



JA Del Río



New Effective Tax Rates per type of economic activity



Speakers



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Agenda

- Overview
- Assessment of the effective tax rate by the Tax Administration Service [in Spanish: SAT]
- Economic activities
- Focus on Transfer Pricing
- Conclusions

The image shows a circular architectural structure, possibly a dome or a large atrium, viewed from below. The structure is composed of a series of concentric rings of windows or openings. The central opening is a large, bright white circle. Two decorative circular motifs, resembling stylized sunbursts or geometric patterns, are positioned at the top and bottom of the central opening. The word "Overview" is written in a red, serif font in the center of the white circle.

Overview



Amendment to the Federal Tax Code Spanish: el Código Fiscal de la Federación]

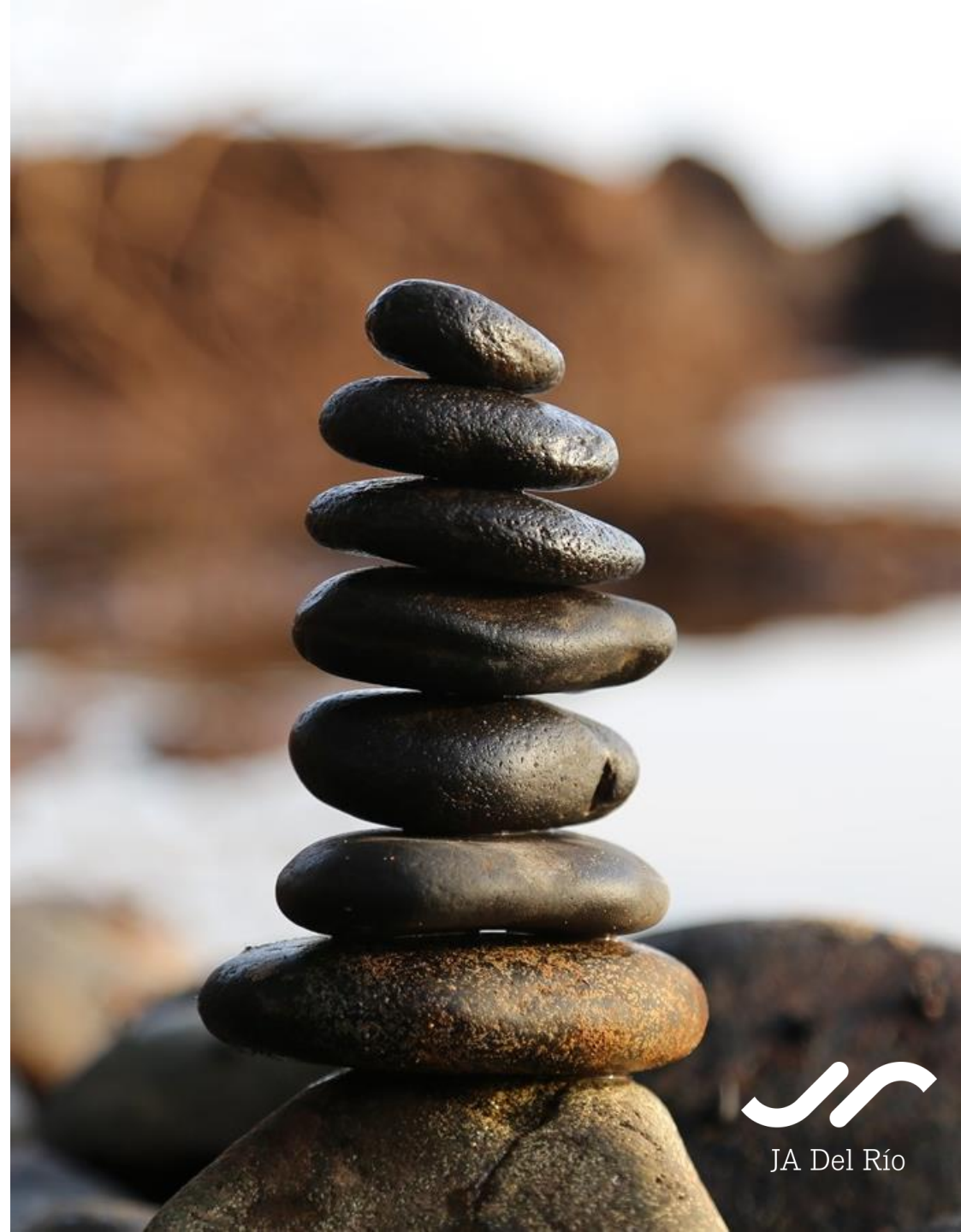


December 08, 2020

- Article 33, section I, subsection i is added)
- New attributions for the tax authorities consisting in providing assistance to taxpayers, and announcing to them on a regular basis specific parameters regarding profit, deductible items, or effective Income Tax rates.
- Tax payers can fulfill their tax obligations with greater certainty in a preventive and cooperative compliance setting.
- Information based on the economic sector or industrial line of business that it belongs to.

Amendment to the Federal Tax Code Spanish: el Código Fiscal de la Federación]

- The tax authorities in Mexico will assess the tax risk per type of activity according to their tax registration.
- Tax audit procedures are not considered to be exercised.



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Assessment of the Effective Tax Rate



Effective Income Tax Rate

- **Tax risk:** is the default contingency on the tax provisions that are applicable to the tax payer or to a group of taxpayers that results in the correct payment of Income Tax. [in Spanish: ISR].
- **Effective tax rate:** is calculated based on the information shown in the last annual Income Tax return that corresponds to the fiscal year in question, by dividing the amount of Income Tax incurred in the corresponding fiscal year by the cumulative income of the said year.

