

## Simulated operations in Mexico: Focus of corruption



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### J. Isabel García Requenes

PhD in Teaching Methodology  
Autonomous University of Zacatecas  
E-mail: jigr1965@hotmail.com

### ABSTRACT

Companies that Invoice Simulated Operations (EFOS) are called Phantom Companies, and as their name indicates, they are organizations that issue invoices for movements that are not actually occurring, which causes a serious problem with the Tax Administration Service. (SAT).

These companies do not have employees or domicile, but they have the papers in order before the corresponding instances, such as registration with the Treasury, before the Ministry of Economy, with constitutive acts, etc., and most importantly: they have the stamps to issue invoices. for providing services or producing goods that they are unable to provide. They are companies that do not physically exist and are generally used to commit alleged crimes such as tax evasion, money laundering or the diversion of public resources.

The "ghost" companies by themselves do not evade taxes, nor launder money, nor disappear public resources, but require a whole structure of corrupt officials who design the scheme to simulate contracts to divert the money, as well as multiple operators, such as financial advisers, lawyers, notaries, accounting firms and lenders who execute it in the purest style of organized crime, in addition to the collusion of some authorities that allow and favor impunity and the protection of this network of corruption.

In the Mexican Public Administration, they have been used to disguise the diversion of resources, which should be used for the benefit of Mexicans, in favor of an individual.

In seven years, the SAT has detected almost 11,000 shell companies. The last update of the list, as of December 16, 2021, states that a total of 10,990 Companies that Bill Simulated Operations (EFOS) for more than two trillion pesos were identified. The problem is so serious that the Public Sector acquired between 50 and 70% of all false invoices detected in recent years.

**Keywords:** "Ghost" companies, Simulated operations, SAT, Corruption, Public sector.

### 1 INTRODUCTION

The present work has its origin in the problems faced by the Mexican Tax System with the appearance of Companies that Invoice Simulated Operations (EFOS) or non-existent, which at first had the purpose of tax evasion and over the years, this mechanism infiltrated public agencies to divert public resources. Since January 1, 2014, article 69-B was added to the Federal Tax Code (CFF, 1981), which empowers the SAT to detect companies that carry out non-existent or simulated operations and cancel the invoices they issue to, in turn, cut off the flow of money. (Camacho, 2018)

As of that year, the SAT began the publication of the list of "ghost" companies and on June 25, 2018, the Decree (2018) reforming the article in question was published in the Official Gazette of the Federation (DOF), due to the various interpretations that its nature had generated. The Supreme Court of Justice of the Nation (SCJN) itself has encouraged the SAT not to act with all the force conferred by the powers contained in the CFF.



Companies that profit from the sale of Digital Tax Receipts over the Internet (CFDI) are known as EFOS (Simulated Operations Billing Companies, because they invoice operations, purchases or services that were never actually carried out.

The intention of these "ghost" companies is to convince taxpayers that by buying these invoices they will reduce their taxes, in exchange for paying them a commission, which regularly attends to a percentage of the amount of the invoice (Attorney General's Office for the Defense of the Taxpayer, 2018), which usually ranges between 4 and 8%.

These companies generate serious unfair competition to the detriment of Mexican companies and entrepreneurs, who are really working and paying their taxes. However, taxpayers who buy such invoices become EDOS (Companies that Deduct Simulated Operations), that is, people or companies that simulate an increase in their operating expenses to pay less taxes when deducting those invoices (Attorney for the Defense of the Taxpayer, 2018). This purchase and sale of digital tax receipts that protect simulated operations is one of the modalities that tax evasion acquires.

At first, the SAT went after the borrowers of the "shell" companies, most of them with a low socioeconomic profile who live in marginalized areas who were paid a minimum amount of money to become founding partners or had their identity stolen, but not against those who create the companies and manage the money. which proved fruitless.

The strategy of publishing the blacklist of "ghost" companies provided for in Article 69-B of the CFF has been insufficient, since they are created expressly to simulate operations, they are not interested in being exhibited as EFOS. It is better for evaders to disappear it and set up a new company to replace the one that the SAT detected and published. Therefore, it is estimated that its average life is fifteen months (Initiative that reforms, adds and repeals various provisions of the Value Added Tax Law, the Income Tax Law, the Federal Tax Code and the Federal Law against Organized Crime and the Coord Law., 2018).

