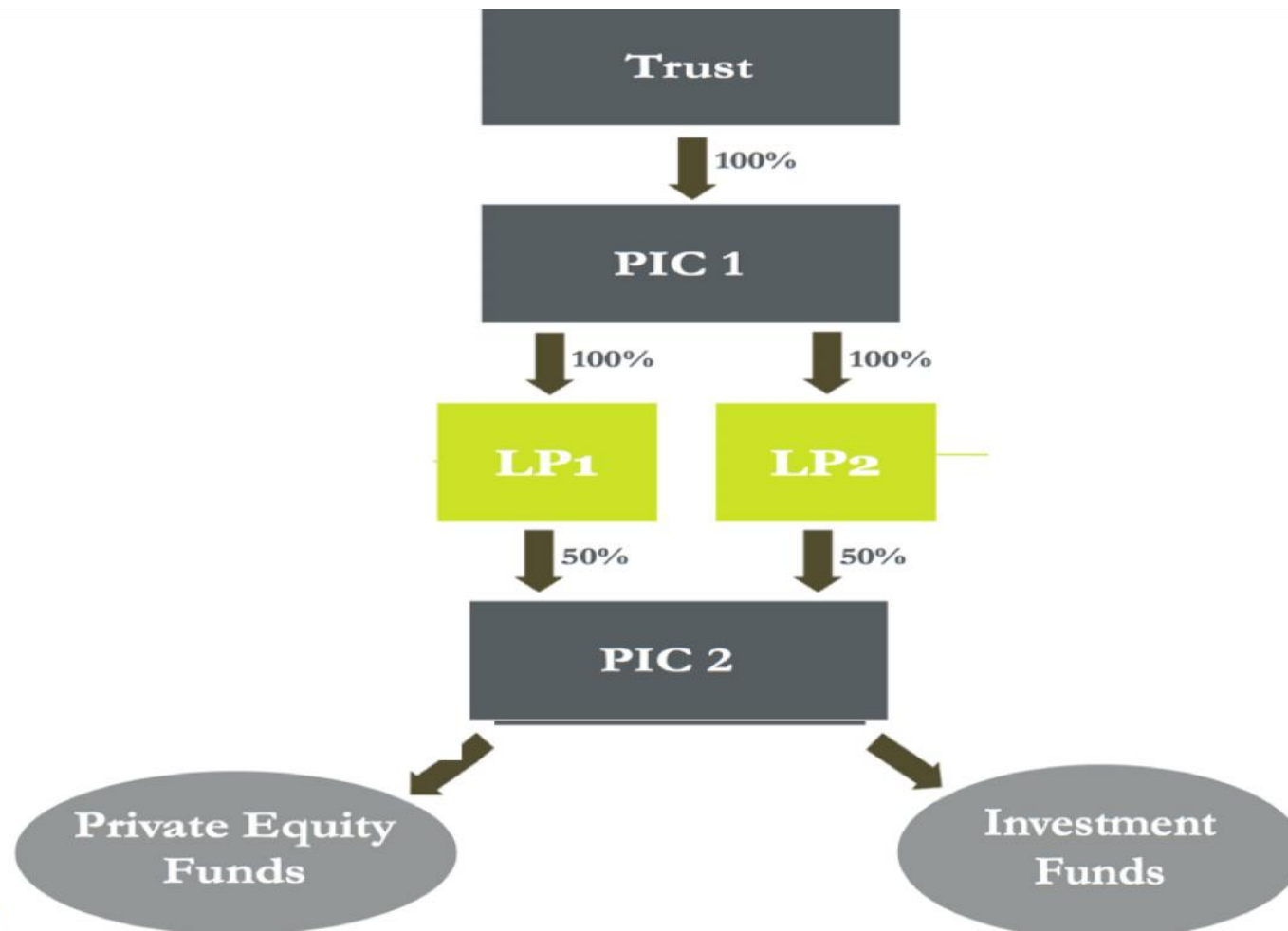
# Life Insurance - Possible Structure

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- Family members appointed as beneficiaries under the trust, to receive shares of SingaporeCo tax free upon death of settlor.