$$\text{Effective tax rate} = \frac{\text{Income Tax incurred}}{\text{Cumulative income}}$$



Authority database

- In order to determine the effective income tax rate the authorities considered the information in the institutional databases that including the following:
 - annual tax returns,
 - tax reports,
 - information regarding the tax situation of the taxpayers [in Spanish: ISSIF],
 - informative returns,
 - digital tax receipts via Internet [in Spanish: CFDI],
 - customs declarations





Effective Income Tax Rate

- On June 13th and August 1st, several effective Income Tax rates for the 2016, 2017, 2018 and 2019 tax years were published regarding the type of economic activity consistent with what is stated in the Federal Registry of Taxpayers [in Spanish: RFC].
- Taxpayer must compare their effective tax rate with the rate published by the Tax Administration Service [SAT].
- Economic activity that corresponds to the majority of your income, regardless of that which is stated as current in the Federal Registry of Taxpayers.
- Having a greater tax risk in one or more fiscal years would lead to correct a tax situation through the filing of amended returns.

What do the authorities expect?

↑ Tax risk = ↑ Probability of an in-depth review

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Review:

- Tax planning,
- Transactions (including those entered into with related parties),
- Corporate restructuring (national & international)
- Interpretation of domestic and or international provisions
- Application of double-taxation agreements,
- Deduction of payments that can represent an erosion of the Mexican tax base,
- Transactions with Companies Invoicing Simulated Operations [in Spanish: Empresas Facturadoras de Operaciones Simuladas], (EFOS),
- Among others.

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Economic Activities



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Economic Activities

Economic activities are those that are contained in Schedule 6 of the current Periodic Amendments to the Tax Law [in Spanish: Resolución Miscelánea Fiscal].

