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General anti-avoidance rule and disclosure obligations

The 2020 proposed tax reform (the "Tax Reform") submitted by the Mexican Secretary of Finance before Congress, includes relevant changes to the Federal Fiscal Code ("FFC") that may significantly broaden the tools for authorities to assess taxpayers through the incorporation of a new general anti-avoidance rule ("GAAR"), as well as a new set of rules that will require both tax advisors and taxpayers to disclose most transactions.

General anti-avoidance rule

In order to counter tax avoidance arrangements implemented by taxpayers, the Tax Reform includes a GAAR that is intended to apply to transactions that lack of a business purpose, and that are carried out to obtain a tax benefit. Transactions might be either (i) recharacterized as those that would have been implemented to obtain the economic benefit that was pursued, or (ii) disregarded for tax purposes if there is no such benefit.

Within the context of an audit procedure, tax authorities would have the ability to presume that a transaction lacks of a business purpose, based on the facts and circumstances that are discovered during an audit. Nevertheless, taxpayers will have the opportunity to argue against the presumption before the audit concludes.

In terms of the Tax Reform, the presumption that a transaction lacks business purpose would be applicable if (i) the tax benefits obtained following its implementation outweigh the economic benefits (economic test), or (ii) if the intended economic benefit could have been achieved by executing a lesser amount of transactions that, if so reduced, would have increased the tax liability of the transaction (step transactions test).

In respect to the economic test, it is essential to highlight that the GAAR forgets that there are transactions in which the taxpayers may also have economic and financial losses, which should also be considered to avoid disregarding the existence of real losses for the taxpayer.

If the GAAR is enacted, companies would have to carefully review transactions that are -or appear to be- intended to achieve tax efficiency.

Disclosure obligations

The Tax Reform provides a new set of rules that would require tax advisors to disclose certain "Reportable Structures" (esquemas reportables), that allow taxpayers to obtain a tax benefit in Mexico regardless of their tax residency.

Transactions are considered to be Reportable Structures if they represent a tax benefit in Mexico. These Reportable Structures include transactions that: imply a transfer of NOLs; consist of payments that are interconnected and allow the capital to return to the original payer; prevent the application of a rule that disallows a deduction; prevent the application of dividend withholding taxes; involve the use of foreign vehicles which beneficiaries are not appointed when incorporated; avoid triggering a permanent establishment in Mexico; imply the use of a hybrid instrument; involve corporate restructurings, sale and contributions of goods or financial assets, or capital redemptions; use financial derivatives; among others.

For such purposes, the proposed rules establish that there are “General Reportable Structures” and “Personalized Reportable Structures”. Tax advisors would have to disclose General Reportable Structures by filing an informative return 30 business days after they first contact the taxpayer about the structures; whereas Personalized Reportable Structures are disclosable 30 business days after the earliest of (i) the structure is made available to the taxpayer for its implementation, or (ii) the first step to implementing the structure being taken.

After disclosure, a “Committee” formed by the tax authorities would analyze the structure through technical sessions and may extend an invitation both to the taxpayer and the tax advisor to attend. The Committee would be required to issue its opinion about the legality of the reported structure within 8 months following disclosure; if not, the structure would be considered as valid until a notification informing otherwise is made. It is worth mentioning that the Tax Reform is not clear about the consequences of implementing a structure after the elapse of the 8 months period, and thereafter it receives a negative opinion.

In case the opinion -which would be binding to both the taxpayer and the advisor- validates the structure, it would be excluded from the disclosure obligations. If the opinion declares the structure as illegal, the taxpayer would have to refrain from implementing it or, if already partially or totally implemented, the taxpayer would have to file a return correcting its tax liability within 60 business days. It is important to bear in mind that these opinions would be challengeable.

After disclosing a Reportable Structure, advisors would receive an ID number which must be delivered to any taxpayer that intends to implement such structure. If taxpayers implement the Reportable Structure, they would be required to include the ID number in their annual tax returns.

It is important to bear in mind that also taxpayers would be required to disclose a Reportable Structure when, among others, their advisor does not provide the ID number, does not deliver a certificate stating that the structure is not reportable or when the structure is designed and implemented in-house. Additionally, if a Reportable Structure is not disclosed, the five-year statute of limitations for tax authorities to issue a tax assessment will be suspended.

It is clear that, if passed, this disclosure obligation will create major challenges for both taxpayers and advisors, as they will have to reveal most of the transactions they advise or are advised on in a regular basis; otherwise, both advisors and taxpayers could be subject to considerable fines that go up to approximately USD $1 million dollars.

Should you require additional information do not hesitate to 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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