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COVID-19 Tax – Force majeure

Amid the health crisis brought by COVID-19, it is of outmost importance for Mexican taxpayers to understand the applicability of the relevant force majeure tax provisions.

For such purposes, please bear in mind that on March 30, 2020, the Mexican National Health Council published a [decree](#) in the Official Federal Gazette (the “DOF”) pursuant to which it declared the epidemic generated by the COVID-19 disease as a state of sanitary emergency due to force majeure and authorized the Ministry of Health to determine the actions deemed necessary to address such emergency (the “[Sanitary Emergency Decree](#)”). Additionally, on March 31, 2020, the Ministry of Health published a [decree](#) in the DOF whereby, mainly, it ordered the immediate suspension, from March 30th to April 30, 2020 (the “[Contingency Period](#)”), of all non-essential activities in the public, social and private sectors (the “[Suspension of Activities Decree](#)” and together with the Sanitary Emergency Decree, the “[Decreets](#)”). Pursuant to their publication in the DOF, such Decreets are binding and have full legal effects.

For further information on these Decreets, please review the Newsflash entitled: [COVID-19 - Declaration of health emergency due to force majeure](#).

Specifically, the Suspension of Activities Decree establishes that tax collection activities are considered as essential activities and must, therefore, continue during the Contingency Period.

Although there are many discussions around the subject and especially about the Decreets issued by the Federal Government, in general terms, the force majeure concept refers to an unforeseeable and insurmountable event that makes it impossible to fulfill an obligation and is considered by Mexican tax provisions as follows:

Mexican Income Tax Law (“MITL”)

i) Loss deduction

The MITL establishes that taxpayers may deduct losses derived from a force majeure event.

The loss of goods derived from force majeure events shall be deductible only to the extent that their acquisition value corresponds to their market value, whereas the loss of assets due to force majeure events shall only be deductible to the extent that such assets are considered as deductible investments.

Loss of goods derived from force majeure events that are not reflected in inventory shall be deductible in the year in which they occur, and the amount of the loss shall be equal to the amount pending to be deducted on the date the loss is suffered. Please note that the MITL refers not only to losses of fixed assets but also to fixed assets that are no longer useful.

In the case of loss of value in inventories due to deterioration or other causes not attributable to the taxpayer, the MITL establishes that the deduction must be considered during the year that the circumstance arises, to the extent that specific requirements are met.

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ii) Sanctions, compensations and contractual penalties

The MITL establishes that sanctions, compensations for damages or contractual penalties shall not be deductible unless their payment is required by law when they derive from created risks, civil torts, force majeure, or third party actions. Nevertheless, if the damage or the event that gave rise to the payment of a contractual penalty is caused by the taxpayer, the expense shall not be deductible even if its payment is required by law.

For such purposes, the Sanitary Emergency Decree should trigger the legal consequences of a force majeure event and thus taxpayers must analyze i) if they are legally required to pay for such concepts, and ii) if their payment was imputable to the taxpayer (unlikely in the context of the current sanitary emergency), to determine if an indemnity or contractual penalty should be considered as deductible items or not.

It is important to highlight that regardless of the contractual nature of a penalty, its mandatory payment legally derives from the *pacta sunt servanda* principle, which establishes that the parties to an agreement are required to comply with the terms and conditions they agreed upon. If, for any reason, this obligation is not applicable as a consequence of the contractual unforeseen events theory or a particular clause of an agreement itself, then the contractual penalty could be considered as non-deductible.

For further information on the potential consequences derived from contractual obligations, please review the please review the Newsflash entitled: [COVID-19 – Potential Effects on Contractual Obligations](#).

Federal Fiscal Code (“FFC”)

i) Tax remissions and incentives

The FFC grants the executive branch with the ability to waive or exempt taxpayers from the total or partial payment of contributions, as well as to authorize the payment of such contributions in installments, in order to prevent certain regions of the country from being affected as a consequence of, among others, pandemics. Additionally, the FFC grants the executive branch with the ability to grant subsidies or tax incentives.

Please note that this ability is still applicable even following the recent amendment to article 28 of the Federal Constitution (March 6, 2020), given that the purpose of such reform was to prohibit tax remissions or waivers that were arbitrarily granted by tax authorities, without eliminating those necessary to counter force majeure events.