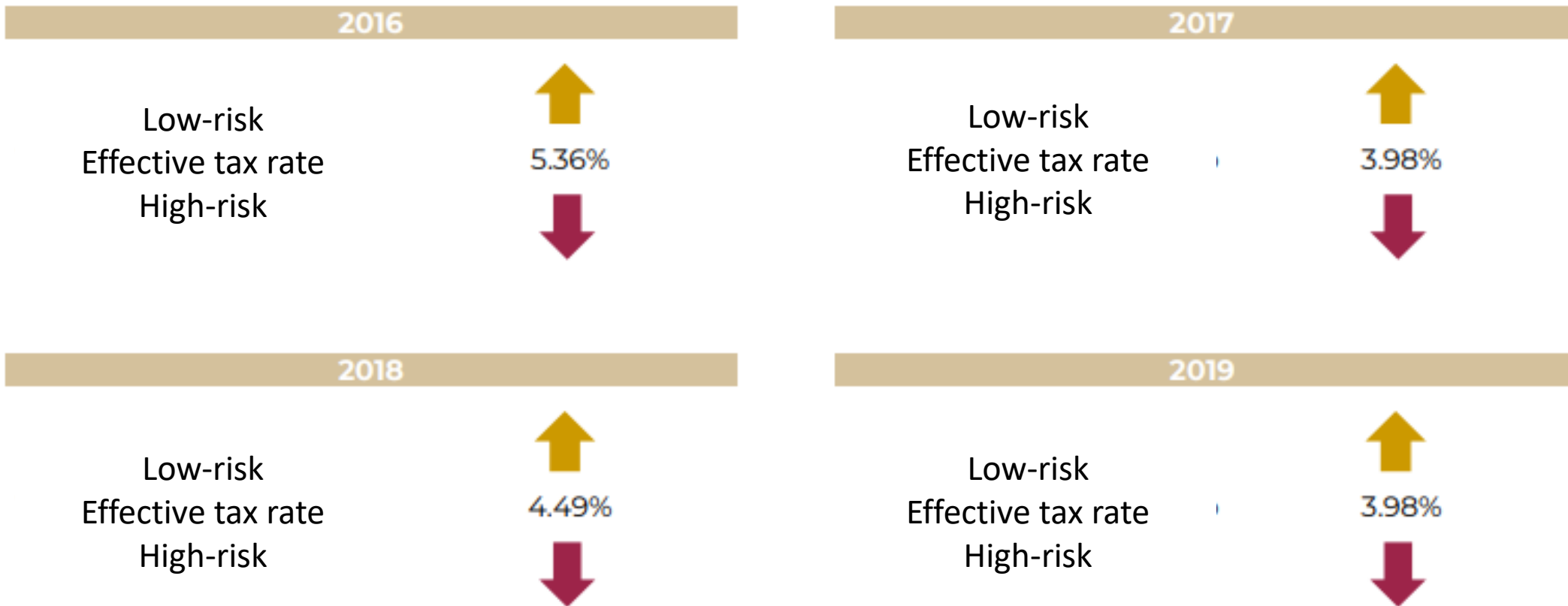
1st Publication
June 13th, 2021

- Mining
- Manufacturing industries
- Wholesale trade
- Retail trade
- Financial services and insurances

2nd Publication
August 1st, 2021

- Construction
- Temporary accommodation services
- Food and beverage preparation,
- Business support services
- Waste management services and remediation services,
- Transportation, mail, and storage
- Real estate and rental services
- Professional, scientific, and technical services,
- Electricity
- Water.
- Gas supply and services distributed through pipelines to end-users;

Manufacturing of gasoline motors and parts for motor vehicles



A low-angle, upward-looking photograph of a circular architectural structure, possibly a dome or a large atrium. The structure is composed of concentric rings of grey concrete or stone. Numerous rectangular windows are arranged in a circular pattern around the perimeter, some of which are illuminated from within. At the very center is a large, bright white circular skylight. Two decorative circular motifs, resembling stylized sunbursts or geometric patterns, are positioned symmetrically above and below the central skylight. The overall atmosphere is clean, modern, and symmetrical.

