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Mexico and U.S. Rules Regarding The Assessment of Tax Deficiencies – A Comparative Study

The rules regarding the assessment of income tax deficiencies determined by the tax authorities, generally as a result of an audit are different between the Mexican tax law and the U.S. tax law. In this regard, this article intends to serve as a general comparative study of the differences of such tax laws in the matter of a tax assessment and other issues that are relevant as the result of the assessment process.

MEXICO

I. The starting point – Issuance of a Statutory Notice of Deficiency ("SNOD")

- The starting point of any assessment and ultimate collection of a tax deficiency determined by the *Servicio de Administración Tributaria* ("SAT") in a tax audit is the issuance by SAT of a resolution by which the SAT determines the amount of the income tax deficiency and provides the facts and legal reasons that sustain the determination of the tax deficiency ["*resolución determinante de un crédito fiscal*" (for the sake of convenience, we will refer to these resolutions as SNOD in this article; nevertheless the reader should understand that the Mexican SNOD differs from the U.S. SNOD)].[i]

- As noted above, the SAT notifies the taxpayer of the facts and legal reasons that went into the determination of the tax deficiency in the SNOD, and also of the taxpayer's right to challenge the SNOD through the filing of either an appeal with the SAT or a nullity claim with *Tribunal Federal de Justicia Fiscal y Administrativa* ("TFJFA").[ii]

- Generally, SAT has a limited period of 12 months after the notification of the beginning of the tax audit to finish the tax audit.[iii] This means, thae SAT has only 12 months to finish the audit and issue the SNOD to the taxpayer.[iv]

- This 12 month period cannot be extended by SAT. If SAT finalizes the tax audit after the expiration of such period, all of the acts performed by SAT during the tax audit and the SNOD become null and void.[v]

The Statute of Limitations ("SOL")

- The SOL limiting the time to audit a taxpayer and to assess an income tax deficiencies is five years after the date of the filing of the income tax return.[vi]

- This five-year period cannot be extended, but it can

U.S.

I. The starting point – Issuance of a Statutory Notice of Deficiency ("SNOD")

- Similar to the Mexican case, the Internal Revenue Service ("IRS") has the power to perform tax audits of taxpayers and to determine income tax deficiencies. Nevertheless, the IRS can only assess such tax deficiency, after the IRS issues the taxpayer a SNOD.

- A SNOD is a notice by which the Commissioner of the IRS notifies the taxpayer of the deficiency,[xix] and it generally includes the following documents:

  1. A letter explaining the purpose of the notice, the amount of the deficiency, and the taxpayer's options;
  2. A waiver allowing the taxpayer to concede the additional tax liability;
  3. A statement showing how the deficiency was computed; and
  4. An explanation of the adjustments made to the taxpayer's tax return if the taxpayer filed a tax return.[xx]

- The SNOD informs the taxpayer of the taxpayer's right to petition the U.S. Tax Court, within 90 days (150 days if the SNOD is addressed to a person outside U.S.) after the mailing of the SNOD to the taxpayer's last known address, for a redetermination of the deficiency.[xxi]

- Generally, the IRS's time limit to finish an audit is controlled by the SOL discussed below.

The Statute of Limitations ("SOL")

- The "SOL" limiting the time to audit a taxpayer is three years from the date the income tax return is filed.[xxii]

be suspended.[vii]

- The SOL increases to 10 years if the taxpayer: (i) does not obtain a taxpayer identification number ["*Registro Federal de Contribuyentes" ("R.F.C.")*]; (ii) does not have accounting books or does not keep them for a term of five years; (iii) does not file a tax return; or (iv) does not provide certain information about other taxes (such as Value Added Tax) in his tax return.

II. Assessment of Tax

- The tax deficiency determined by SAT as a result of the tax audit generally becomes collectable by SAT 45 days after the SNOD is issued and no appeal filed by the taxpayer.[viii]

- This 45-day term corresponds to the term that the taxpayer has to file an appeal to the SNOD, (The defenses available to the taxpayer against the SNOD are briefly discussed in the next section.)

- This means, that if a taxpayer does not file an appeal within the 45-day period, the SAT can begin enforced collection activity using any collection power authorized by law against the taxpayer.

