

International Bar Association Annual Conference 2023
Recent Developments in International Taxation
Mexico

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Mexico investment and tax climate

Mexico requires actions that strengthen competition and reduce regulatory burden¹, according to findings of the OECD within its February 2022 Economic Survey on Mexico. Specifically, a climate of uncertainty is frequently perceived by investors within the energetic arena due to legislative reversals. Competition must be encouraged rather than having limited tendering procedures or direct assignments for infrastructure projects.

On public finance, there is an important need of funds for the current federal administration's flagship infrastructure projects (Maya Train, Dos Bocas Refinery and an airport aiming to service Mexico City's metropolitan area).

On the tax arena, no major tax reform has been enacted by the current Federal Government, which has directed the latter's strategy for revenue collection through more aggressive tax audits. The Mexican Tax Administration Service has led audit programs targeting specific economic sectors, focusing on compliance aspects and strengthening the still very formalistic Mexican tax system.

Moreover, the tax authorities are reluctant on authorizing tax refunds, which imply an exhausting verification process with the taxpayer's counterparties, constantly questioning the material elements that surround each economic transaction. Furthermore, taxpayers in Mexico are dealing with a series of complex informative obligations, as well as with complex rules for the issuance of electronic tax invoices (CFDIs) which are subject to constant modifications.

The tax authorities have continued to publish their reference parameters on effective tax rates for 21 industrial sectors for tax years 2016 through 2021, as a means to promote a self-assessment on taxpayers to measure the risks associated with the effective tax rate that each one has determined.

Despite the Federal Government's plan to have austerity measures as a driver within its policies, which has had an impact in the operative budget of the Tax Ombudsman's office in Mexico, the latter remains as a viable means for mediation in complex cases between taxpayers and the tax authorities.

Tax litigation remains very active in Mexico and in recent years, substance-over-form proceedings have become more active for guaranteeing taxpayers' rights, despite the constant challenges the Judiciary Branch is dealing with, specifically on matters pending to be ruled which are of the utmost interest to the Executive Branch (i.e. cuts to Mexico's election agency budget).

The Supreme Court of Justice has been more active on tax matters, issuing a series of controversial precedents that have an important impact on taxpayers' economic transactions.

¹ <https://issuu.com/oecd.publishing/docs/mexico-2022-oecd-economic-survey-executive-summary>

Mexican Mining Law Amendment

On May 8, 2023, the Mexican Government enacted a Decree amending several provisions of the Mining Law, the Law on National Waters, the Law on Ecological Equilibrium and Environmental Protection and the General Law for the Prevention and Integral Management of Waste, regarding mining and water concessions.

Said amendment was approved by the Mexican Congress on April 28, 2023 modifying the duration of the concession titles in the matter, which will be reduced from fifty to thirty years.

The duration of mining concessions may be extended once for an additional term of 25 years. At the end of such term, the concessionaire may participate in the tender of the same mining lot for a final additional 25-year period, as long as the corresponding authorizations and permits for its operation have been granted, along with the necessary water concession for industrial use in mining.

The amendment additionally stipulates for concessions to be granted through public tender processes, eliminating the "free land and first applicant" scheme, and establishing new requirements for the granting of concessions (environmental and social impact).

Also, the Decree establishes that the transfer of previously granted concession titles shall be subject to authorization by the Ministry of Economy; creates the figure of water concessions for specific use in mining; prohibits the granting of mining concessions in protected natural areas and establishes responsibilities for waste generated by such activities, in addition to providing new grounds for cancellation and criminal penalties for non-compliance.

This amendment is being challenged on the basis of having been approved under multiple irregularities in its legislative process.

Multilateral instrument

On international tax matters, Mexico is a signatory to the Multi-Lateral Instrument (MLI). which was subscribed on June 2017, approved by the Mexican Senate on October 2022 and finally ratified and deposited before the Organisation for Economic Co-operation and Development (OECD) on March 15, 2023.

The MLI will become effective in 2024 and the tax treaties for the avoidance of double taxation entered into by Mexico may be modified, to the extent that the other State is party of the MLI, and the latter has selected Mexico as a Covered Tax Treaty.