Transfer Pricing



Transfer pricing and effective tax rates

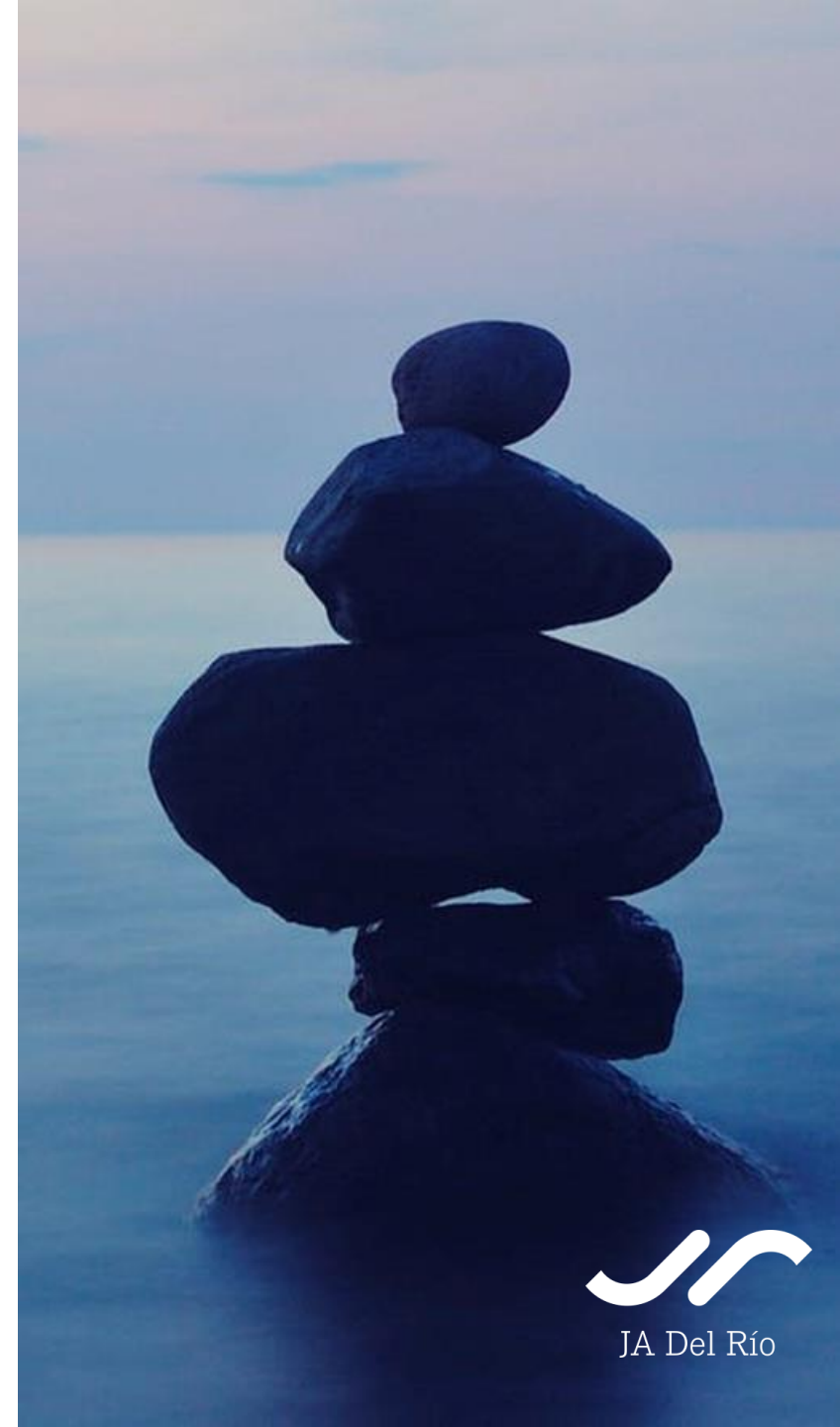


Summary

- The Tax Administration Service, [SAT], has published the aforementioned effective tax rates for 80 economic activities in the mining, manufacturing, industry, wholesale, retailer service sectors, construction, business support services, as well as for financial and insurance services and others.
- The effective tax rate as defined by the Tax Administration Service is the justification for tax incurred/cumulative income.
- Taxpayers with an effective tax rate $>$ the benchmark rate will have a lower risk of being audited, while those taxpayers with an effective tax rate $<$ the benchmark rate will have a greater risk of being audited.
- The expectation from the authorities is that taxpayers secure effective interest rates that are equal to or greater than the percentages that are determined for each fiscal

Transfer pricing and the effective tax rates

- The comparability analysis is generally applied to the economic analysis carried out in the transfer pricing documentation, in order to determine that it complies with the arm's length principle.
- One of the methods commonly used by Mexican taxpayer is the Transactional Net Margin Method (TNMM).
- This methodology requires a comparative analysis to be established for companies that carry out F/A/R that are similar to the parties involved in the transaction, which in the majority of cases is the Mexican taxpayer.