It is important to put a focus of alert to the corruption that has been occurring in the entities of the public sector, whether of the Federation, of the States and of the Municipalities that contract with budgetary resources simulated benefits of services that, being intangible, it is difficult to verify their delivery or effective provision, such as consultancies, logistics services, logo design, institutional image, advertising, studies, etc., in addition to being paid to "ghost" companies.

In this way, public institutions resort to ghost companies to simulate expenses in works such as paving streets, purchasing materials, remodeling facilities among others. Sometimes shell companies do provide the services for which they were hired but they do so with very low-quality standards that do not match the resources they received, other times the services are not even carried out. (Bacquerie, 2022)



## 2 OBJECTIVES AND GOALS

The main objective is to publicize what ghost companies are, what their modus operandi is and what proposals have been made in Mexico to combat them.

The present work is justified because in our country it is a latent issue that deserves an exhaustive and deep investigation, since the consequences are very serious since they cause not only the embezzlement of the treasury, but also generate the deficiency in services and the increase of the public debt.

## 3 MATERIALS AND METHODS

This research has as main sources of information documents such as codes and laws in force in Mexico, books and magazines that talk about ghost companies, national and local newspapers that on numerous occasions and very frequently present notes that denounce this type of crime, as well as official internet pages such as the Attorney for the Defense of the Taxpayer (Prodecon) which is an autonomous agency defending taxpayers and the SAT; In addition studies that experts have carried out on the subject. Therefore, it is considered that this work is documentary and descriptive.

## 4 RESULTS

"Shell" companies are companies that have a perfectly legal existence on "paper"; that is, they are constituted before a notary, are registered in the Public Registry of Property and in the Federal Taxpayers Registry (RFC), have tax domicile, have an electronic signature, and issue invoices through the SAT platform. Some of these companies even pay small amounts of taxes to disguise their criminal acts. (Roldán, 2018, p. 170)

These companies have two characteristics that define them. The first is that they disappear very easily, that is, when making a physical verification they are companies that do not have facilities, nor with a real infrastructure, they do not have personnel working, nor capacity to provide services or produce goods. In their place are abandoned buildings, empty apartments, dismantled offices. In the best of cases a cubicle where a receptionist behind a counter ensures that, coincidentally, the company that is trying to locate vanished just a few weeks ago, this coupled with the simulation of operations which has led to them being known as ghost companies.

The second characteristic is that the only mission that these companies have is to issue invoices for non-existent or simulated services, which has also led them to be known as "invoices" or "front companies".

Article 69-B of the Federal Tax Code (CFF) establishes that when the tax authority detects that a taxpayer has been issuing vouchers without having the assets, personnel, infrastructure or material capacity, directly or indirectly, to provide the services or produce, market or deliver the goods covered



by such vouchers, or that said taxpayers are not located, The non-existence of the operations covered by such vouchers shall be presumed.

Since 2014, article 69-B was added to the CFF, which gives the SAT powers to detect ghost companies and cancel the invoices they issue to, in turn, cut off the flow of money. As of that year, the SAT began publishing the list of companies that carry out non-existent or simulated operations and on February 7, 2018, the First Chamber of the Supreme Court of Justice of the Nation (SCJN) declared the article in question constitutional.

According to the book of The Master Scam the procedure to integrate the blacklist is: First, if "the company is not at the reported address, its partners are borrowers, etc., the SAT includes the companies in a first list of "alleged ghosts".

From that moment on, the owners of the reported company have 30 business days to prove that, in fact, they are a real company that has infrastructure, assets, personnel and the ability to perform services or produce goods. If they prove so, the company will go to the list of "distorted".

Second, if taxpayers do not rebut this presumption, the SAT then issues new lists in which the accusation is firm and the qualification of "ghost companies" is already definitive. These lists are also published in the Official Gazette of the Federation to warn that no one can do business with these companies."

By appearing on the final list, the CFDIs that were issued are invalid and taxpayers who used them must prove that they acquired the goods or received the services.

Both the shell companies and the taxpayers who interacted with them are incurring the crime of tax fraud, which is punishable by three to nine years in prison.