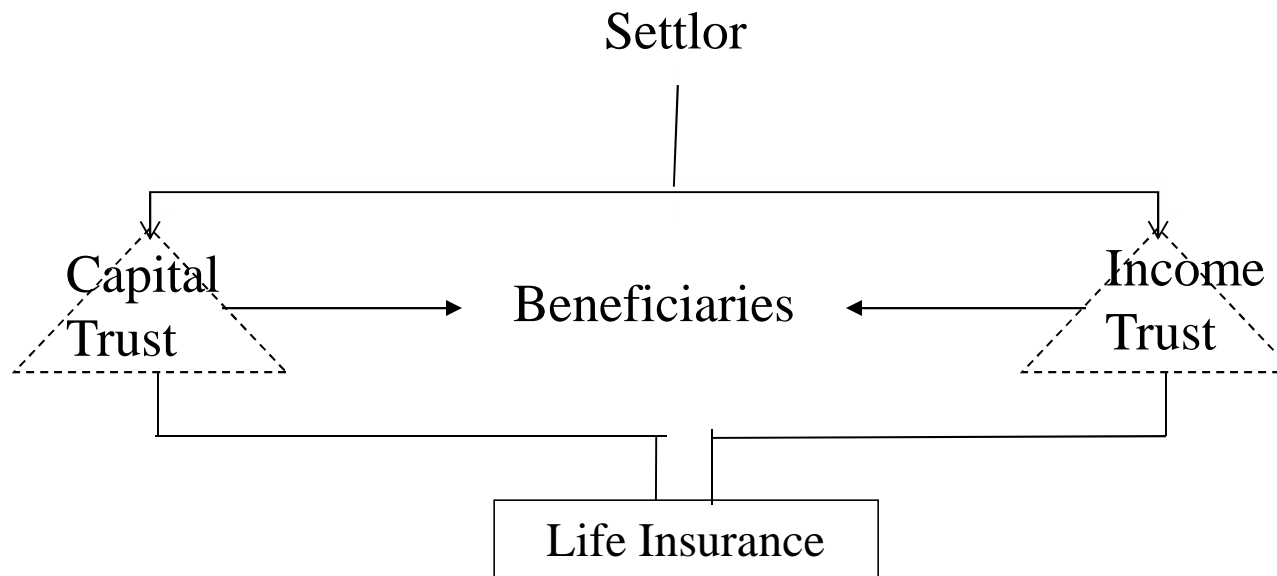
# Life Insurance – Possible Structure





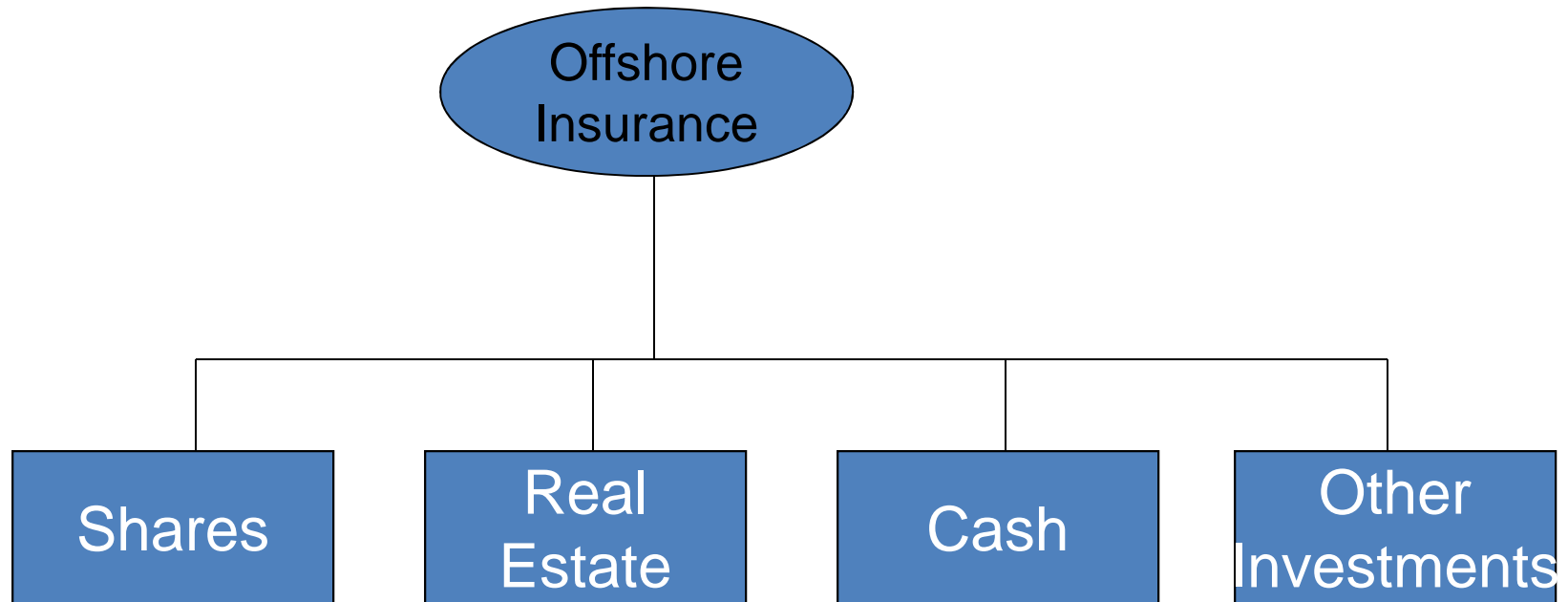
# Life Insurance – Possible Structure

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# Life Insurance - Possible Structure

