

Mexico City, May 1, 2015

Via email

CTPCFC@oecd.org

Mr. Achim Pross
Head of the International Co-operation
and Tax Administration Division OECD/CTPA

Dear Mr. Pross,

On behalf of IFA Grupo Mexicano, A.C. (Mexican branch of the International Fiscal Association), please find below our comments on the Public Discussion Draft “BEPS ACTION 3: STRENGTHENING CFC RULES” (the “Discussion Draft”). Comments are divided by Chapter and, within each Chapter, reference is made to both the Recommendations and certain Questions for consultation.

CHAPTER 2: DEFINITION OF A CFC

I. Recommendations

We agree with the Recommendations in paragraphs 30-31 of the Discussion Draft.

- Questions for consultation

3. Are there any practical problems with either the narrow or the broad version of the modified hybrid mismatch rule mentioned above?

We support the narrow option over the broad option since the latter could potentially subject more income to CFC taxation than is necessary to combat BEPS. However, we note that further work needs to be undertaken in order to clearly define when a payment is “base eroding”.

CHAPTER 3: THRESHOLD REQUIREMENTS

I. Recommendations

We agree with the Recommendations in paragraph 43 of the Discussion Draft.

In such regard, we consider that the low-tax threshold should compare the tax rate in the CFC jurisdiction to a percentage of the tax rate of the parent country’s own rate (i.e., at the most 75% of the statutory corporate tax rate).

We also believe that, for purposes of calculating the effective tax rate, the denominator should be the tax base in the parent jurisdiction had the CFC income been earned there (as opposed to the tax base computed according to an international accounting standard).

Regarding the “unit” used for the calculation, we favor the broad approach on a company-by-company basis, as using other units would increase both the administrative complexity and compliance burden associated with the low-tax threshold.

Finally, we consider that the abovementioned features would, at the same time, address BEPS concerns and grant certainty to taxpayers.

- Questions for consultation

4. What practical problems, if any, arise when applying a low-tax threshold based on an effective tax rate calculation?

Our experience shows that practical problems often arise in calculating the tax base in the parent jurisdiction (i.e., Mexico) had the CFC income been earned there, particularly in relation to timing issues, foreign exchange (FX) gains/losses and taxable/deductible inflationary adjustments, since other jurisdictions recognize certain items of income at a different moment or do not recognize FX or inflationary effects at all.

5. How could these problems be addressed or mitigated?

We consider that both FX gains/losses and inflationary adjustments should not be included for purposes of calculating the effective tax rate, since such gains/losses or adjustments are dependent on the particular situation of the parent jurisdiction and not on that of the CFC jurisdiction.

CHAPTER 4: DEFINITION OF CONTROL

I. Recommendations

We agree with the Recommendations in paragraph 65 of the Discussion Draft.

Regarding the level of control, we consider that (a) control should be found when the parents own more than 50% control; (b) in order to determine whether or not minority shareholders are acting together, a focus on related parties must capture most structures that raise BEPS concerns; (c) non-residents should not be taken into account in determining the level of control; (d) control should be defined to include both direct and indirect control; (e) control should be found if the control threshold is met at each level of the chain of ownership; (f) control should be established at the end of the year, including an anti-abuse provision; and (g) CFC rules should consider interests held by all resident taxpayers.

- Questions for consultation

8. Are there particular practical problems that arise when applying a control test that considers interests held by unrelated or non-resident parties? If so, what are they, and how can they be dealt with?

Yes. Applying a control test that considers interests held by unrelated or non-resident parties, particularly in the “acting-in-concert” version, will probably create significant administrative and compliance burdens (e.g., lack of information available, uncertainty, disputes). These burdens could be dealt with by designing a control test with the features mentioned above.

CHAPTER 5: DEFINITION OF CFC INCOME

- Questions for consultation

9. What are the practical problems with any of the three substance analyses set out above? How could these practical problems be dealt with?

We consider that the main problem with all of the substance analyses is that they would probably lead to uncertainty, if they are stand-alone rules and are not applied alongside other more mechanical rules.

14. Does the discussion above consider all categories of income that should be attributed under CFC rules?

We suggest clarifying how should other categories of income (e.g., rents, other income) be treated.

16. What practical problems arise with applying the categorical approach and the excess profits approach?

It is not clear how would other categories of income be treated (e.g., rents, other income).

18. Which approach is most likely to accurately attribute income that gives rise to BEPS concerns? Is one approach likely to be more effective than the other in terms of dealing with IP income?

We consider that, in principle, the categorical approach attributes income more accurately than the excess profit approach. However, the latter when combined with a substance-based exclusion might become a simpler and more mechanical approach than that required by a substance analysis. If that were the case, we would favor option 4 for the risk-inclusive rate of return and using the tax basis of tax acquisition cost for the valuation, as determined under the law of the parent jurisdiction.

21. What difficulties or practical problems arise in applying an entity approach or a transactional approach?

We favor the entity approach over the transactional approach since the former reduces administrative burdens.

22. What concerns arise from the two approaches in terms of administrative burdens and compliance costs?

We believe that the entity approach is more appropriate than the transactional approach in the context of developing countries, since it is easier to administer for both taxpayers and tax administrations.

I. Others

For purposes of determining if the different types of income received by the CFC (interests, dividends, etc.) shall be considered as CFC income or not, depending if they derive from an active trade or business, the possibility of requesting a ruling before the local tax authorities of the parent jurisdiction confirming such situation could be established, specifically in those cases in which there is uncertainty.

This alternative would grant legal certainty to taxpayers, although they shall bear the administrative burden of providing the tax authorities all the necessary documents demonstrating that the referred income derives from an active trade or business.

CHAPTER 6: RULES FOR COMPUTING INCOME

I. Recommendations

We agree with the Recommendations in paragraph 131 of the Discussion Draft.

- Questions for consultation

25. Does this chapter accurately reflect the issues that could arise with losses or are there any other situations that need to be considered?

On the question of whether the use of losses should be limited to offset against profits of the similar character (e.g., passive losses against passive profits), once again we consider such a limit would cause administrative complexity and increased compliance burdens. A related issue would be how to properly identify expenses that resulted in both active and passive losses with only one of them; an allocation rule would be needed in such regard.

CHAPTER 7: RULES FOR ATTRIBUTING INCOME

I. Recommendations

We agree with the Recommendations in paragraphs 142-143 of the Discussion Draft. We believe, however, that the attribution threshold should be tied, or at least very much aligned, to the minimum control threshold, as to reduce the administrative complexity and compliance costs of the rules.

We further consider that the attributed income should be treated as having been earned by the taxpayer directly, in order to reduce the need for any separate characterization rules.

- Questions for consultation

26. What difficulties, if any, arise under existing CFC provisions for attributing income?

One of the most important difficulties in such regard arises when the attribution threshold and the minimum control threshold are not aligned and, thus, the determination of how much income should be attributed does not capture the taxpayer's influence on the CFC.

CHAPTER 8: RULES TO PREVENT OR ELIMINATE DOUBLE TAXATION

I. Recommendations

We agree with the Recommendations in paragraph 155 of the Discussion Draft.

II. Others

Regarding the sale of shares of a CFC in which the taxpayer holding the shares has already been taxed on undistributed income of the CFC, another alternative (besides not taxing the sale) in order to avoid double taxation, could be to increase the tax cost basis of the shares with said undistributed income recognized by the taxpayer (after tax).

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The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA branch and in no case in the name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.