Consequently, in terms of the FFC, the executive branch is empowered to waive or exempt taxpayers from paying contributions, as well as to grant subsidies and fiscal incentives, so long as they are granted under the terms and conditions established by the FFC, but the executive branch has simply chosen not to grant any so far.

ii) Enforcement measures and fines

In terms of the Suspension of Activities Decree, the Tax Administration Service (the “SAT”) should still be able to impose enforcement measures (i.e., fines, preventive seizures, among others) to taxpayers throughout audit procedures, in case taxpayers, persons that are jointly and severally liable to them or third parties related to them, prevent or obstruct in any way or form the development of their verification procedures.

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However, the FFC provides for an exception under which such enforcement measures would not be imposed when taxpayers, joint and several parties to them or third parties related to them, provide a written statement to the tax authorities establishing that they are prevented from fully or partially attending requests made in the context of their verification procedures due to force majeure events, so long as they are able to support it by submitting the corresponding evidence as well.

In addition, the FFC establishes that no fines shall be imposed from either failing to comply with tax obligations -when the obligation is spontaneously met outside the required deadlines- or when a taxpayer infringes a tax provision as a result of a force majeure event. We consider that the enactment of the Suspension of Activities Decree should not automatically imply that all taxpayers that infringe compliance tax provisions should fall into such exception; rather, it is necessary to make a case by case assessment to determine whether the failure to do so effectively occurred as a consequence of a force majeure event, such as the declared sanitary emergency.

iii) Audit procedures

Pursuant the FFC, the deadlines to conclude audit procedures shall be suspended in case tax authorities are unable to proceed with their verification procedures due to force majeure events until the force majeure event ceases to exist; this situation must be confirmed and published on the DOF and the SAT's website.

Since article 1 of the Suspension of Activities Decree establishes that tax collection activities are to be considered as "essential activities", the deadlines to conclude audit procedures are not currently suspended, which is why as of the date of this document officers from the SAT are still working. Therefore, compliance deadlines to requests issued by the SAT within the context of tax audits should still be computed normally.

Further, absent a legal provision establishing otherwise, all audit expiration deadlines and statute of limitation periods should still be computed normally.

Although there is no express provision, for audits carried out by State authorities that are part of the National System of Fiscal Coordination ("*Sistema Nacional de Coordinación Fiscal*"), pursuant to the Fiscal Coordination Law (*Ley de Coordinación Fiscal*) and administrative collaboration agreements on federal tax matters, if a suspension of activities is declared at State levels due to a force majeure event, deadlines for ongoing federal tax audits may be interpreted to have been suspended as well; in these cases, submitting a written request to suspend such procedures before the corresponding tax authorities is recommended.

Considering that the Federal Government will require additional resources to confront the current situation, it is likely that the SAT will initiate a significant number of audits during the next few months. Thus, taxpayers should be prepared and, if necessary, carefully analyze information requests to prevent such audits from concluding with a tax assessment.

iv) Contentious-administrative procedures

Due to the fact that the SAT continues to work on a regular basis, the 30-day period established in the FFC to file an administrative appeal requesting for the annulment of a tax assessment should be normally computed.

Further, since the SAT's auditing abilities have not been affected by any of the Decrees, taxpayers that wish to suspend administrative collection procedures of tax assessments should submit the corresponding guarantees for such purposes within the regular deadlines.

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It is important to note that on April 3, 2020, the Taxpayer's Defense Office (“PRODECON”) issued [General Decree 003/2020](#), establishing that all face-to-face activities carried out in their central offices and delegations shall be suspended (not their services), from April 6, 2020 until the General Health Council determines that the contingency has ceased.

Contentious administrative procedures or amparo petitions currently held at the Administrative Federal Courts or the corresponding judicial Courts, are currently suspended. Therefore, deadlines to file any sort of submissions (i.e., lawsuits, complaints, evidence, among others) are currently not running.

In terms of the official Decrees published by the Administrative Federal Courts, the Federal Judicial Council and the Supreme Court of Justice, activities of administrative and judicial Courts are scheduled to resume on April 20th, 2020; however, due to the measures that the Federal Government has been recently taking, this deadline is likely to be extended.

Should you require additional information do not hesitate to contact Oscar A. López Velarde (olopezvelarde@ritch.com.mx) or Santiago Llano (sllano@ritch.com.mx), partners of the Tax practice at Ritch Mueller.

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