Transfer pricing and effective tax rates

- The effective tax rates published by the Tax Administration Service, [SAT], can be used for calculating the operating margin (operating profit/income) before taxes applying certain assumptions.
- As a point of reference for transfer pricing, considering a tax rate in Mexico of 30% on net earnings, it can be assumed that the expectation of the operating margin of the Tax Administration Service is at least three times of that which is obtained in the published reference parameters, assuming that income or financial expenses are not representative.
- For example, taking the effective rate from the sector: “Manufacturing of gasoline motors and parts for motor vehicles”, this would be 3.98% for the 2019 fiscal year, and as such, can turn into an operating margin of 9.95% (in certain cases).
- The following table summarizes the results of the operating margin generated in the same years by state-owned companies of the United States that carry out similar activities in the auto parts and automotive equipment sectors (an average of 8 economic activities).



Comparison of the effective tax rate vs operating margins

	Effective tax rates per sector				Expected operating margin (in certain cases)				
	2016	2017	2018	2019	2016	2017	2018	2019	
Manufacturing of gasoline motors and parts for motor vehicles	5.36%	3.98%	4.49%	3.98%	13.40%	9.95%	11.23%	9.95%	
Manufacturing of electrical equipment and electronics for motor vehicles	4.47%	3.95%	3.44%	3.95%	14.90%	13.17%	11.47%	13.17%	
Manufacturing of guidance and suspension system parts for motor vehicles	3.96%	3.68%	3.55%	3.68%	13.20%	12.27%	11.83%	12.30%	
Manufacturing of brake system parts for motor vehicles	3.16%	2.72%	2.67%	3.26%	10.53%	9.07%	8.90%	10.87%	
Manufacturing of transmission system parts	3.14%	3.51%	3.41%	3.42%	10.47%	11.70%	11.37%	11.40%	
Manufacturing of seats for motor vehicles	2.26%	2.08%	2.05%	2.17%	7.53%	6.93%	6.83%	7.23%	
Manufacturing of metal stamping parts for motor vehicles	5.31%	4.07%	4.63%	4.67%	17.70%	13.57%	15.43%	15.57%	
Manufacturing of other parts for motor vehicles	6.24%	5.41%	4.89%	4.93%	20.80%	18.03%	16.30%	16.43%	
Average	4.24%	3.68%	3.64%	3.76%	13.5%	11.8%	11.6%	12.1%	
					Interquartile range of comparable companies- Auto parts and automotive equipment				
					Upper quartile	11.68%	11.30%	10.81%	9.09%
					Median	8.88%	9.25%	8.30%	7.61%
					Lower quartile	7.05%	7.72%	7.49%	5.67%
					Average	9.57%	9.98%	9.99%	8.03%

The average operating margin from the auto part and parte automotive manufacturing sectors during the 2016-2019 fiscal years seems much greater than the average profit margin obtained from state-owned companies in the United States in a similar industry (SIC Code).



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Comparison of the effective tax rate vs operating margins

	Effective tax rates per sector				Expected operating margin (in certain cases)			
	2016	2017	2018	2019	2016	2017	2018	2019
Manufacturing of tubes and iron and steel posts from purchased material	2.73%	3.12%	2.92%	2.14%	6.83%	7.80%	7.30%	5.35%
Manufacturing of other products from iron and steel from purchased material	4.19%	3.13%	3.64%	4.25%	13.97%	10.43%	12.13%	14.17%
Aluminum industry	3.60%	2.76%	2.62%	3.20%	12.00%	9.20%	8.73%	10.67%
Die casting of all types of parts from iron and steel produced in another state	4.58%	4.58%	4.69%	4.47%	15.27%	15.27%	15.63%	14.90%
Die casting of non-ferrous metal parts	3.33%	3.63%	3.32%	4.50%	11.10%	12.10%	11.07%	15.00%
Manufacturing of wrought and stamped metallic parts	2.98%	3.82%	3.19%	2.81%	9.93%	12.73%	10.63%	9.37%
Manufacturing of other metallic products	5.06%	4.31%	4.18%	4.05%	16.87%	14.37%	13.93%	13.50%
Average	3.78%	3.62%	3.51%	3.63%	12.28%	11.70%	11.35%	11.85%