In the case of public officials, the possible offences that could be defined would be embezzlement (consisting of the misappropriation of money belonging to the State), money laundering (the concealment of these resources of illicit origin) and organized crime (when three or more persons organize permanently or repeatedly, to carry out operations with resources of illicit origin).

To understand how a shell company operates, we have the following example: a government agency hires a company to do a work. The shell company, obviously, does not build anything, but it does receive the contract money. In exchange, it issues invoices that are real, since they are registered with the SAT, but in practical terms are false, since they are "legalizing" the payment of a work that was simulated, that is, it was never built.

The apocryphal invoices have been used by governors, universities, local and municipal governments, as well as public agencies to evade the corresponding payment of their taxes.

With the name of Master Scam, a group of journalists designated the set of irregular or fraudulent actions carried out jointly by Higher Education Institutions (IES) and federal agencies, at



the request of the latter, to obtain financial resources that can be used for political campaigns or mere private appropriation by public officials of said agencies.

In the book *The Master Scam. Graduates in disappearing public money*, the fraud committed by public universities revealed in 2017 is summarized as follows:

a) everything begins in 2015, when it is discovered that of the hundred audits carried out on Higher Education Institutions (HEIs) since 2000, and carried out by the Superior Audit Office of the Federation, 16 repeated the triangulation scheme between government entities, HEIs and companies.

b) the scheme involved 11 public agencies, a dozen HEIs and several hundred companies, 128 of them "ghosts";

(c) The total number of operations carried out irregularly amounted to 7.7 billion pesos, 3.4 billion of which were located in shell companies.

d) all this set of activities was part of a complete system of corruption, which is discovered from the Public Account Reports presented by the Superior Audit Office of the Federation.

It was a state policy that was always planned so that the great politicians were invulnerable.

The authors insist on the permanence or constancy of the *modus operandi* used throughout all those years. The steps of this were always the following:

The model consisted of using a loophole in the Procurement Law, which in its article 1 allowed a government institution to make agreements to hire another institution without the need to make a tender (the mandatory process in the government when hiring or buying anything).

Let's take an example of the correct use of the famous article 1: if an agency such as the National Water Commission required an environmental study to evaluate the construction of a work, instead of a tender to hire a company, it would make an agreement with the National Autonomous University of Mexico (UNAM).

That would save you time, you would get a job done by experts and, in the process, the money of the service would stay in a public institution.

But, in the *Master Scam: the history of embezzlement*, agencies such as the Ministries of Economy, Education, Social Development and Agriculture, as well as Pemex, Banobras, the Institute of Education for Adults, the ISSSTE Housing Fund (Fovissste) and several others adapted the process with these simple steps:

1. A government agency established an agreement with a public university to perform supposed services that were not related to educational activity and as varied as distributing pantries, locating people who could not read, installing a telephone network in buildings or drilling oil wells.

2. The university kept between 10% and 15% of "moche" of the amount that the dependency paid it and with the rest it subcontracted to the companies that the dependency told it.



3. The companies were ghost or illegal. They had no employees, infrastructure or capital to do any services. They only existed on paper.

4. The services were not fulfilled, or, in the best case, they only hired a legal company that did the work and the rest of the money passed from company to company.

The last step to the perfect crime was to "close" the deal. The law required the agency that, before paying the university, it must have photographs, reports, lists, trades or whatever served as proof that the service had been done, which are officially known as *deliverables*.

These documents officially justified the outflow of public resources.

For example, the Secretariat of Social Development (Sedesol) already had the verifiable ones ready, already signed and everything, and the Secretariat only signed as received accepting the fulfillment of the service (which only existed on paper). The universities had only been intermediaries so that the money ended up in shell companies. (Roldán N. & Ureste M., 2022)

There were 3 thousand 433 million pesos that were delivered to ghost companies and whose partners live in neighborhoods and one billion pesos more were the commission for the universities and the rest served to, supposedly, hire services. In many cases, there is no documentary evidence that these existed.

Public universities had budget cuts every year and debts that, until 2017, had seven bankrupt due to the growth of payrolls, benefits and retirements above their budgets, so they were the fertile ground to repeat a diversion scheme as many times as the federal agencies wanted, because nobody would suspect them, but that does not justify their participation in the Master Scam.

