

Update on the Automatic Exchange of Information: Where Does Mexico Stand?

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Background

In continuing with the effort being made to combat tax fraud and tax evasion and promote the importance of co-operating with other countries to endorse the automatic exchange of information, and as a consequence of the report presented by the Organization for Economic Cooperation and Development (OECD) to the G8 Summit on delivering a standardized and global model for automatic exchange, which was ratified by the G8 leaders, who encouraged the OECD to start working with the G20 countries to present a new standard for the automatic exchange of information, in February 2014, the OECD published the Standard for the Automatic Exchange of Financial Information¹.

This document is intended to be used by those jurisdictions wishing to automatically exchange financial information and is aimed at avoiding the

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proliferation of different standards that would increase the implementation costs for governments and financial institutions.

The report contains the bases of the form in which reporting and due diligence should be followed by countries to obtain information from their financial institutions and also to enter into agreements with other countries to automatically exchange that information on an annual basis.

It includes the text of the model Competent Authority Agreement (CAA), which is related to the detailed rules on the exchange of information as well as the Common Reporting and Due Diligence Standard (CRS), which contains the reporting and due diligence rules, which are designed with a broad scope across three dimensions:

a) Financial information to be reported, which includes all types of income (interest, dividends, income from insurance contracts, etc.), account balances and the proceeds from the sale of financial assets.

b) Financial institutions, which not only include banks and custodians but also brokers, collective investment vehicles and insurance companies, are all required to report.

c) Reportable accounts held by individuals and entities (including trusts and foundations), as well as a requirement to review passive entities, in order to report who the ultimate individual controlling these entities is.

Even though the CRS originated in the FATCA rules published by the U.S. government, there are some differences between the two models. The first difference is that CRS is of a multilateral nature, whereas the FATCA is intended for the bilateral exchange of information. Other differences are those related to specific U.S. tax aspects, in particular the concept of taxation on the basis of citizenship, which differs from the tax residency approach followed by the CRS, and the presence of a significant FATCA withholding tax, which is not the case in the CRS.

The Standard for Automatic Exchange of Financial Account Information, published by the OECD, is an attempt to set the general ground rules to help countries migrate from the current on-request exchange of information scheme, to a higher single standard, which is the automatic exchange of information.

This Standard has yet to be improved by the OECD and expectations are that a detailed commentary to help ensure its consistent application, as well as the information and guidance on the necessary technical solutions, will be completed by mid-2014.

Current Global Developments in the Automatic Exchange of Information

One sign that the global trend is to adopt this kind of information exchange scheme, which is also in line with the effort being made by the OECD and G20 countries, is that on March 19, 2014, several countries

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(both OECD and non-OECD) issued a joint statement committing themselves to the early adoption of the CRS published by the OECD in February 2014 as a step towards their capacity to tackle cross-border tax evasion².

The intention of these early adoption countries is to be exchanging information in this way by the end of September 2017 or September 2018, depending on whether accounts are held by individuals or entities.

The latest development, which reinforces the global trend to improve the information exchange mechanisms to avoid tax evasion and to promote tax transparency among the different jurisdictions, is the Declaration on Automatic Exchange of Information in Tax Matters signed on May 6, 2014 by those countries that originally committed to adopt the CRS, in addition to some other countries³.

It is relevant that among the countries party to this Declaration there are some that, when the FATCA rules were published by the U.S. government, originally questioned the feasibility and legal grounds of this exchange of information scheme, and also were seen as the financial centers where taxpayers around the world would transfer their financial resources to

avoid being subject to disclosure with their local tax administrations.

However, this initial perception about some of those countries can now be seen as inaccurate, since in terms of the Declaration those countries are determined to tackle cross-border tax fraud and tax evasion and to promote international tax compliance through mutual administrative assistance in tax matters by adopting the CRS published by the OECD.

Therefore, as can be seen, within the last year, the automatic exchange of information scheme has developed from the mere intention of a few countries to fight tax evasion, to a well-structured mechanism that will clearly change the way cross-border transactions are taxed, which is based on the grounds established in the Standard for the Automatic Exchange of Financial Account Information, that will continue to be improved with new commentaries and technical solutions to implement the CRS, to be completed by mid-2014.

Where Does Mexico Stand in This Global Trend?

Mexico has been very active in promoting the exchange of information. Currently Mexico has a wide network of Exchange of Information Agreements

with several jurisdictions, including countries that were part of the black list established in Mexican tax provisions.

Proof of the above is that Mexico is one of the countries that signed the commitment for early adoption of the CRS, published in February, 2014 by the OECD, which was later ratified by the Declaration on the Automatic Exchange of Information in Tax Matters signed on May 6, 2014 to which Mexico was also party. Moreover, Mexico is one of the first countries in the world to enter into an intergovernmental exchange of information agreement (IGA) with the U.S. to exchange FATCA-type information. Specifically, the IGA was entered into by both countries in November 2012 and became effective starting 2013⁴.

The IGA was recently replaced by a new agreement entered into by both countries in April 2014⁵. The new

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IGA maintains the essence of the agreement signed in 2012, as it did not modify the information or the terms under which the information will be exchanged, but brings in new elements that will help both the Mexican and the U.S. tax administrations expedite the flow of information. In addition, it establishes certain exceptions for some Mexican financial institutions that would not be compelled to comply with FATCA requirements.

Under this new agreement, U.S. financial institutions continue to be obliged to provide information only with respect to Mexican resident individuals or entities holding reportable accounts in the U.S., as opposed to what happens to U.S. citizens that maintain accounts through foreign entities in Mexican financial institutions, where the latter are required to disclose the information to the U.S. tax administration, if the parties controlling the foreign entities are U.S. citizens.

Therefore, under the new IGA, financial resources held by Mexican residents in accounts maintained in the U.S. through foreign entities, which are ultimately controlled by them, remain undisclosed considering that U.S. financial institutions do not have to look into

these entities to determine whether the controlling party is a Mexican resident.

It should be noted that, even though this is the form in which the current IGA between Mexico and the U.S. is drafted, the global trend in automatic exchange of information and also the form in which the CRS is being drafted by the OECD, is to require foreign financial institutions to look into foreign entities to determine and disclose who the parties controlling them are, in order to prevent taxpayers from continuing to conceal financial resources from their local tax administrations.

Considering the above, it is likely that since Mexico has been so active in this matter over the last few years and has also been one of the countries that signed the Declaration on Automatic Exchange of Information in Tax Matters, which refers to the CRS recently published by the OECD as the guideline for the automatic exchange of information, it may start adopting the corresponding regulations in order to require foreign financial institutions, including U.S. financial institutions, to report Mexican persons that try to circumvent these provisions by holding accounts through foreign entities.

Therefore, taking into consideration the current global trend which is leading countries to have full transparency with respect to the information they are exchanging and also the fact that this trend is moving very fast towards having more countries incorporating to this new information exchange scheme, it is advisable for Mexican taxpayers to be aware of any further developments in this matter, as this may end up causing them to be under a more strict scrutiny from the Mexican tax authorities considering all the information they will have at hand in the following years.

1 <http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-of-financial-account-information.htm>

2 <http://www.oecd.org/tax/transparency/AEOIjointstatement.pdf>

3 <http://www.oecd.org/mcm/MCM-2014-Declaration-Tax.pdf>

4 <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Mexico-11-19-2012.pdf>

5 <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Mexico-4-17-2014.pdf>

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