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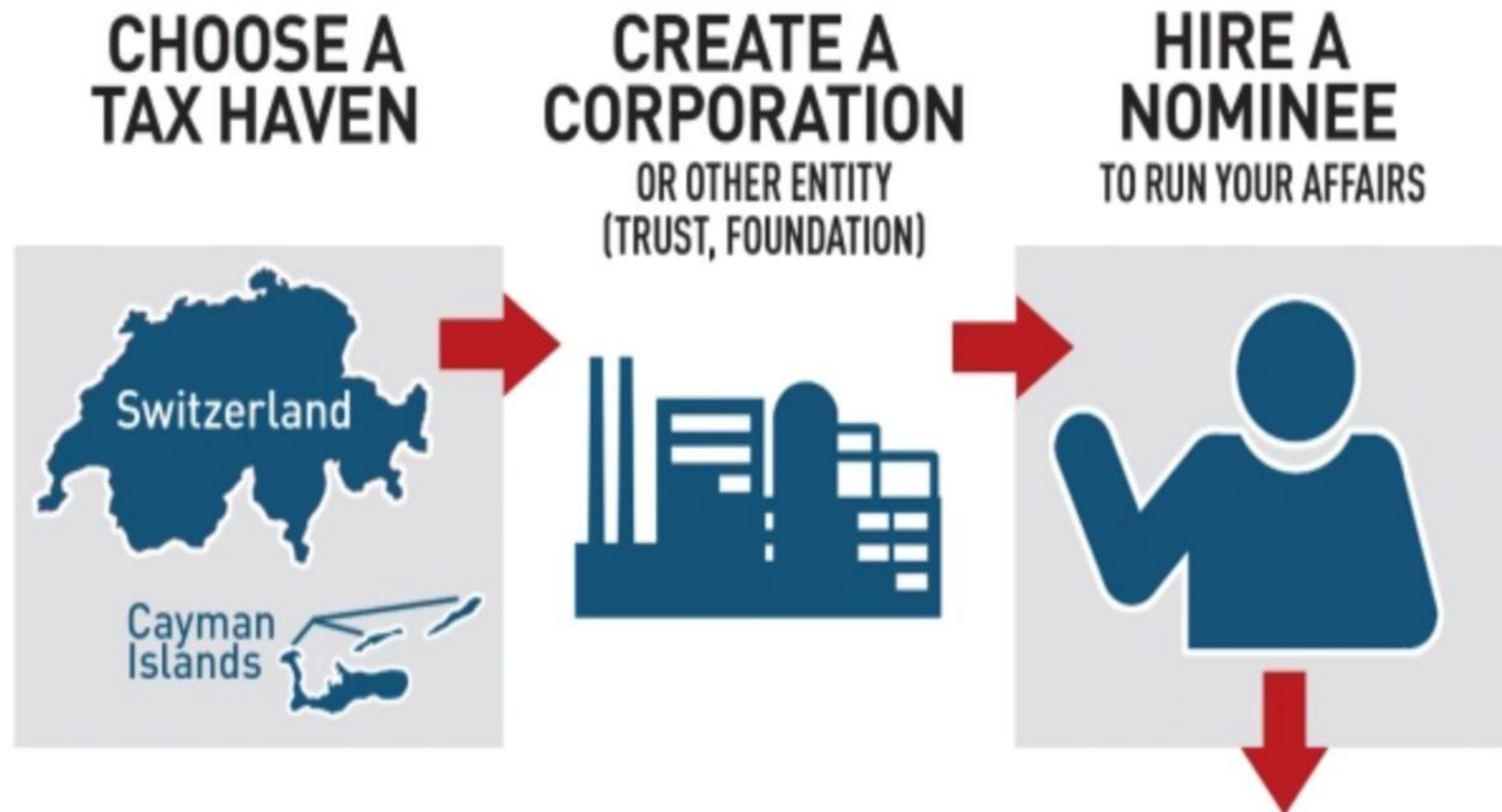
# Non-Efficient Structures

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- Non-efficient structures:
  - Mexican taxpayer has direct or indirect **control** over timing of distributions from top vehicle.
  - Top vehicle in a **blacklisted country**.
  - Top vehicle is **fiscally transparent**.
  - Non-compliant structures may, depending on the specific facts and circumstances, include:
    - Private foundations (e. g. Panama).
    - Bearer share entities (e. g. Uruguay).
    - Nominees
    - Others.

