

ClientAlert

Tax

October 2014

Prorated Expenses, Finally Deductible

As of October 17, 2014, expenses incurred abroad on a prorated basis with parties that are not income tax payers in Mexico will be fully deductible to the extent certain requirements are met. The foregoing is pursuant to a new rule issued by the Mexican Revenue Service Administration ("SAT") and published in the *Official Gazette* on October 16, 2014.

This new rule is very positive for Mexican affiliates of multinational corporations that throughout the years have struggled with the tax treatment of intercompany charges made on a prorated basis.

For decades the Mexican Income Tax Law ("MITL") has prohibited the deductibility of said expenses, which has forced taxpayers to either treat legitimate expenses as non-deductible or to challenge the legal provisions in litigation.

The issuance of this rule is a bold step by SAT, given that the deductibility of these payments is disallowed by statute, but it is also an appropriate and well-justified measure, considering that the Supreme Court on March 19, 2014 had issued a judgment in which it concluded that the prohibition set forth in the MITL shall not be seen as an absolute prohibition, and that in fact the deductibility of such expenses should be allowed if the corresponding expense meets the following three-pronged test:

- (1) That the transaction that originates the expense is agreed on an arm's length basis and complies with transfer pricing rules;
- (2) That the taxpayer has all the necessary documentation so it can be demonstrated that: the transaction is authentic, the amounts are correct, it is a strictly indispensable expense, it has a reasonable business purpose and it is based on objective tax and accounting criteria; and
- (3) That there is a reasonable relation between the expense incurred and the benefit received by the taxpayer.



If you have questions or comments about this Alert, please contact one of the lawyers listed below:

Vicente Corta
Partner, México City
+ 52 55 5540 9602
vcorta@whitecase.com

Ismael Reyes Retana
Partner, México City
+ 52 55 5540 9661
reyesis@whitecase.com

Guillermo Aguayo-Garza
Partner, México City
+ 52 55 5540 9609
guillermo.aguayo@whitecase.com

Juan Ignacio López Domínguez
Associate, México City
+ 52 55 5540 9108
juanignacio.lopez@whitecase.com

Oficina Ciudad de México
Blvd. Manuel Ávila Camacho no 24 PH
Col. Lomas de Chapultepec
CP11000
México D.F.
+ 52 55 5540 9600

The new rule adopts the foregoing principles, elaborating on the details to comply with each of them, and also includes two new requirements: (1) that the recipient of the expense must be a resident of a country that has entered into a tax information exchange agreement with Mexico, and (2) that if the payment is made in consideration for services, that the services were effectively rendered.

Although some of the terms used in the rule are not totally clear (i.e. “objective tax and accounting criteria”, “reasonable and adequate relation between the expense and the benefit”), the sole possibility for Mexican companies of deducting expenses determined on a prorated basis, without being totally exposed to a disallowance of the deduction and a consequent tax assessment, is a good step forward.

This Client Alert is provided for your convenience and does not constitute legal advice. It is prepared for the general information of our clients and other interested persons. This Client Alert should not be acted upon in any specific situation without appropriate legal advice and it may include links to websites other than the White & Case website.

White & Case has no responsibility for any websites other than its own and does not endorse the information, content, presentation or accuracy, or make any warranty, express or implied, regarding any other website.

This Client Alert is protected by copyright. Material appearing herein may be reproduced or translated with appropriate credit.