

## **LATINLAWYER Reference - Tax Litigation 2016 - Mexico Questionnaire**

### **1. What is the tax authority in your jurisdiction, and can you give a general description of its structure? Provide a general assessment of the authority?**

The Mexican Ministry of Finance and Public Credit is the authority competent to administer the federal tax system in Mexico. According to law, most of its authority to administer taxes is delegated to the Mexican Tax Administration Service. The Mexican Tax Administration Service is the agency in charge of reviewing, auditing, collecting and enforcing federal tax laws. The Chief of the Mexican Tax Administration Service heads the agency and the President appoints him with consent by the Senate.

State and municipal tax authorities administer and enforce state and municipal tax laws, including payroll, gaming and real estate taxes. However, the most important sources of revenue to cover federal as well as state and municipal budgets are the federal taxes and duties. The Mexican Tax Administration Service and the state and municipal tax authorities have entered into cooperation and coordination agreements to share responsibility for the collection of taxes throughout Mexico, and to allocate revenue. According to those agreements, the Mexican Tax Administration Service collects corporate income tax, individual income tax, value added tax, excise taxes and import duties whereas state and municipal tax authorities collect individual income tax from sales of property in addition to state and municipal taxes.

For the purpose of administering the federal tax system, the Mexican Tax Administration Service is divided into six divisions: General Audit Administration, General Collection Administration, General Legal Administration, General Taxpayers' Services Administration, General Customs Administration and General Administration of Large Taxpayers. The General Audit Administration coordinates local audit administrations, which receive and review all tax returns filed by the taxpayers. In addition, it controls all audit and review procedures to tax returns throughout Mexico. The General Collection Administration coordinates enforcement of tax assessments and collects all tax bills owed to the government through local collection administrations. The General Legal Administration provides legal advice to other areas, draft rulings and revenue rules and resolves internal appeals. The General Taxpayers' Services Administration receives and processes all requests and filings (other than tax returns) from taxpayers. The General Customs Administration coordinates all customs houses and ports of entry into Mexico and enforces customs laws as well as collects customs duties and countervailing duties. Finally, the General Administration of Large Taxpayers audits tax returns filed by taxpayers reporting income in excess of Mx\$500,000,000 pesos, group companies and international transactions including transfer pricing.

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Under the law, depending on the type of procedure, the Mexican Tax Administration Service takes between 15 business days and three months to respond to filings of taxpayers. Responses to refund requests should be made within a 40-business-days strict timeframe. Responses to tax ruling requests should be made within three months, but in specific complex cases it may take more. The timing to respond has been reduced to between five and 10 days in practice of standard procedures such as filing of certain notices. Email communication and digital platforms have also reduced the time it takes to receive communications from tax authorities.

Over the past years, the tax administration has been involved in a modernisation and sophistication process. As of the close of the first half of 2015, registered taxpayers exceeded 49 million with a 13.4 per cent increase in the last 12 months. For year-end 2014, the Mexican Tax Administration Service received 5.2 million tax returns. Between January and June 2015, the Mexican Tax Administration Service began 34 million audit actions, including notices of audit, requests for information and analysis of data from taxpayers and third parties. Finally, between January and June 2015 the authorities prevailed in 55 per cent of the litigation procedures filed by the taxpayers against enforcement actions. These figures show the high level of activity of the Tax Administration Service. Also, in recent years the General Administration of Large Taxpayers has identified many transactions aimed at avoiding taxes. In addition, under the 2014 Tax Reform, taxpayers are required to upload accounting records onto the electronic system of the Mexican Tax Service. This tool is expected to allow the Mexican Tax Administration Service to monitor and audit in real time the transactions recorded by the taxpayers. Additionally, aggressive transactions identified by the Mexican Tax Administration Service have been published, indicating the fact pattern and the approach of the tax authorities in reviewing such transactions, warning the taxpayers of the consequences of finding such transactions in the course of tax audits and reviews. Finally, consistent with the Base Erosion and Profit Shifting initiative of the Organisation for Economic Cooperation and Development (OECD), amendments to tax laws became effective, aggressively limiting tax planning structures and requiring disclosure in related party transactions. The above description shows how the Mexican Tax Administration Service is approaching enforcement of laws and aggressively combating tax avoidance.

Recently, the structure of the Mexican Tax Administration Service was amended to create a Hydrocarbons Tax Administration in order to audit and review taxpayers in the hydrocarbons industry. Creation of this Tax Administration allows for focus on industry rather than on the volume of income, which is a departure from the current organisational structure of the Mexican tax authorities.

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## 2. Can you outline the typical process involved with tax disputes in your jurisdiction, from filing, to notice of deficiency, to litigation? Are there alternative procedures

Upon an assessment, the auditors issue a notice of deficiency which is notified to the taxpayer. Taxpayers can appeal before the local tax counsel administration (which is delegated by the general legal administration), before the General Administration of Large Taxpayers, or file a lawsuit against the tax administration service before the Federal Tax and Administrative Court.