The average operating margin from the manufacturing sectors of iron, metallic, and steel products, and by-products during the 2016-2019 fiscal years seems much greater than the average profit margin obtained from state-owned companies in Latin America and the United States in a similar industry (SIC Code).

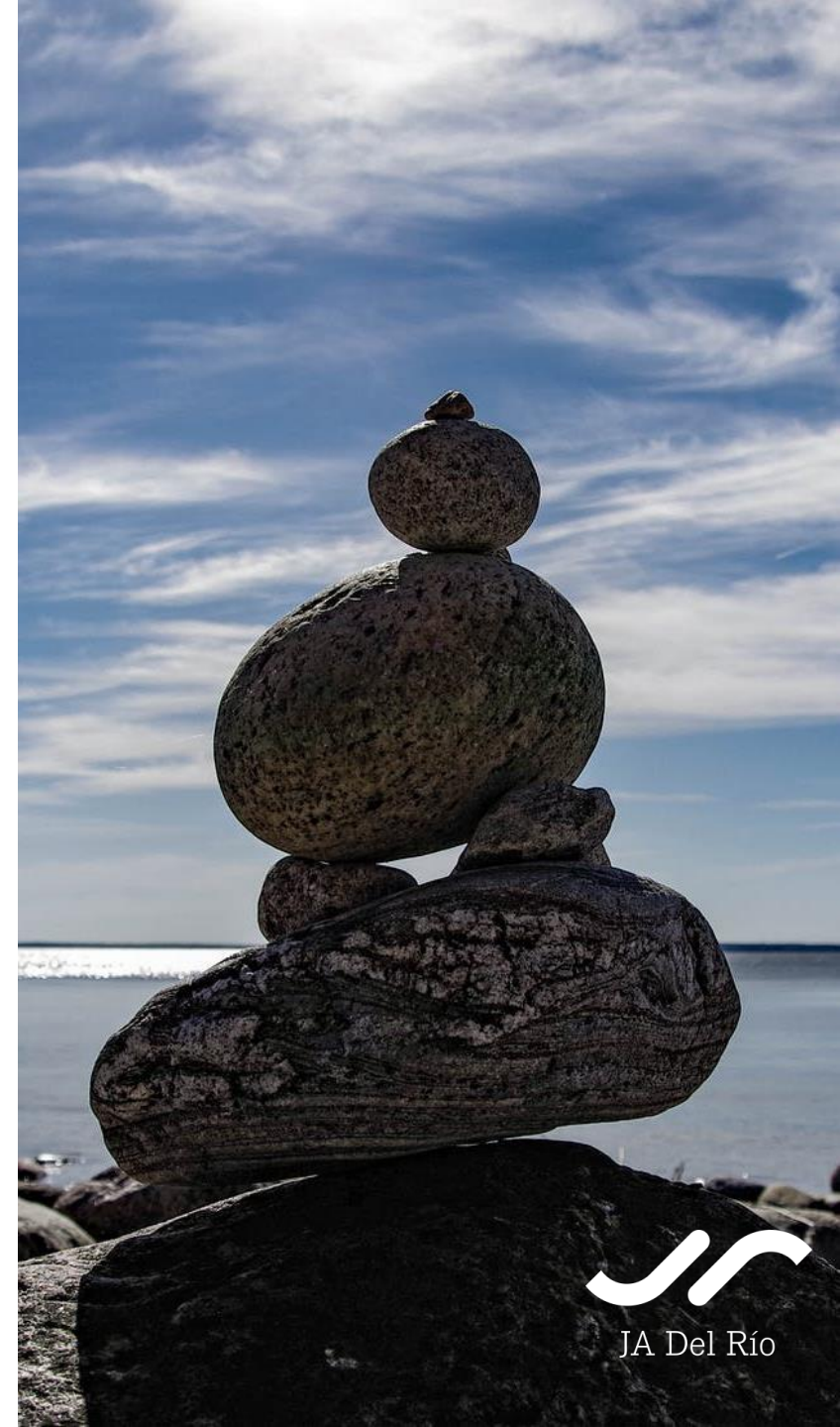
	Interquartile range of comparable companies- Metal, iron, and aluminum manufacturing and associated products in Latin America			
Upper quartile	11.88%	12.87%	11.34%	8.81%
Median	8.95%	6.97%	8.74%	7.63%
Lower quartile	4.16%	4.71%	6.44%	4.37%
Average	9.21%	9.35%	9.90%	7.99%
	Interquartile range of comparable companies- Metal, iron, and aluminum manufacturing and associated products in the United States			
Upper quartile	11.10%	9.44%	9.26%	10.30%
Median	8.47%	6.84%	7.44%	8.07%
Lower quartile	4.91%	3.95%	4.86%	5.51%
Average	8.69%	8.35%	9.01%	8.28%