- On the other hand, if the taxpayer files an appeal with SAT in response to the SNOD within the 45-day period, SAT's powers to collect the tax deficiency are suspended for five months or for the time necessary to resolve the appeal filed by the taxpayer with SAT, whichever period is later.[ix]

- Nevertheless, the IRS can request taxpayers to extent the normal SOL of three years; commonly through the execution by the taxpayer and the IRS of an agreement to extent the SOL.[xxiii]

- This agreement allows the IRS to extent the audit or to finish the tax audit after the original SOL.[xxiv]

- The IRS notifies the taxpayer of his or her right to decline or limit the extension of the SOL.[xxv]

- In addition, the IRS can determine that a 6-year SOL applies, when the taxpayer omits gross income in an amount greater than 25% of the total gross income reported on the income tax return, regardless of whether the omission was negligent, accidental, or intentional.[xxvi]

- Finally, the SOL can be kept open if the taxpayer files a tax return that contains false or fraudulent information with the intent to evade taxes. In this case, the IRS can assess the tax deficiency at any time in the future.[xxvii]

II. Assessment of Tax

- How an income tax deficiency becomes assessable in the U.S. is one of the main differences between the U.S. and the Mexican System.

- An assessment is the recording of the taxes due (deficiency) by the taxpayer in the books of the IRS. In other words, the assessment of a tax deficiency marks the point when the payment of such deficiency can be requested and collected by the IRS upon proper notice and demand.[xxviii]

- The IRS can make a deficiency assessment within 60 days after the expiration of the 90-day period granted to the taxpayer after the mailing of the SNOD to file a petition with the Tax Court for a redetermination of the deficiency, assuming a petition is not timely filed.[xxix]

- Nevertheless, if the taxpayer files a petition with the Tax Court requesting a redetermination of the tax deficiency, the IRS is prevented from assessing any tax deficiency until the Tax Court decision becomes final. Final means that the IRS can assess the tax deficiency on the 90th day after the entry of the Tax Court decision.[xxx]

- If the Tax Court decision is appealed, the decision would not become final during the pendency of the appeal and until the term to file a petition for

III. Means of Defense Against the SNOD

- The taxpayer has two alternatives when challenging the SNOD, both of which shall be filed within 45 days after the issuance of the SNOD:

(i) Appeal with SAT.- The taxpayer can elect to file an appeal with SAT, which is resolved by the SAT according to the evidence obtained during the audit.

One of the advantages of filing an appeal with SAT is that the taxpayer does not have to bond the tax deficiency during a period of five months or for the time that SAT takes to resolve the appeal, whichever is later.[x]

If the appeal with SAT results in an unfavorable decision for the taxpayer, the taxpayer is still entitled to file a nullity claim against the appeal's resolution and the SNOD within 45 days after the notification of the appeal's resolution.[xi]

(ii) Nullity Claim with TFJFA[xii]- Instead of filing an appeal with SAT, the taxpayer can elect to file a nullity claim directly with the TFJFA.[xiii]

The taxpayer can appeal the TFJFA resolution by filing an *amparo* claim before the Tax Court. The *amparo* claim is studied and resolved by the federal courts with jurisdiction in administrative law ("*Tribunales Colegiados de Circuito en Materia Administrativa*"), the legal action in the *amparo* must be the focus in the violation of constitutional rights by the TFJFA's resolution.[xiv]

certiorari expires, notwithstanding, the tax deficiency will become assessable after the expiration of the 90-day period after the entry of the Tax Court decision, even if the taxpayer files a notice of appeal.[xxxi]

III. Means of Defense Against the SNOD

- Before the IRS issues a SNOD, the taxpayer generally has the ability to review and contest the Revenue Agent's Report ("RAR") or other similar document (generally known as a 30-day letter), by which the IRS Examination Division determined the proposed income tax adjustments. The 30-day letter provides notice to the taxpayer of the taxpayer's right to request Appeals Office consideration within 30 days from the issuance of the 30-day letter.[xxxii]

- In this sense, the taxpayer has a pre-SNOD appeal opportunity.

- If the Appeal's resolution is against the taxpayer or the taxpayer does not request IRS Appeals Office consideration, the IRS will mail the taxpayer a SNOD, giving the taxpayer the right to file a petition with the Tax Court, within 90 days after the mailing of the SNOD, for a redetermination of the tax deficiency.

- Nevertheless, even if the taxpayer files a Tax Court petition without having had Appeal's Consideration, the taxpayer will generally be entitled to Appeal's Consideration while his or her case is before the Tax Court.

