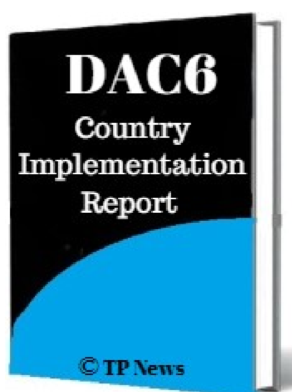


# Mexican 2020 Tax Reform: key international tax proposals

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By *Ricardo Rendón (Partner, Chevez, Ruiz, Zamarripa y Cía, S.C., Mexico)*

On September 8, 2019, the Executive Branch of the Mexican Government submitted to the Congress *Tax Reform for 2020*, which includes key tax changes to the country's tax law primarily inspired by the OECD's base erosion and profit shifting (BEPS) project.

This article provides an overview of some of these tax proposals.

*Permanent establishment definition*

It is proposed that the definition of permanent establishment be amended to bring it into line with the BEPS Action 7 proposal.

The amendment focuses on cases where a non-resident enterprise acts through a non-independent agent that habitually performs activities leading to the conclusion of contracts executed by the non-resident enterprise, under its name or on its behalf, under certain circumstances.

*Hybrid mismatch arrangements*

Bearing in mind concerns highlighted by the OECD in its Report on BEPS Action 2, the proposed bill underlines additional requirements for deducting payments made to related or unrelated parties through structured agreements, in cases where the recipient of the payment is not

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subject to tax in its country of residence or is considered to be subject to a preferential tax regime.

An additional rule is introduced to prevent a double non-taxation scenario when dealing with cross-border payments made between members of the same group of companies.

As such, payments made by Mexican entities shall not be tax deductible in Mexico, when such payments are also deductible for a member of its group, including such entity, in a country or jurisdiction where they are considered tax residents. Certain specific exceptions are set out where a double non-taxation does not occur.

*Interest deduction limitation*

Based on the current Mexican tax legislation, there are two sets of rules which impose limitations for deduction of interest payments in financing transactions carried out with related parties:

- *Back-to-back rule*: Interest payments arising from loans granted to Mexican entities by foreign related parties, when they qualify as back-to-back transactions under the broad assumptions provided by law are deemed dividend payments for income tax purposes, and thus non-deductible.
- *Thin capitalization rules*: Interest payments arising from loans granted to Mexican entities by foreign related parties, which, broadly speaking, exceed a 3:1 debt-equity ratio, are non-deductible.

Under the proposed bill, an additional limitation is included based on the BEPS Action 4 recommendation, with a view to avoiding transactions that could be considered to erode the tax base in Mexico so that aforementioned interest payments should not exceed 30 percent over the adjusted EBITDA for tax purposes (as defined by the law) in any given year.

This new rule provides for a three-year carry forward of the interest that does not meet the 30 percent threshold deduction in the year at hand.

*Recharacterization of certain juridical acts*

Another BEPS-inspired measure introduced in the Federal Tax Code pertains to the recharacterization (for tax purposes) of juridical acts when there is lack of business sense and which generate a tax benefit. For these purposes, there is lack of business sense when the quantifiable economic benefit (present or future) is lower that the tax benefit.

*Reportable schemes obligation*

A new obligation is to be included to disclose tax schemes that generate or could generate, directly or indirectly, a tax benefit so tax authorities may obtain information on what they have identified as risk areas, and for these

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A new obligation is to be included to disclose tax schemes that generate or could generate, directly or indirectly, a tax benefit so tax authorities may obtain information on what they have identified as risk areas, and for these authorities to know who is advising about these schemes, and who is receiving such advice.

It is proposed that tax advisors (defined as any person responsible or involved in the design, commercialization, organization, implementation or administration of a reportable scheme or makes available such reportable scheme) would be the ones mainly obliged to report the tax planning schemes from which a tax benefit may be derived. However, the obligation applies to the taxpayer if there is legal impediment for the advisor to fulfil its reporting obligation.

For these purposes, a long list of different situations, very broadly described, are considered as reportable schemes.

These include schemes that prevent foreign tax authorities to exchange information with the Mexican tax authorities, schemes which involve transfer of tax losses, return swaps, the transfer of fully depreciated assets, corporate reorganizations and restructurings, and transactions involving changes in the equity participation of entities, among others.

The reporting obligations would apply to any reportable scheme carried out as early as January 1, 2020, or before such date when tax benefits arising from such schemes materialize from that date onwards. In other words, the obligation would apply retroactively.

The author is Tax Partner at Mexico's leading law firm Chevez, Ruiz, Zamarripa y Cía, S.C. He would like to thank Moises Gutierrez for his assistance in writing the article.

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