Transfer pricing and effective tax rates

- This analysis aims to provide a general idea of what would be the expected minimum operation margin based on the effective tax rates published by the Tax Administration Service [SAT], and is non-comprehensive; nor is it a direct comparison.
- If the Mexican tax payer has a large part of its income or deductions with related parties, it might seem that the natural process for assigning a higher effective tax rate will be through a transfer pricing adjustment.

Transfer pricing and effective tax rates

- Review transfer pricing policies, their documentation, and comparable companies used in the comparative analysis, and how the earnings are diverted from what is expected from the tax authorities, in order to use a risk measure that will be useful for the company in allowing it to take appropriate action in complying with the arm's length principle.
- For Mexican subsidiaries of multinational groups that carry out activities in both manufacturing as well as distribution, it would not be reasonable to expect a greater operating margin on the total earnings of the company, but rather only on the activities performed.



A photograph of a circular architectural structure, possibly a dome or a large atrium, viewed from below. The structure is composed of a series of concentric rings of concrete or stone. The innermost ring is a large, bright white circular opening, likely a skylight. This opening is flanked by two decorative circular motifs, each featuring a complex, geometric, and somewhat floral design. The outer rings of the structure are punctuated by numerous small, rectangular windows or openings, some of which are illuminated from within, creating a warm glow. The overall composition is highly symmetrical and geometric.