- No payment of the deficiency determination must be paid until after the Tax Court decision becomes final..[xxxiii]

- As mentioned above, if the Tax Court determination is unfavorable to the taxpayer, the taxpayer has 90 days after the entry of the Tax Court decision to file a notice of appeal with the corresponding federal circuit court of appeals.[xxxiv]The decisions that are appealed do not become final during the appeal and until the time to file a petition for certiorari expires.[xxxv]

- The IRS may not assess the tax deficiency during the 90-day period to file a notice of appeal. The appeal's resolution can be appealed through the filing of a petition for certiorari with the Supreme Court. The decision in this case becomes final when the Supreme Court denies the petition or thirty days after the issuance of the decision by the Supreme Court.[xxxvi]

IV. Bond of the Tax Deficiency

- The only way to suspend the collection activities of SAT, after the notification of the appeal's resolution, is through the bond or payment of the deficiency.[xv]

a) Time to bond the deficiency

The time to bond the deficiency varies depending on the appeal that the taxpayer chooses to file. In this sense, if the taxpayer files an appeal before SAT, the taxpayer shall have to bond the deficiency within 5 months after the filing of the; if the appeal is resolved after the term of 5 months, the taxpayer shall bond the deficiency until the appeal is resolved.[xvi] If the taxpayer challenges the SNOD directly with the TFJFA, the taxpayer shall bond the deficiency after the 45 day period, which starts the following day that the SNOD is notified to the taxpayer, expires.[xvii]

b) Amount of the bond

The bond of the tax deficiency shall include the following concepts:

1. The amount of the unpaid taxes due (taking into account inflation adjustments);
2. The interests caused and those that might be caused in the following 12 months;[xviii]
3. The penalties caused and those that might be caused in the following 12 months; and
4. The execution costs incurred by SAT and those that might be caused in the following 12 months.

c) Ways to bond the tax deficiency

Among the ways that the taxpayer has to bond the

IV.- Bond of the Tax Deficiency

- The taxpayer has to bond the deficiency until the 90-day period to file a notice to appeal expires.

a) Time to bond the deficiency

In order to stay the assessment and collection of the tax deficiency after the filing of a notice to appeal with the federal circuit court of appeals, the taxpayer has to file before or with the filing of the notice of appeal a bond with the Tax Court, or file a jeopardy bond under the income tax law.[xxxvii]

b) Amount of the bond

The bond of appeal shall be a sum fixed by the Tax Court, which cannot exceed double the amount of the portion of the deficiency in respect of which the notice of appeal is filed, and with surety approved by the Tax Court, conditioned upon the payment of the deficiency as finally determined, together with any interest, additional amounts, or additions to the tax provided for by law.

The bond of the tax deficiency shall include the following:

1. The amount of the unpaid taxes due;
2. Penalties; and
3. Potential interest assessments relating to the deficiencies.[xxxviii]

The surety or letter of credit arrangement that is required with the bond must be open-ended. In this way it is assured that the bond will remain in force until all tax liabilities, as finally determined, are satisfied.[xxxix]

c) Ways to bond the deficiency

Among the ways that the taxpayer has to bond the deficiency are:

1. Cash bond;
2. Commercial surety approved by the Department of the Treasury;[xl]
3. Letter of credit arrangement; or
4. Collateral in the form of U.S. bonds

deficiency with SAT are: or notes posted as security.[xli]

1. Cash bond;
2. Mortgage or pledge;
3. Bail issued by authorized institutions;
4. Seizure by SAT
5. Joint liability assumed by a third party, etc.

Conclusions: The assessment of a tax deficiency is one of the most important steps in the collection process because it marks the time in which the tax authorities can demand payment and, if necessary, commence the enforced collection of the outstanding taxes. The limitations on assessment by the IRS in the U.S. allow taxpayers to submit tax deficiency determinations to the review of the courts without the need to prepay the deficiency or to bond the deficiency, and without the risk of being subject of the IRS collection powers, almost until the last step of the litigation process (appeal before Federal Circuit Courts of Appeals). On the other hand, the Mexican system of assessments puts a huge burden on the taxpayers who have to bond the deficiency in order to suspend the collection activities of SAT, al least during the litigation process with the TFJFA and during the direct *amparo* proceedings with the federal courts.