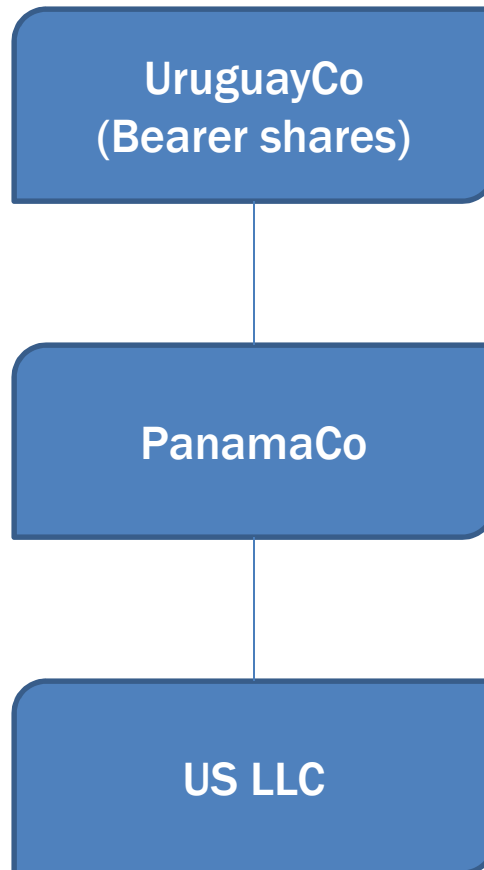
# Nominees

## How to create a **shell company**



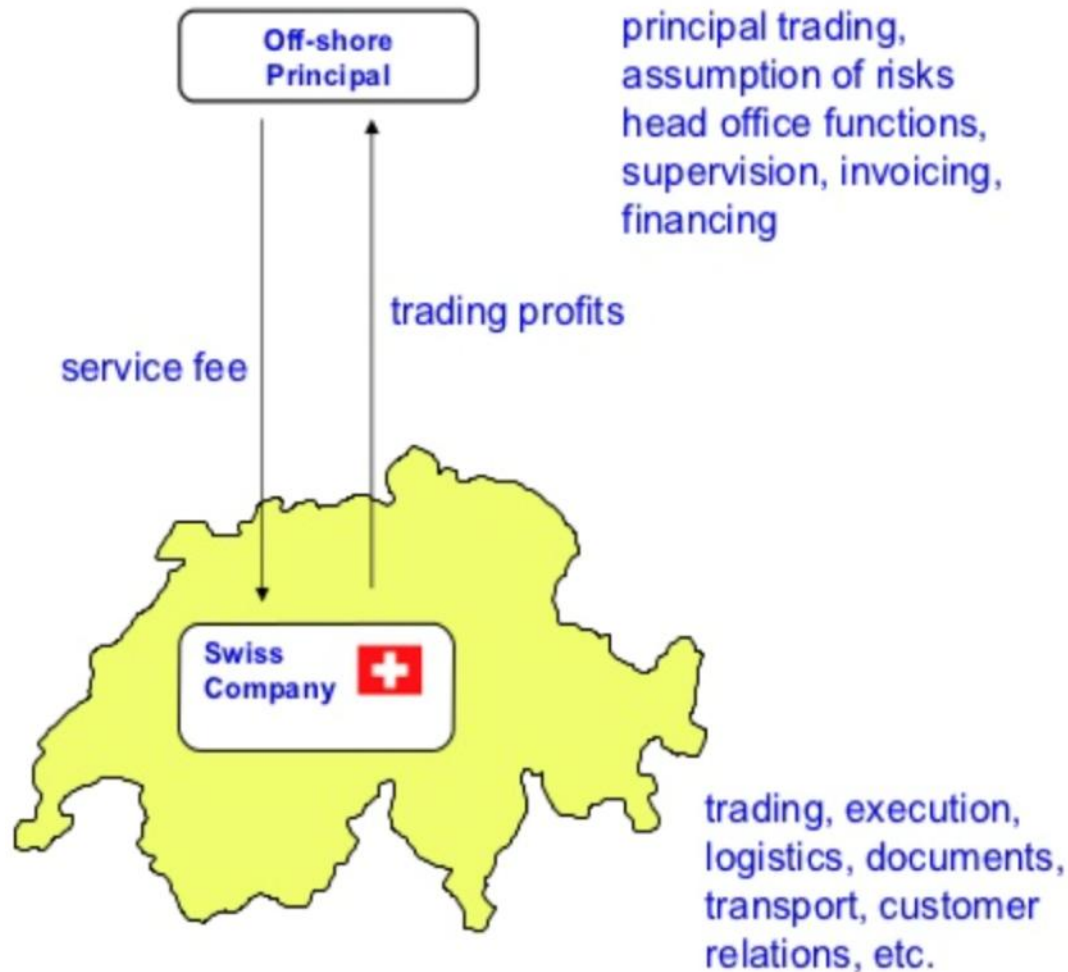
# Bearer Shares

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# Tax Rulings

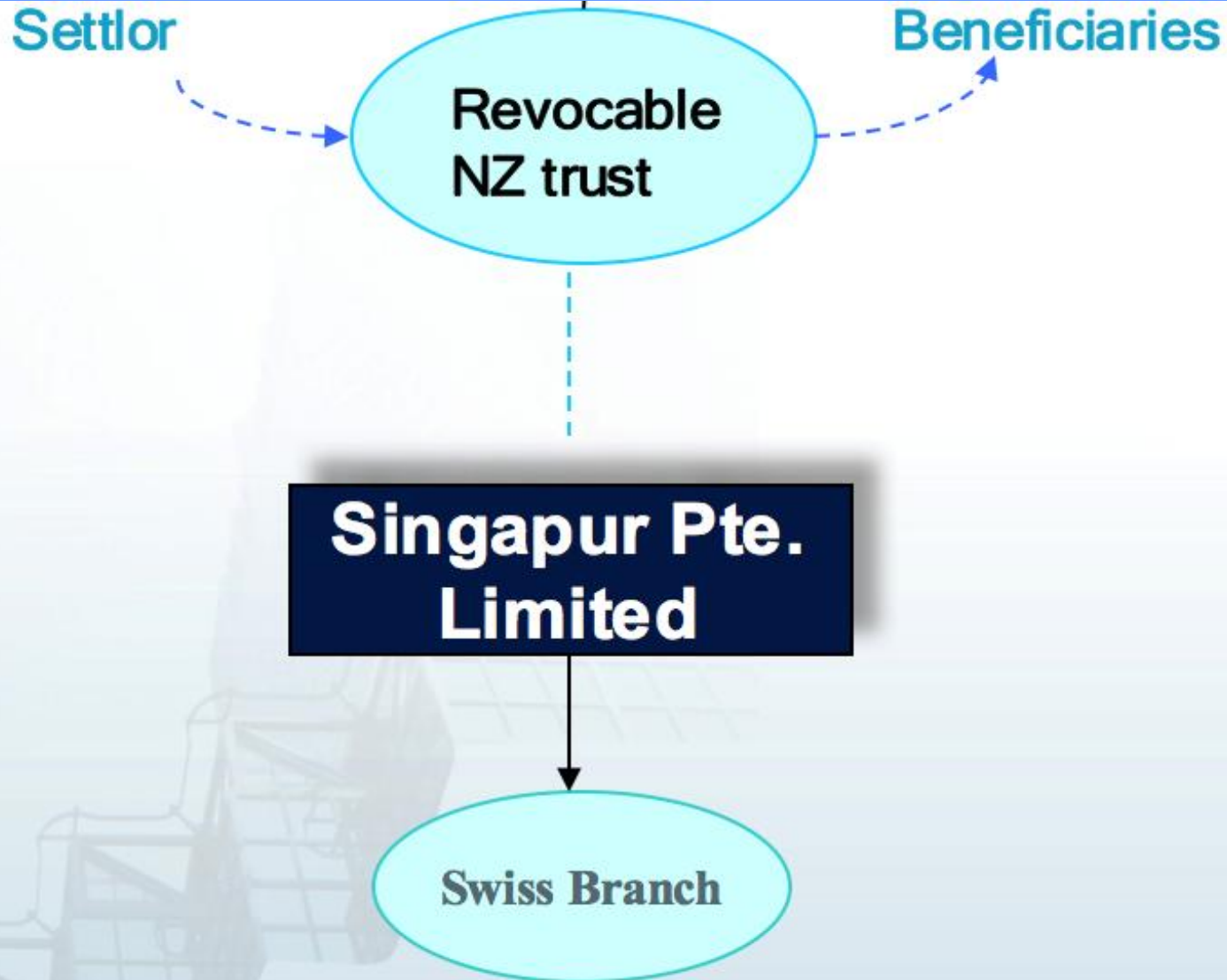
## Swiss Company with Off-shore Principal



Possible to get advance ruling (APA) in Switzerland based on functional analysis (functions, assets and risks) and/or transfer pricing report

Effective overall tax ranges from 0 to 12% (safe harbor likely around 5 to 6%)