The entry into force of the MLI represents an expected and challenging phase as part of the international tax agenda within the short and medium term, which

will provide an insight of the tax authorities' perspectives in the application of the Tax Treaties for the Avoidance of Double Taxation.

Since Mexico became a signatory party to the MLI, Multi-national groups with relevant cross-border transactions involving Mexico have revisited their international structures to make a self-assessment on any potential challenging position from the tax authorities, building up stronger defense files sustaining the business reasons of transactions thereof.

Impact on cross-border transactions

Mexican Government has been keen on incorporating OECD's regulations to its domestic legislation, particularly with respect to the Base Erosion and Profit Shifting (BEPS) Action Plan. Particularly, on tax year 2020 important additions were made to Mexican tax legislation following the OECD's regulations.

Having appropriate dispute resolution mechanisms is key for providing legal certainty to taxpayers. In recent years, the Mutual Agreement Procedure (MAP) has been actively used for dealing with cross-border tax disputes, being a good means for alternative resolution, but also having certain complexities and limitation within such process.

Mexico, as signatory of the MLI made several reservations, including the non-application of arbitration clauses; thus, such means of dispute resolution will not be available for international tax cases where Mexico is a party. This certainly was not well received by the international tax community; however, the MAP will remain as a means for dispute resolution on cross-border tax disputes.

Inflationary scenario

Inflation plays an important role in the tax area in Mexico. Taxpayers are obliged to recognize on an annual basis the inflationary effects on debts and credits.

Businesses are revisiting their financial positions, and restructuring their investment portfolios on available financial products that provide better solutions to mitigate inflationary effects. Investment funds have been a special focus of businesses on a variety of products that are linked to inflation resistant assets.

Relevant case precedents

a) VAT – offset

On tax matters, the Supreme Court of Justice has recently ruled on a relevant case on value added tax (VAT). On March 2023, the Second Chamber of the Supreme Court of Justice ruled that offset applicable in civil law is not a means of payment for VAT purposes and may not lead to a refund of favorable balances or tax credit; rather, it is a means to determine the moment when consideration for services rendered is effectively paid and for which VAT is due and payable.

Such binding decision implies that even when a taxpayer holds both, a debtor and a creditor position with its counterparty, VAT must be disbursed, since, according to the Supreme Court of Justice, offset is not a valid means for payment of VAT and the corresponding tax effects may not be recognized.

This legal precedent upholds the criteria that the tax authorities have been sustaining in past years, where VAT refunds were not authorized in case VAT was not effectively disbursed by the contracting party to whom such tax was shifted as a consequence of taxable transactions carried out (sale of goods, rendering of services or temporary use or enjoyment of goods).

b) Bad debts deductibility

Bad debts may be deducted on the earlier upon prescription or when there is a practical impossibility of collection, whichever occurs first. For tax year 2022, relevant modifications were incorporated to the rules that relate to the tax deduction of losses resulting from bad debts that are uncollectible by taxpayers.

Under such reform, it does not suffice to start an arbitration process or file a lawsuit against the debtor to demonstrate that the account receivable is considered uncollectible and therefore, deductible.

Since 2022, taxpayers would need to obtain a definitive resolution issued by a court to demonstrate that they exhausted all means to try to collect the receivable, which certainly delays the moment in which such deduction may be claimed.

On such matter, the Second Chamber of the Supreme Court of Justice resolved that such requirement is constitutional and is non-retroactive.

Agenda

For the remaining part of the current Federal Government's term, it is not envisioned a major tax reform; rather, continuity on the strategy in directing efforts towards collection derived from tax audits.

On trade matters, on 2021 the Governments of Mexico and Canada requested a formal procedure of consultations for dialogue with respect to the United States, Mexico and Canada Free Trade Agreement (USMCA) and find a mutually satisfactory solution with the US, related to content rules for the automotive industry. Such request escalated to a dispute panel which ruled that the US interpretation on calculating the regional content percentage of a vehicle is contrary to the agreements reached in the USMCA. Governments of the signatory countries must resume conversations to find a satisfactory solution.