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Application of the new interest deductibility limitation

Pursuant to the new limitation included in section XXXII of article 28 of the Mexican Income Tax Law with respect to interest deductibility, the “net interest” of the fiscal year that exceeds the amount obtained by multiplying the “adjusted tax profit” by a 30%, shall be considered as non-deductible.

When carrying out the respective computation (in order to anticipate the impact that might be triggered by this new limitation at the end of the fiscal year), it is not entirely clear how some elements shall be considered for this purpose. This may give rise to different interpretations that may create inconsistencies in some cases; among these elements are the following:

- Distribution of the amount of MXN \$20,000,000 (which is permitted to be reduced in order to compute the amount of the fiscal year’s net interest) among the group/related parties (i.e., in cases in which an entity of the group has a higher amount of taxable interest than payable interest).
- Interest that may be deducted when the adjusted tax profit is negative.
- Adjusted tax profit and interest income with foreign source that should be included.
- FX effects to be considered as interest.
- Interest that in principle is non-deductible which may be considered in the 10 year carry-forward calculation.
- Extent of the application of tax losses rules regarding interest that in principle is non-deductible (i.e., what happens in cases of mergers or spin-offs).
- Doubts on whether certain type of debts may be considered as destined to finance excluded activities (i.e., refinancing).
- How interest derived from debts destined to finance excluded activities has to be excluded, as well as possible distortions due to reducing from the adjusted tax profit, income derived from such activities.
- Interaction with thin-capitalization rules.
- Effects related with the annual inflationary adjustment.
- Moment to recognize the impact in the Net Tax Profit (“UFIN”)/Net Tax Profit Account (“CUFIN”) and in the creditable valued added tax.
- Other type of considerations (i.e., dividend recharacterization).
- Administrative tax rules pending to be published by the tax authorities (i.e., consolidated calculation).

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Considering the aforementioned and due to the lack of clarifications on these subjects by the tax authorities (i.e., through the issuance of the corresponding administrative tax rules, at least as of today), we recommend to carry out the corresponding computations, in order to determine the potential effect of the possible non-deductible interest.

We also recommend to start analyzing the arguments in order to file a potential *amparo* suit against this legal provision at the beginning of next year.

If you require additional information, please contact Oscar López Velarde (olopezvelarde@ritch.com.mx) or Santiago Llano Zapatero (sllano@ritch.com.mx), partners of the Tax practice at Ritch Mueller.

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