## 5 DISCUSSION

On November 8, 2019, the Fiscal-Penal Reform was published in the DOF, which entered into force on January 1, 2020, modifying five legal systems, the Federal Law Against Organized Crime, the National Security Law, the National Code of Criminal Procedures, the Federal Tax Code and the Federal Criminal Code (2019).

Through this reform, the tax crime of buying and selling invoices that protect simulated operations is typified as organized crime (Saldívar, 2018), when the damage to the treasury exceeds \$ 7,804,230.00 and at least three taxpayers participate, a situation that will merit informal preventive detention in terms of the National Code of Criminal Procedures (Robles, 2019).

According to the Decree that reforms, adds and repeals various provisions of the Federal Tax Code, the National Code of Criminal Procedures, the Federal Law against Organized Crime and the National Security Law, (2019), indicates in article 113 Bis of the CFF will be imposed a penalty of two to nine years in prison, to anyone who, by himself or through an intermediary, issues, buys or acquires tax receipts that protect non-existent, false operations or simulated legal acts.





Likewise, it will be sanctioned with the same penalties, to the one who knowingly allows or publishes, through any means, announcements for the acquisition or disposal of tax receipts that protect non-existent operations.

When the crime is committed by a public servant in the exercise of his functions, he shall be dismissed from employment and disqualified from one to ten years, in addition to the aggravating circumstance indicated in article 97 of the CFF. A complaint will be required by the Ministry of Finance and Public Credit to proceed criminally for this crime. This crime and the one provided for in Article 400 Bis of the Federal Criminal Code (CPF), may be prosecuted simultaneously (2019).

According to La Jornada, these measures to combat "ghost" companies could result in an increase of more than a third in the public budget and, consequently, would place the federal, state and municipal governments in a position of strength to promote economic development, generate jobs, combat poverty and guarantee basic services to the population (2018).

For the MDF María Fernanda Haro Mejía, the modification has caused controversy by equating the conduct of omission of the payment of contributions with the commission of a crime such as homicide, trafficking in minors, terrorism or genocide, considered an excessive and disproportionate measure, so certain groups plan to address the issue before the Supreme Court of Justice of the Nation through, an action of unconstitutionality. (Haro, 2019)

Likewise, the possibility that a taxpayer is susceptible to falling into the assumption of tax fraud and consequently as part of organized crime by virtue of arbitrary decisions by the SAT, has caused terror, the fact that a company has the material documentation that endorses the activities carried out, but said authority considers it insufficient and declares that it invoices or deducts simulated operations, this is due to the well-known purely collection position of the tax authority (Haro, 2019, p. 43).

There are people or companies that profit from the sale of Digital Tax Receipts (CFD), which are known as EFOS (Billing Companies of Simulated Operations) or "ghost companies", because they invoice operations, purchases or services that were never actually carried out; That is, they pretend that the taxpayers to whom they issue the invoices are their customers.

The intention of these shell companies is to convince taxpayers that by buying these invoices they will reduce their taxes, in exchange for paying them a commission, which regularly attends to a percentage of the invoice amount, which usually ranges between 4 and 8%.

The companies that sell this type of invoices are, for the most part, service providers, since these, being intangible, have the advantage of not being able to be traced as easily as the sale of goods or merchandise.

These companies generate serious unfair competition to the detriment of Mexican companies and entrepreneurs who are really working and paying their taxes.



However, taxpayers who purchase such invoices become EDOS (Companies Deducting Simulated Operations), that is, people or companies that simulate an increase in their operating expenses to pay less tax by deducting those invoices.

This purchase and sale of digital tax receipts that cover non-existent or simulated operations is one of the modalities that tax evasion acquires.

The main cause of the fall in collection by the SAT is due to the operations simulated by the EDOS such as: Increasing deductions improperly, requesting fraudulent VAT refunds for such operations, invoicing goods that did not pay taxes for their importation and money laundering.

The use of these vouchers has generated damages in the tax system, such as the lower or no payment of taxes and an increase in requests for the return of balances in favor covered by these vouchers to the detriment of collection.

Unfortunately, despite the sanctions that the SAT has issued, the simulation of tax receipts has an increasing impact within Mexico, the reality is that instead of disappearing it seems that it has no end in sight.