# Tax Rulings



# Hybrid Mismatches

## Typical Structures: Hybrid instruments Debt qualification in Luxembourg



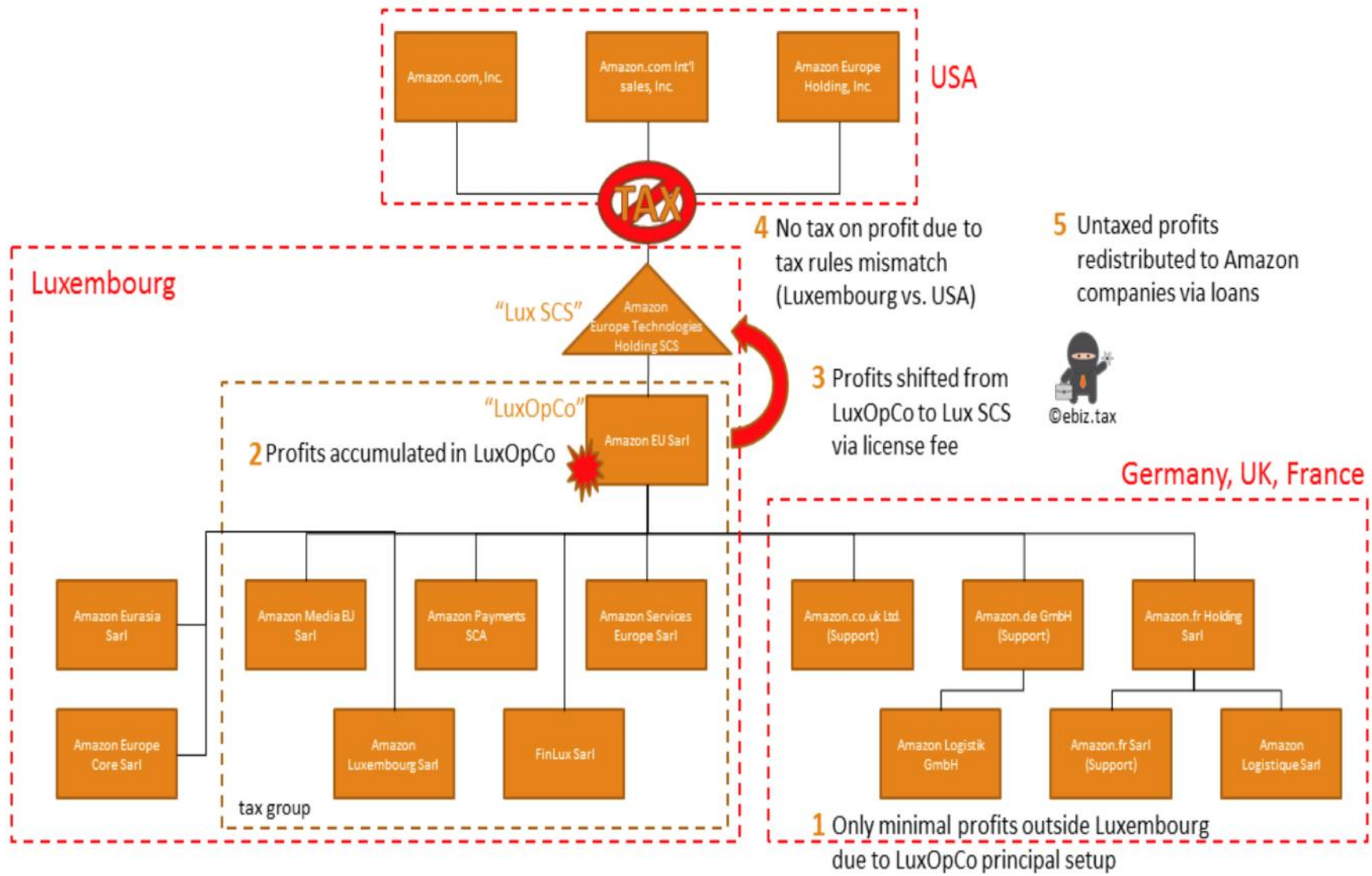
### Debt qualification in Luxembourg if :

- (Low) Interest rate accruing even in case of losses
- Variable interest based on profits before tax
- No stapling provision
- No entitlement to voting rights
- Preferably not convertible into shares
- No entitlement to participation in liquidation proceeds or hidden reserves,
- Short term (i.e. <49 years)
- Ranking prior to capital

No single factor is decisive. A comprehensive analysis is required. Tax agreement needed to secure tax treatment in Luxembourg