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[i] *Article 50, Codigo Fiscal de la Federacion ("CFF").*
[ii] *Article 120, CFF.*
[iii] *There are specific reasons under which the 12-month period to finish the tax audit can be suspended, such as strikes, when the taxpayer does not answer the information request made by SAT, when the taxpayer abandons his tax domicile without filing the notice with the SAT by which the taxpayer informs SAT of his new tax domicile.*
[iv] *Article 46-A, CFF*
[v] *Ibid.*
[vi] *Article 67, CFF*
[vii] *Among the reasons that cause the suspension of the SOL are the following: (i) the SAT requires the taxpayer, persons subject to joint liability, or third parties related to the taxpayer to provide information, accounting books, or any other document related to their tax returns for the purpose of reviewing them; (ii) SAT reviews the tax opinion prepared by a certified public accountant ("C.P.A.") about the financial statements of the taxpayer; (iii) SAT performs field examinations tax audits; (iv) the taxpayer files an Appeal with SAT or a nullity claim with Tribunal Federal de Justicia Fiscal y Administrativa ("TFJFA"); (v) the taxpayer abandons her tax domicile without filing the corresponding notice with the SAT, by which the taxpayer informs SAT of his new tax domicile; (vi) there is a strike; or (vii) until an executor is appointed after a taxpayer's death. See Articles 67 and 42, CFF.*
[viii] *Article 65, CFF. According to the CFF, notifications cause effect the next day that they are notified to the taxpayer.*
[ix] *Article 144, CFF.*
[x] *Ibid.*
[xi] *Article 13 (I)(a), Ley Federal de Procedimiento Contencioso Administrativo ("LFPCA")*
[xii] *The TFJFA is an administrative court, similar to the U.S. Tax Court; nevertheless, the TFJFA has a broader jurisdiction that covers several administrative matters (such as intellectual property, administrative law, tax law, etc.). In addition, the jurisdiction of the TFJFA covers deficiency and refund tax cases. Moreover, in any deficiency tax case involving the TFJFA, the taxpayer must post a bond for the deficiency in order to suspend any collection activities by the SAT.*
[xiii] *Article 141, CFF.*
[xiv] *See Article 17 and 170 (I), Ley de Amparo.*
[xv] *The payment of the deficiency does not cause any effect over the right of the taxpayer to file a nullity claim with TFJFA.*
[xvi] *Article 144, Mexican Tax Code.*
[xvii] *Ibid.*
[xviii] *The Mexican Federal Tax Code limits the accrual of interest (over the amount of a tax deficiency) up to five years.*
[xix] *IRC § 6212(a).*
[xx] *IRM Part. 4. Examining Process, Chapter 8. Technical Services, Section 9. Statutory Notice of Deficiency, 4.8.9.2 (07-09-2013).*
[xxi] *IRC § 6213(a).*
[xxii] *IRC § 6501(a).*
[xxiii] *Commonly, the taxpayer files IRS Form 872 "Consent to Extent the Time to Assess Tax" ("Form 872"), or IRS Form 872-A "Special Consent to Extent the Time to Assess Tax" ("Form 872-A"), in order to provide consent to extend the original or already extended SOL depending on if the extension of the SOL is for a specific period of time or extended until the IRS or the taxpayer undertake certain actions (Form 372-A).*
[xxiv] *IRC § 6501(c)(4)(A).*
[xxv] *IRC § 6501(c)(4)(B).*
[xxvi] *The taxpayer can avoid the 6-year SOL by providing adequate disclosure in the tax return reflecting the probable omission of gross income. See IRC § 6501(e)(1)(A)(ii).*
[xxvii] *There are generally three different types of assessments: (i) automatic or self-assessment; (ii) deficiency assessment; and (iii) jeopardy assessment.*
[xxviii] *IRC § 6203.*
[xxix] *The taxpayer has the right to request from the IRS a copy of the record of assessment that sets forth the name of the taxpayer, the date of assessment, the character of the liability assessed, the taxable period, and the amounts assessed. See IRC § 6203 and Treas. Reg. § 301.6203-1.*
[xxx] *IRC § 6213(a).*
[xxxi] *IRC § 7485(a).*
[xxxii] *IRC § 6501(c).*
[xxxiii] *IRC § 7481.*
[xxxiv] *IRC § 7483.*
[xxxv] *Ibid.*
[xxxvi] *IRC § 7481(a)(2)(B) and (3)(A) and (B).*
[xxxvii] *IRC § 7485(a).*
[xxxviii] *CCDM 36.2.6.2.1.2.4 (2)(A).*
[xxxix] *CCDM 36.2.6.2.1.2.4 (2)(C).*
[xl] *See Treasury Department Circular 570.*
[xli] *See Treasury Department Circular 154.*