Under the appeal process, taxpayers have 30 business days to file an appeal before the local tax counsel administration with jurisdiction within the territory where the taxpayer's tax domicile is located. Once the local tax counsel administration receives the appeal, the audit file is sent from the relevant audit office. The local tax counsel administration has three months to issue a resolution on the case, which can be extended to six months in case the taxpayer requests additional time to submit evidence not included in the audit file. The issues under dispute must relate to the procedure or substantial interpretations of the law or facts made by the auditors issuing the notice of deficiency. Collection procedures are suspended while the appeal process remains unresolved.

Under the Federal Law of Administrative Dispute Procedure, taxpayers have 45 business days to file a petition with the Federal Tax and Administrative Court. Petitions must include cause of action and documentary evidence to support allegations; otherwise, the petition is dismissed. Upon receipt of the petition, the Federal Tax and Administrative Court sends the petition to a chamber, which can be regional or metropolitan. Regional chambers are located in the most important cities of the country while metropolitan chambers are located in Mexico City. Regional and metropolitan chambers have jurisdiction over tax matters based on the tax domicile of the taxpayers. The Superior Chamber has full jurisdiction to hear all relevant tax cases and exclusive jurisdiction to hear international tax cases.

Once the relevant chamber receives the petition, it reviews and issues an order to request more information or service the audit administration office that issued the relevant notice of deficiency. The local legal administration or the tax counsel administration has 45 business days to respond to the petition. Once the chamber of the tax and administrative court receives the response, both the taxpayer and the local legal administration or the tax counsel administration, as the case may be, have five business days to submit witnesses or expert witnesses. Once the relevant chamber hears the witnesses or expert witnesses, the parties have five business days to file closing arguments. After this five business days term elapses, the chamber issues a closing order indicating that no additional action is required to resolve the case and will issue its judgment within a 60-day term. In practice, the chambers extend terms given their workload, and judgment may be issued as far as 120 days from the date in which the chamber issues the closing order.

3. Are there alternative dispute resolution mechanisms prior to trial, such as mediation or arbitration? Are such processes mandatory or contingent on the agreement of the parties?

Settlement agreements were introduced with the 2014 Tax Reform as an alternative dispute resolution method in tax matters, in which Mexico's Office of the Taxpayer Advocate participates as facilitator, mediator and witness between tax authorities and taxpayers. Mexico's Office of the Taxpayer Advocate was created to advocate taxpayers in their dealings with the tax authorities in the course of a tax audit or review. The Office of the Taxpayer Advocate is headed by the Taxpayers Advocate as proposed by the President and appointed by the Senate. Taxpayers subject to an audit or review of tax obligations are entitled to apply for settlement agreement at any time before receipt of the final assessment notice.

The settlement agreement allows taxpayers to reach an agreement with tax authorities regarding facts and the consequences of the interpretation of a tax law arising in the course of a tax audit. Taxpayers in disagreement with the conclusions of fact or law consequences reached by tax authorities may apply for a settlement agreement with the Office of the Taxpayer Advocate. An officer of the Taxpayer Advocate will request a response from the tax authority and will conduct a procedure aimed at reaching a settlement agreement on the subject matter of the application. Settlement agreements are binding for both taxpayers and tax authorities, and are not subject to appeal. The rules of procedure to reach settlement agreements look for completion within a 40-business day term. Legal audits and procedures are suspended during the settlement agreement procedure.

In less than three years, the settlement agreement has become a very important and useful means of reducing disputes between taxpayers and tax authorities. Taxpayers and tax authorities increasingly recognise the Office of the Taxpayer Advocate as an alternative for resolving tax disputes in a fast and fair fashion. According to the 2014 report released by the Office of the Taxpayer Advocate, in 2014 alone the Office of the Taxpayer Advocate received 873 settlement agreement applications. 303 applications were received in the central office in Mexico City, and 570 applications were received in the local offices throughout Mexico. Out of those, 81 applications reached a settlement agreement. This means that 66.26 per cent of the files opened reached a settlement agreement.

#### 4. What is the process for appealing trial court decisions?

Under the Mexican tax system, both the taxpayers and the tax administration service before the Federal Circuit Court of Appeals can appeal resolutions of the tax and administrative court within 15 business days.

Taxpayers appeal court decisions by filing an amparo claim alleging violations to constitutional principles, either during the trial process or in the court decision itself. Authorities appeal court decisions by filing a review alleging violations to laws of procedure or misinterpretations of the court set forth in the decision. No additional or new evidence is accepted in the appeal procedure.

Generally, the Federal Circuit Court of Appeals takes between three and six months to resolve amparos and reviews relating to tax matters. However, the time frame varies depending on the workload of the courts and complexity of the disputed issues.