# Hybrid Mismatches



# Treaty Shopping

## Typical Structures: Holding (SOPARFI) EU or non-EU Subsidiaries

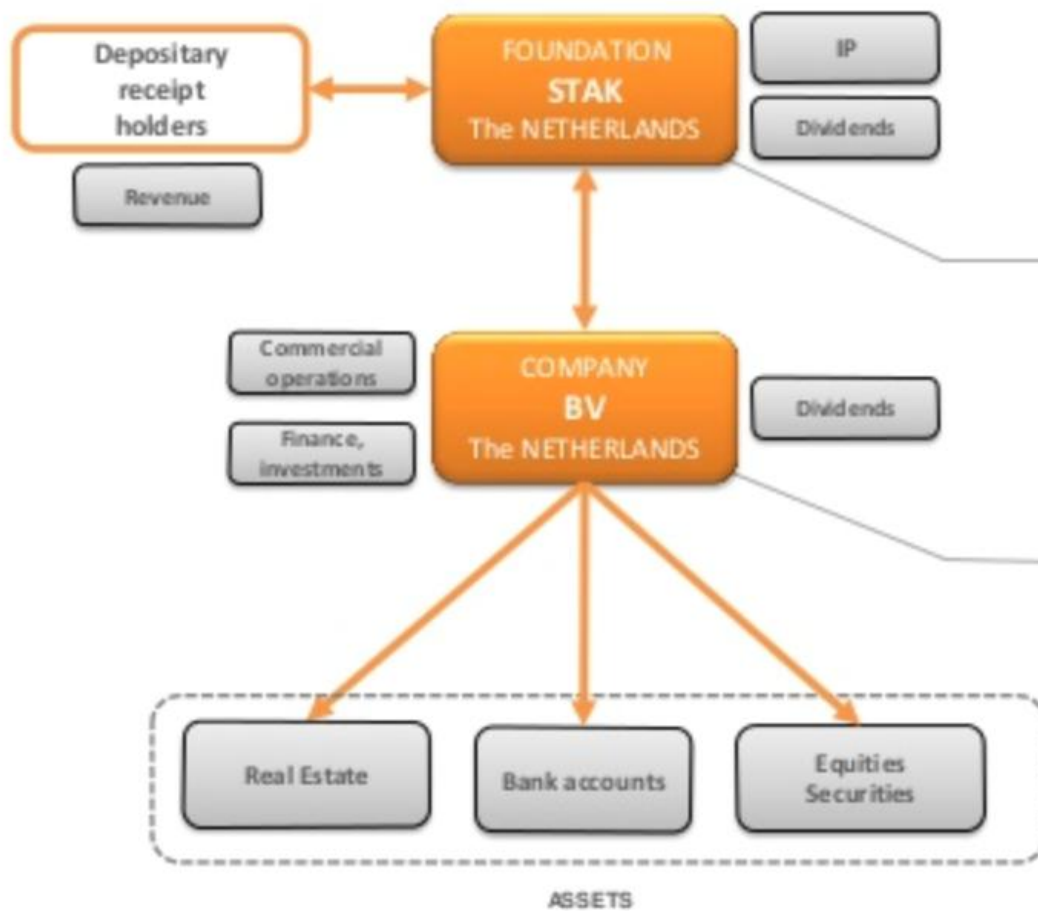


- No withholding tax on dividends paid to tax treaty parent company if :
  - 10% ownership or acquisition price of EUR 1.2m
  - 12 month holding period
- Full exemption on incoming dividends and capital gains (participation exemption regime) if
  - 10% ownership or acquisition price > € 1.2m (dividends)/ € 6m (capital gains)
  - 12 month holding period
  - If EU subsidiary subject to tax or non EU sub. taxed at an effective rate > 10,5%
- In general, no or low foreign withholding tax on incoming dividends from EU/ non-EU subsidiaries pursuant to EU Directive and tax treaties

# Treaty Shopping - Transparency

## STAK + BV:

an example of holding structure in the Netherlands



✓ The **separation of the legal and economic ownership** in a reliable jurisdiction considering the current and future relations between the depository receipts holders described in the Charter of the foundation

✓ The proper **asset protection** from the actions of creditors, individual shareholders of the subsidiaries, unjustified tax claims and wrongful actions of the authorities

✓ Operational **management and control** over the international business structures and assets

✓ **Transparency** and investment attractiveness, quick sale of assets to the third party investors