Other
considerations



Other considerations

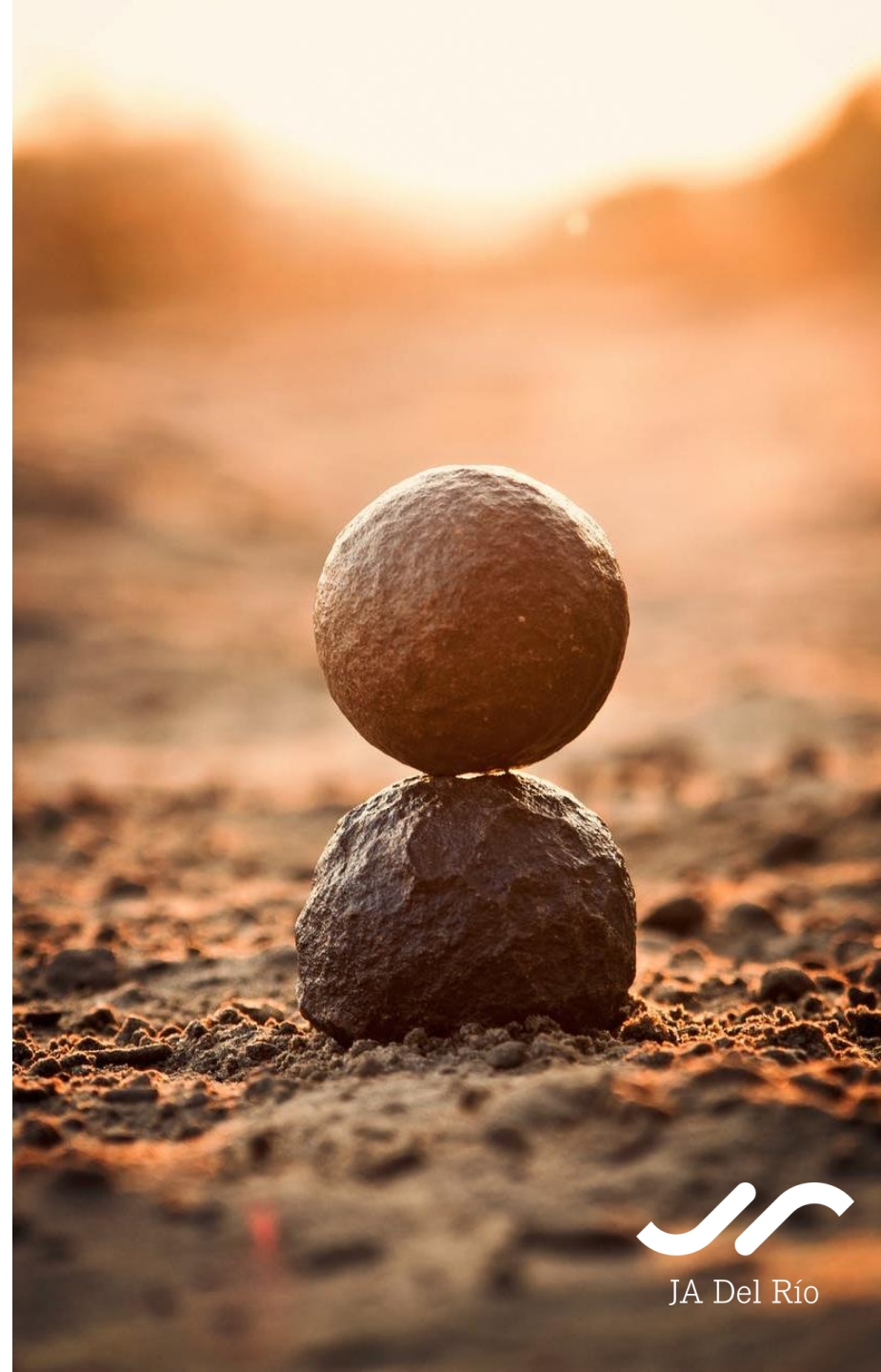
- In the corresponding fiscal years, the margins determined by the authorities do not correspond to the margins that are determined according to arm's length principle.
- The information obtained from the Tax Administration Service, [SAT], was obtained from the database of *large taxpayers*.
- The information available for comparable companies in transfer pricing corresponds mainly to companies in the United States.
- The profit margin calculated by the Tax Administration Service considers deductible and non-deductible items as per fiscal law, while transfer pricing only considers it for accounting purposes.
- The taxpayer must be able to demonstrate the obtained profit margin.

A photograph of a circular architectural structure, possibly a dome or a large atrium, viewed from below. The structure is composed of a series of concentric rings of concrete or stone. The innermost ring is a large, bright white circular opening, likely a skylight. The surrounding rings are dark and feature numerous small, rectangular windows or openings. At the top and bottom of the central white circle, there are two identical decorative circular motifs, each with a complex, geometric, and somewhat floral design. The overall lighting is bright and even, highlighting the architectural details.

Conclusions

Conclusions

- Remember that the rates published by the Tax Administration Service, [SAT], are a point of reference for measuring risk, and do not imply an immediate adjustment by the taxpayer.
- Make sure that intercompany transactions are at market value, in order to minimize a potential risk when the effective rate is below that which is suggested by the Tax Administration Service.
- For companies that have two or more types of income, the payment of expected taxes per activity should differ when comparing effective rates.
- The methodology used by the Tax Administration Service for comparing effective rates does not correspond to a transfer pricing method, and must not be seen as such.





Let 's Talk!

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