#### 5. Is there a formal discovery process in tax litigation and controversy in your jurisdiction, and is it the same as that for general litigation?

There is no formal discovery process in tax litigation and controversy in Mexico. Under the rules of procedure, the parties furnish evidence to the judge, who analyses and determines whether such evidence is sufficient to prove the facts and merits of the allegations of the parties.

#### 6. Is attorney–client privilege recognised in your jurisdiction? Does it cover drafts of tax documents? Do any similar forms of privilege protect communications between other professionals, such as accountants, and their clients?

In Mexico, there is no attorney-client privilege. While there is a statutory obligation for legal professionals to maintain confidentiality regarding the matters they are working on, the concept of privilege as known in other jurisdictions does not exist in Mexico.

#### 7. Are there formal rules of evidence and procedure? Are they different from general litigation rules?

There are formal rules of evidence and procedure. They follow the rules of general administrative litigation. In general, documents, information and photographs must be filed with the court together with the claim. Witnesses are subject to interrogatory by the parties and are under oath. Perjury is subject to criminal charges. Expert testimony is allowed on technical, scientific and artistic issues. All evidence other than documentation is received by the court in a hearing. In practice, documents and expert testimony on accounting issues are the most common means of proving facts and technical issues connected with determinations of the tax authority.

Regarding documentation, strict rules require that documents written in languages different from Spanish must be submitted together with proper translations into Spanish made by a translator authorised by the civil court of any of the 32 states of Mexico. In addition, public documents produced outside Mexico will be given public faith only if they are apostilled in accordance with the Hague Convention Abolishing the Requirement of Legalisation for Foreign Public Documents of 1961. If the jurisdiction where the document is produced is not party to the Hague Convention, the document must be legalised with the Mexican consulate credited in the relevant jurisdiction.

Regarding expert witness, the rules provide that each of the parties (the taxpayer and the tax authorities) appoints and presents its own expert witness. Each expert witness will have access to the file to learn about the evidence submitted by the parties. The court grants each expert witness 15 business days to prepare and render the opinion. The expert witness must ratify the terms of the opinion. When the opinions are contradictory with each other, the court appoints a third-party independent expert witness who will have access to the file and will be given 15 business days to prepare and render the opinion.

## 8. Does the judge or opposing counsel question witnesses in tax litigation?

Yes. Under the rules, both judge and opposing counsel can question witnesses on the facts relevant to the dispute. The judge issues a schedule order indicating the date and time of the hearing where interrogatory will take place. First the taxpayer will ask questions, and then the tax authorities will have the right to ask questions. The court will also have the right to ask questions if the judge deems it necessary, to learn details of any facts or issues discussed. A court reporter will transcribe the questions and answers.

## 9. Can criminal charges be levied under tax law, and how often are criminal sanctions sought?

Yes, criminal charges can be brought against taxpayers. Until 2011, tax authorities often brought criminal charges against taxpayers for tax fraud. However, in recent years criminal prosecution has been reduced to tax fraud cases relating to underreporting of income or reporting of tax losses or credits based on false documentation. A practice found by the tax authorities regarding a sector of taxpayers is to take deductions and credit value added taxes based on false invoices issued by third parties with whom taxpayers have no legal or business relationship. This practice is subject to deep scrutiny from tax authorities, who increasingly prosecute criminal investigations against taxpayers using these invoices. The use of digitally stamped invoices and the obligation to upload accounting records to the tax authorities has increased their ability to spot and identify these practices

## 10. Does the same agency prosecute both criminal and civil tax litigation?

No. Under the law, the general legal administration office or the local legal administration office, depending on the corresponding jurisdiction, prosecutes the civil tax litigation. Criminal litigation is handled by the Office of the General Attorney upon request of the Office of the Federal Fiscal Attorney of the general legal administration office.

## 11. Are trials heard by the general courts, or are there specialist tax courts?

The Federal Tax and Administrative Court and the state administrative courts have exclusive jurisdiction to hear federal, and state and municipal tax related cases, respectively. Federal courts and circuit courts have jurisdiction to hear appeals in the form of amparo and review filed by the taxpayers and the tax authorities, respectively. These federal courts and circuit courts hear all kind of administrative cases including tax cases. In very limited cases involving relevant tax policy and constitutional interpretations, the Supreme Court of Justice hear tax cases from both federal and local jurisdiction.

## 12. Which party has the initial burden of proof on common tax issues? What level of proof must be established?

Under Mexican tax law, tax determinations of the Mexican Tax Administration Service enjoy a rebuttable presumption of correctness. Based on this rule, taxpayers have the burden of proof to rebut the facts and to support the merits of the Tax Administration Service's claims. Burden of proof is shifted to the tax authorities when taxpayer denies a fact; however, no shift applies in cases where denial implies the affirmation of a fact.