✓ **Tax planning** by applying the international tax treaties

# Fiscally Transparent Entities

## Typical Structures:

### Private wealth management company (SPF)

#### Investments in securities



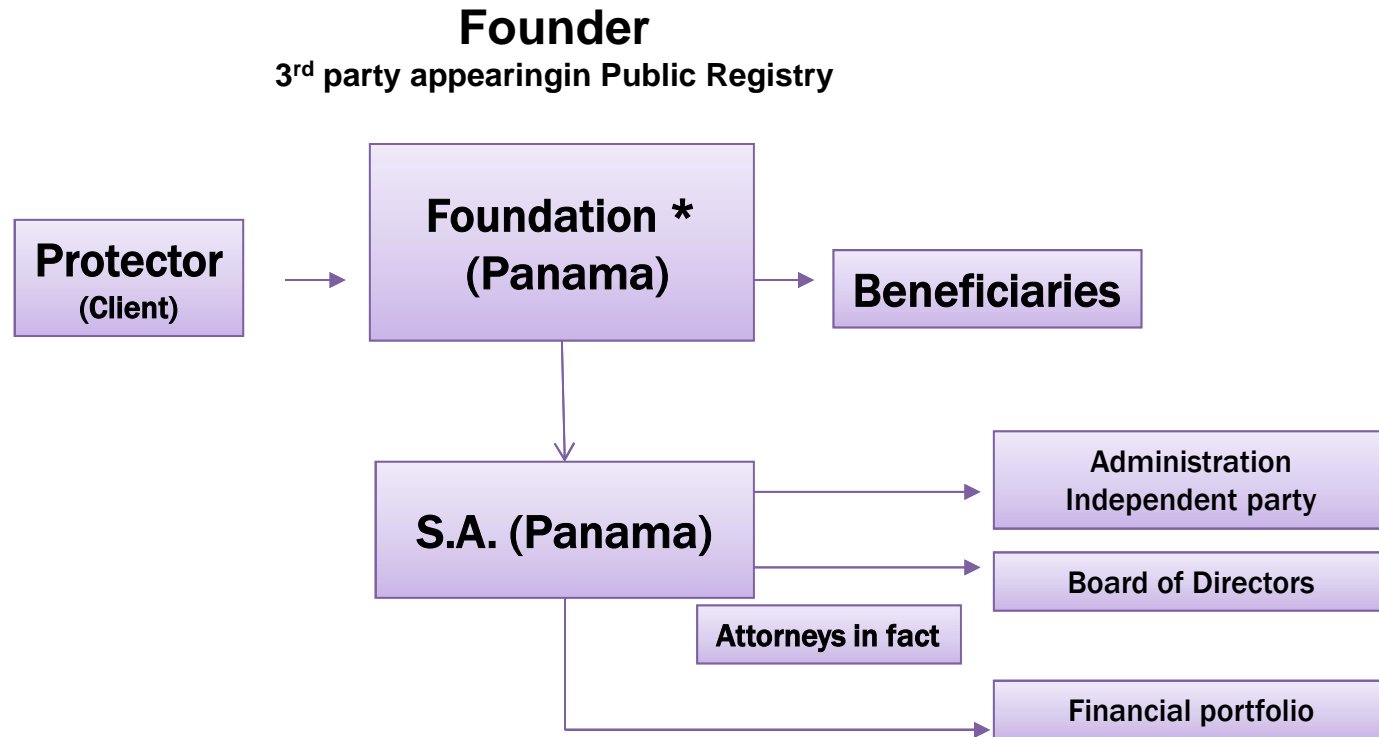
- Directly or indirectly (through patrimonial vehicle) held by a limited number of private shareholders
- Not subject to any tax in Luxembourg (only registration duty of 0,25% of the share capital)
- No withholding tax on dividends paid without condition
- Does not enjoy the benefits of the EU Directives or DTTs
- Cannot grant remunerated loans



# Fiscally Transparent Entities



# Anonymity



# Structures Summary

Unacceptable Structures	Acceptable Structures	Examples of Possible Structures
<ul style="list-style-type: none"> <li>• Trust, companies, foundations established in a LTJ to avoid filing information returns if blacklisted. Note these are not subject to PTR where there is no control.</li> <li>• Structures that permit the Mexican tax payer to control timing of distributions of income.</li> <li>• Structures in which Mexican taxpayer has an interest in income taxed at less than 21%.</li> <li>• Structures using fiscally transparent entities: <i>e.g.</i> Dutch C.V., LLC, Scottish partnership.</li> <li>• No US grantor trusts</li> </ul>	<ul style="list-style-type: none"> <li>• No connection with a LTJ provided there is no control.</li> <li>• No control over income.</li> <li>• Use only trust, corporate or insurance structures. [not US grantor trusts]</li> </ul>	<ul style="list-style-type: none"> <li>• Split capital Singapore corporation owned by capital and income trust established in New Zealand, Singapore, U.S.</li> <li>• Luxembourg Life Insurance policies with death benefit and investment component.</li> </ul>

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# The Future of Private Banking

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From “catch me if you can” to “you can run but you can’t hide”.



# The Future of Private Banking

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- **Tax planning in general and private banking planning in particular can no longer consist in hiding assets or identities of investors in given jurisdictions with the expectation that they will not come to light.**

# The Future of Private Banking

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- There is still room for planning.
- But now based on the likelihood that the tax authorities will eventually learn all details of the investments and/or structures:
  - types of vehicles
  - amounts involved
  - returns
  - beneficial ownership
  - etc.



# The Future of Private Banking

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- **This requires expert knowledge and sophisticated planning:**
  - **Structures should be compliant. Keep in mind:**
    - Mexico's CFC rules.
    - BEPS
    - FATCA
    - Transparency and Exchange of Information
  - **Seek tax deferral rather than tax avoidance.**
  - **Tax rates may continue to play an important role, but should not be the sole drivers.**
  - **No simulation, no evasion, no tax fraud.**
  - **Well documented, from A to Z.**
  - **Prepared to resist and overcome tax audits.**

# Thank You!

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