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Tax Practice Group Newsletter



Tax compliance and optimization for companies in the midst of COVID-19 and in the absence of federal tax incentives

In the past few days, the Mexican government announced that there were no plans for granting any federal tax incentives, relief or extensions to face the COVID-19 pandemic, regardless of the OECD recommendations, the actions undertaken by several other countries, and the continuous requests from the private sector in Mexico.

In addition, on March 31, the Ministry of Health ordered that only essential activities should continue to be conducted within Mexican territory. For this purpose, essential activities include among others, collection activities by the tax authority. This determination results in uninterrupted tax auditing, collection and sanction activities. In fact, the deadline for companies to submit their annual tax returns (which was not delayed due to the pandemic), lapsed on the same date on which said order was issued.

On the other hand, we are expecting that an “economic reactivation plan” will be announced next April 5, on the occasion of the federal government’s report for the first quarter of 2020. Unfortunately, the expectations for companies to receive any significant support out of this plan are very low.

Given the absence of a relief plan from the federal government, the scant expectations that this situation will significantly change for companies in Mexico, and the uninterrupted revenue collection activities of the tax authority, it is important that, during this COVID-19 crisis, corporate taxpayers adopt both **(i)** preventive and **(ii)** reactive tax strategies.

From a **preventive** perspective, it will be important that companies continue to strictly comply with their tax obligations in Mexico and even increase efforts to correctly do so, including implementing a more robust verification on the adequate tax compliance of their suppliers.

In fact, even where the need to increase tax revenue was already patent prior to the pandemic, it is now foreseeable that the tax authority will have to significantly increase its collection efforts in the midst of a dramatic reduction in oil prices in the last few days. Auditing and sanctions arising from failure to submit tax returns (such as the cancellation of digital codes essential for the issuance of invoices) will likely increase significantly.

We also anticipate an increase in non-compliance from other taxpayers that will be affected by the looming

economic crisis, thereby increasing the possibility of having certain suppliers from companies be blacklisted as taxpayers conducting simulated operations (article 69-B of the Federal Tax Code) and, consequently, jeopardizing the deductibility of payments made by these companies to said suppliers.

Of course, aside from a preventive strategy, companies should also be **reactive** in the face of the total absence of tax incentives, relief or extensions. To achieve this objective, companies should make an effort to analyze the availability of legal alternatives that could assist them in mitigating the adverse economic consequences of the pandemic from a tax perspective.

To that end, the following non-comprehensive list of actions is worth reviewing by companies in this situation. Note that a case-by-case analysis will be needed to determine the standing of each company with respect to any such measures, as well as to identify additional measures that could be available.

Estimated income tax payments. Corporate taxpayers are generally required to make estimated income tax payments on a monthly basis on the 17th day of the month following month. The amount of the advance payments is determined with reference to the profitability of the prior fiscal year and the income received in the relevant month. In July of each fiscal year, taxpayers are entitled to request an authorization to reduce the amount of said estimated payments if they consider they will have a profitability that is lower than that obtained on the prior year and are able to demonstrate such situation. In most cases, the reduction of the gross income vis-à-vis the operative expenses should be sufficient to demonstrate a reduced profitability. The request for authorization must be submitted one month before the due date of the first advance payment that will be reduced (e.g., before July 17 if the reduction is to be applied for the July estimated tax payment that must be submitted on or before August 17).

Authorization to defer payment of taxes or to pay the tax liability in installments. The Federal Tax Code provides an option to request authorization to defer (up to 12 months) the payment of any taxes determined by the tax authority or self-determined by the taxpayer. Alternatively, the taxpayer can request an authorization to pay the tax liability in installments. Generally, under these two alternatives taxpayers are required to pay upfront at least 20% of the total tax liability and to grant a guarantee of payment for the remainder of tax liability in certain cases.

Income recognition. The timing of income recognition is essential for taxpayers. Although generally all corporate taxpayers need to recognize income on an accrual basis, in certain situations the recognition rules for income tax purposes may provide a timing relief. To

achieve optimization on the moment of recognition, it is advisable that invoicing and collection policies of each company are reviewed, while also making sure that operations are properly recorded for accounting purposes.

Indemnity payments and renegotiation of agreements. Due to the lockdown in Mexico and other countries, companies may not be able to fulfill their contractual agreements. This could potentially lead to indemnity payments where the agreement does not provide for contractual force majeure relief in the event of a pandemic, or to renegotiations. It will be important to analyze the deductibility of such payments and to make sure that the contract renegotiation process results in tax efficiencies for the taxpayer such as deferring the recognition of taxable income or the payment of taxes.

Deduction of bad debt. Unfortunately, during this pandemic, uncollectable accounts receivable could increase drastically but for which, nevertheless, the taxpayer has already recognized the corresponding income. Consequently, it is advisable to determine to what extent the taxpayer can be entitled to a tax deduction of these accounts.

Deduction of interest expense. Interest deductibility is subject to several limits and restrictions such as thin capitalization rules and the new 30% of adjusted taxable income limit. Companies that will increase their leverage during this fiscal year should analyze alternatives to reduce the undesirable tax effects of these limitations.

Transfer pricing. The current pandemic crisis should adversely affect the financial results of several companies. As a result thereof, we consider that taxpayers will need to revise the profit margins in their related party transactions based on the new economic reality of comparable transactions, and thus properly comply with applicable arm's length principles.

Maquiladora regime. In the midst of the pandemic crisis and the global economic recession, safe harbor thresholds (6.5% over costs or 6.9% over assets) applicable to the special maquiladora tax regime might result in profit margins higher than those that would be determined under an Advance Pricing Agreement (APA) issued by the tax authority. It is therefore advisable for groups applying the maquiladora tax regime to analyze whether it will be convenient to continue under the regular safe harbor thresholds or to apply for an APA before the tax authority.

Income tax and VAT refunds. In times of crisis cash is king and, therefore, recovering favorable tax balances becomes a top priority for taxpayers. To prevent requirements and delays in obtaining such refunds, it is advisable to properly support each favorable

balance and to anticipate to any requirement from the tax authority.

Multinational companies. Several countries have announced unilateral measures to provide tax relief against this pandemic. To make these measures more efficient, some multinational companies might need to restructure their business or activities in Mexico (e.g., corporate restructures, changes in the supply chain). Mexican tax implications of these possible restructures must be reviewed to determine tax compliance and optimization alternatives.

At Sanchez Devanny, our Tax practice area has extensive experience in these matters. Please do not hesitate to contact us with any comments or questions.

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Tax

This practice pragmatically advises clients on tax planning, federal and local tax optimization for new or existing operations and expansion projects, national and international corporate reorganizations, tax treaties, transfer pricing, private wealth management, and provides representation during complex tax audits and litigation.

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