## 13. Is interest available to the taxpayer following a successful claim for overpayment? If so, how are the rates calculated, and when do they begin to accrue?

The Mexican Tax Administration Service must pay taxpayers interest on overpayment of taxes not refunded within the 40-day term from the filing of the corresponding refund request. Interest will accrue in favour of the taxpayers at the monthly rate of 1.13 per cent calculated on the principal amount due, which shall be adjusted for inflation purposes using the national index of consumer prices. Interest is calculated as from the day following completion of the 40-day term.

In case taxpayers owe other amounts to the tax authorities, amounts due by the tax authorities to the taxpayers may be offset against other tax debts of the taxpayers.

The right to claim a tax refund expires five years from the date of overpayment.

## 14. Which is the competent authority for resolving tax treaty claims in your jurisdiction? Outline how the authority operates in practice.

Under Mexican tax law, the General Administration of Large Taxpayers is the competent authority for resolving tax treaty claims. It delegates its authority in the Central Administration of International Standards and Legal Support and the Central Transfer Pricing Administration. As of December 2014, 16 tax treaty claims have been reported. In general, case analysis and completion takes 12 months. OECD countries including the United States, Australia, Germany and Sweden are the counterparties in reported procedures. Transfer pricing dominates the scene of technical issues disputed by the competent authority; however, treaty interpretation issues including permanent establishment, residency, interest and non-discrimination have increased consistently.

The Central Administration of International Standards and Legal Support and the Central Transfer Pricing Administration follow the OECD Manual on Effective Mutual Agreement Procedures (MEMAP) February 2007 Version regarding the procedural steps of a tax treaty claim. In addition, over the past 15 years, the Mexican competent authorities have reached over 12 mutual agreements with competent authorities.

In general, both Central Administrations are well-equipped groups of lawyers and accountants with international experience and they are open to reaching agreements with competent authorities to reduce exposure of taxpayers to double taxation. However, Mexican competent authorities rarely waive taxation on specific transactions. Under the law, competent authorities must interpret the tax treaties consistent with the OECD Model Tax Convention on Income and Capital.

## 15. Can tax law or regulations be applied retroactively, and under what circumstances?

Under article 14 of Mexico's Federal Constitution, no tax law or regulation can be applied retroactively against the rights of the taxpayers. Retroactive application of the law can be challenged before the federal courts and under the language of the Federal Constitution, and consistent with jurisprudence of the Supreme Court of Justice such retroactive application would be invalid.

## 16. What is the statute of limitations on tax claims, and what are some common ways it can be tolled? Are there exceptions to tolling?

The statute of limitations is five years for tax claims brought by the tax authorities. This term commences on the day following the filing of the relevant tax return. In general, corporations must file annual tax returns on or before March 31. For individuals, annual tax returns must be filed on or before April 30. In case of any amendment to a tax return, the statute of limitations commences on the date of receipt of such amended return by the tax authority. An exception to the five-year statute of limitations is the 10-year time limit for cases where the taxpayer:

- has no accounting records;
- destroys them;
- is not registered with the Federal Taxpayers Registry; or
- does not file the corresponding tax return in any relevant fiscal year.

However, the tax authorities cannot extend the statute of limitations by written agreement with the taxpayer. According to law, tax returns are deemed filed for statute of limitations purposes on the date they are received by the tax authorities. Most tax returns are filed electronically, and a digital acknowledge of receipt is issued to prove receipt of the relevant tax return. The statute of limitations is suspended in cases where the tax authority reviews the taxpayer; in case the taxpayer challenges a tax assessment; when the taxpayer leaves the tax domicile without filing proper notice with the tax authorities or when the taxpayer hides from the tax authorities; or the tax authorities cannot commence an audit because there is a strike or the taxpayer dies. In these cases, the statute of limitations will resume as soon as the situation suspending it terminates.

## 17. Is litigation over VAT or other non-income taxes significant in your jurisdiction?

Yes. Although detailed information is not precise, according to the federal budget, VAT and excise taxes represent the second and third most important revenue sources of public funds for the government. Accordingly, disputes relating to VAT assessment or VAT refund are significant in Mexico.

### **Partner profile**

#### **Carlos Martinez**

Carlos Martinez R specialises in taxation, representing clients in diverse industries, including litigation. Carlos has acted as Mexican tax counsel in numerous domestic and cross-border mergers and acquisitions, joint ventures and restructurings, as well as in financings and capital markets. Carlos has extensive litigation experience both at tax courts and federal administrative courts. Carlos obtained a Law Degree from Escuela Libre de Derecho in 2000 and an LLM Degree from Georgetown University (2003). He also obtained a Postgraduate Degree in Tax Law – Universidad Panamericana (2001) and a Postgraduate Degree in Tax Law – Universidad Nacional Autonoma de México (2004).