## 6 CONCLUSION

The so-called black list of the SAT, which came into force in 2014, is based on article 69-B of the Federal Tax Code, which specifies that when the Treasury detects that a taxpayer issues invoices without having the assets, personnel, infrastructure or material capacity to provide services or market goods, or although they are not located, the non-existence of the operations will be presumed, that is, that they simulate operations or are ghost companies.

The SAT notifies the taxpayer that he has been identified as an alleged simulator through his tax mailbox and he will have a period of 15 days to distort the facts that led the authority to presume the simulation of operations.

The 69 B list is updated quarterly on the SAT portal and in the Official Gazette of the Federation. Those taxpayers who are included in the final list have their digital stamp certificate canceled, which will prevent them from issuing invoices and the tax receipts they have issued in a period five years ago will lose their tax effect.

While the taxpayer must disclose his name, address, Federal Taxpayers Registry (RFC), and in case of non-compliance with the SAT his data is made public, in the case of public entities there is no transparency or accountability. The SAT does not give them the same treatment as taxpayers. The Tax Code says that public institutions are not obliged to pay income tax and this is an argument used by the SAT, as if they were in a different section and it is not so. It is questionable that the SAT does not give the same treatment to the taxpayer and public entities, since the latter have fewer obligations and responsibilities than a taxpayer.





The operations that the Public Administration carries out with ghost companies are not sanctioned or prosecuted with the same rigor as the operations that are carried out between two taxpayers. The hiring of shell companies from public entities may constitute serious and non-serious administrative offenses established in the Law on Administrative Responsibilities of Public Servants, such as crimes related to corruption: bribery, embezzlement, improper use of information and acting under conflict of interest. But the great challenge remains the lack of internal investigations in the Public Administration that conclude in effective sanctions and prevent acts related to corruption.

The lack of will in the Public Administration to implement effective measures to prevent the hiring of ghost companies, from the beginning of the process of contracting services and / or acquisitions and until the last payment to the supplier is concluded. "We see an unwillingness to track the diversion of public resources." (Ramirez, M., 2021)

For Luis Pérez de Acha, an expert in constitutional, fiscal and administrative law and former president of the Citizen Participation Committee of the National Anticorruption System, the criminal-fiscal reform of January 2020 inhibited, although temporarily, the purchase and sale of invoices as a mechanism to evade taxes. However, the EFOS business did not decline. Simply, its marketing was redirected to the increase in public procurement, especially in the states, whose budgets are integrated, for the most part, with federal participations and contributions from revenues collected by the Tax Administration Service (SAT). In 2022, these transfers will amount to 1.8 trillion pesos, an exquisite delicacy for invoices, equivalent to 90% of the total ISR for 2 trillion.

At the federal, state and municipal levels, the budget is high. In the logic of dishonest officials, it is a 'mistake' not to appropriate the money through the EFOS.

Shell companies are multifunctional: they carry out fake operations to evade taxes as well as enter contracts for non-existent public works and services. They are also used to launder money, as well as to transfer it to tax havens or return it to Mexico. All such criminal conduct is committed, of course, through the financial system. The idea that payments between taxpayers and government entities are made in cash is archaic and unrealistic.

Similarly, EFOS are used to dispose of the 'commissions' paid by employers to civil servants under the public contracts assigned to them by them. They are illegal expenses that, to be deducted, taxpayers back up with invoices from shell companies.

Another variant of the invoices is that the diverted resources are used to finance political campaigns, obviously illicitly. The business is round for political parties, candidates and elected governors, which guarantees its own impartiality. Corrupt officials are the first to be disinterested in combating the problem, not even to lessen it.

One of the main problems is that tax legislation, such as Article 69-B of the Federal Tax Code, is only sufficient to combat tax evasion. This legislation is unenforceable in public procurement and



insufficient to charge crimes of government corruption. On the near horizon, a far-reaching legal reform in the exercise and destination of public spending seems unfeasible.

To combat shell companies, it is essential to create the Tax Intelligence Unit, a national plan for this fight through quarterly reports.

This must undoubtedly include the participation of the Attorney General's Office (FGR), the SAT, the National Banking and Securities Commission (CNBV), the Financial Intelligence Unit, the Congress of the Union, civil organizations, schools and academies to prevent the commercialization of invoices, as well as a Mexican Council to combat tax evasion.



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