

# Restructuring Tax Claims in Mexico: Considerations Derived From the Current Government's Tax Policy

By ANDRÉS FERRER



As is the case in most countries, a crucial item to consider when analyzing the different alternatives available to a financially distressed debtor in Mexico is its tax and fiscal situation, especially regarding the existence of any tax or other fiscal claims against it (“**Tax Claims**”).

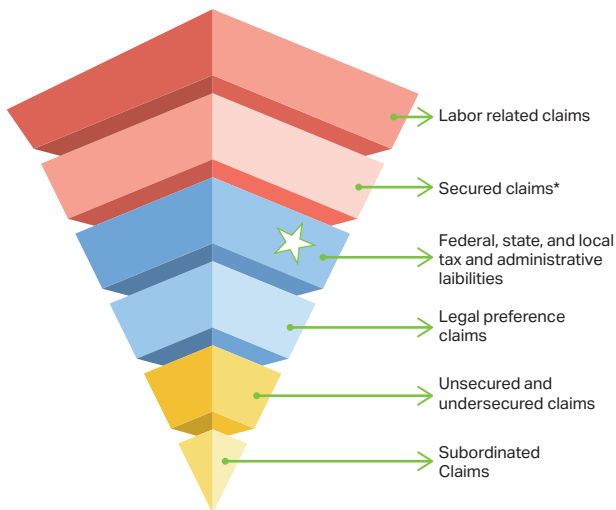
Mexican tax laws expressly provide for certain mechanisms through which Tax Claims may be restructured. Although the legal framework applicable to Tax Claims in the context of restructurings has not been modified, and there are no current bills in Congress seeking to modify it, the current Government’s tax policy—discernable from public statements made by the President and his cabinet, from an executive order issued on May 20, 2019 (described below), and from amendments to tax laws on other topics—may nonetheless pose an important *de facto* obstacle for the

application of debtor-favorable provisions, which could in turn result in significant challenges for insolvencies, restructurings and voluntary work-out efforts in Mexico.

In this article we analyze the challenges that Mexican debtors with significant Tax Claims face when reorganizing. We also outline key considerations that these companies should take into account before deciding to file for an in-court insolvency proceeding.

## Main Mechanisms to Restructure Tax Claims in Mexico

Reorganization of Tax Claims, and the ability of a debtor and Mexican tax authorities to broker and attain an agreement, are constrained to what is expressly provided for and authorized by the Mexican Constitution and applicable legislation. Tax Claims have priority over all unsecured, under-secured, non-labor, and non-alimony claims and interests, including pre and post restructuring investors and stockholders.



\* Up to the value of collateral

In practice, it is not uncommon to find financially distressed debtors that need to renegotiate and restructure private and public debt and Tax Claims, and notwithstanding the wide range of restructuring options available, private creditors' willingness to participate in and enact a restructuring plan is often conditioned upon the debtor being able to reorganize its Tax Claims in a manner consistent with the proposed restructuring and the post-restructuring business plan. Acknowledging the importance of in-court and out-of-court restructuring efforts in order to preserve economic, financial and social value, while at the same time seeking to avoid potential abuses against the public treasury, Mexico's tax legislation, and particularly its Federal Fiscal Code (*Código Fiscal de la Federación*) ("CFF" by its Spanish acronym), includes provisions that expressly authorize Mexican tax authorities to sanction and/or undertake certain acts that could result beneficial or useful for a debtor seeking to work-out its indebtedness and continue its business and operations. The CFF also sets strict limits on what Mexican tax authorities can do.

Among those provisions allowing the Mexican tax authorities a scope for action in financial work-outs, two of them call for special consideration by virtue of their relevance and usage in reorganizing Tax Claims

### Ordinary Tax Payment Plans

Article 66 of the CFF authorizes Mexican tax authorities to convene with tax debtors and sanction payment plans regarding defaulted Tax Claims under the following general terms and conditions (plans described below are referred to as the "Ordinary Tax Payment Plans").

Debtors can choose between either: (i) a plan deferring payment of the defaulted Tax Claims during up to 12 months (the "Deferral Plans"); or (ii) a plan authorizing payment of the defaulted Tax Claims through up to 36 monthly installments (the "Installment Plans"). Debtors shall file before Mexican tax authorities the corresponding form requesting the authorization of the Ordinary Tax Payment Plan, stating whether they opt for a Deferral Plan or an Installment Plan.

In terms of process, Debtors shall pay, simultaneously to filing the request form, 20% of the outstanding and defaulted Tax Claims, including actualizations, fines and other ancillary charges accrued up to the date of said filing. The differences between the plans are as follows:

Feature	Deferral Plans	Installments Plan
Payment	Bullet	Equal monthly installments
Maturity	12 months (max.)	36 months (max.)
Premium	Deferral fees at final payment approved by Congress currently of 1.26% per month	Monthly deferral rate approved by Congress currently ranging between 1.26% and 1.82% per month, depending on plans length
Initial Advance	20%	20%
Default	Fines and additional fees	Fines and additional fees

Mexican tax authorities are not permitted to implement an Article 66 restructuring over Tax Claims derived from: (i) taxes accrued during the current year at the time of filing or during the last six months prior to a filing; (ii) taxes withheld by a debtor from third parties; and (iii) imports and exports taxes.

Unless exempted by the Mexican tax authorities through regulation, debtors shall provide security over the outstanding 80% of the defaulted Tax Claims plus the deferral fees calculated pursuant to the deferral rate approved by Congress.

In addition, authorization of any Ordinary Tax Payment Plan may be revoked if:

1. security over the outstanding defaulted Tax Claims is not granted, or if said security is eroded or results insufficient and is not incremented or replaced;
2. an in-court restructuring or bankruptcy proceeding is commenced against the debtor; and
3. debtor defaults on (a) the balloon payment of the outstanding 80% of the Tax Claims under a Deferral Plan; or (b) three or more installments or the last installment under an Installments Plan.

Finally, Article 66 of the CFF allows Mexican tax authorities, as an exception, to convene and sanction payment plans providing different terms and conditions than those applicable to the Ordinary Tax Payment Plans, but solely to the extent that the taxable income generated by a debtor during the last year in which taxable income was generated (prior to the intended Tax Claims reorganization) amounts to 40% or less of the Tax Claims being restructured.

### **Remittance of Tax Claims (only for in-court restructurings)**

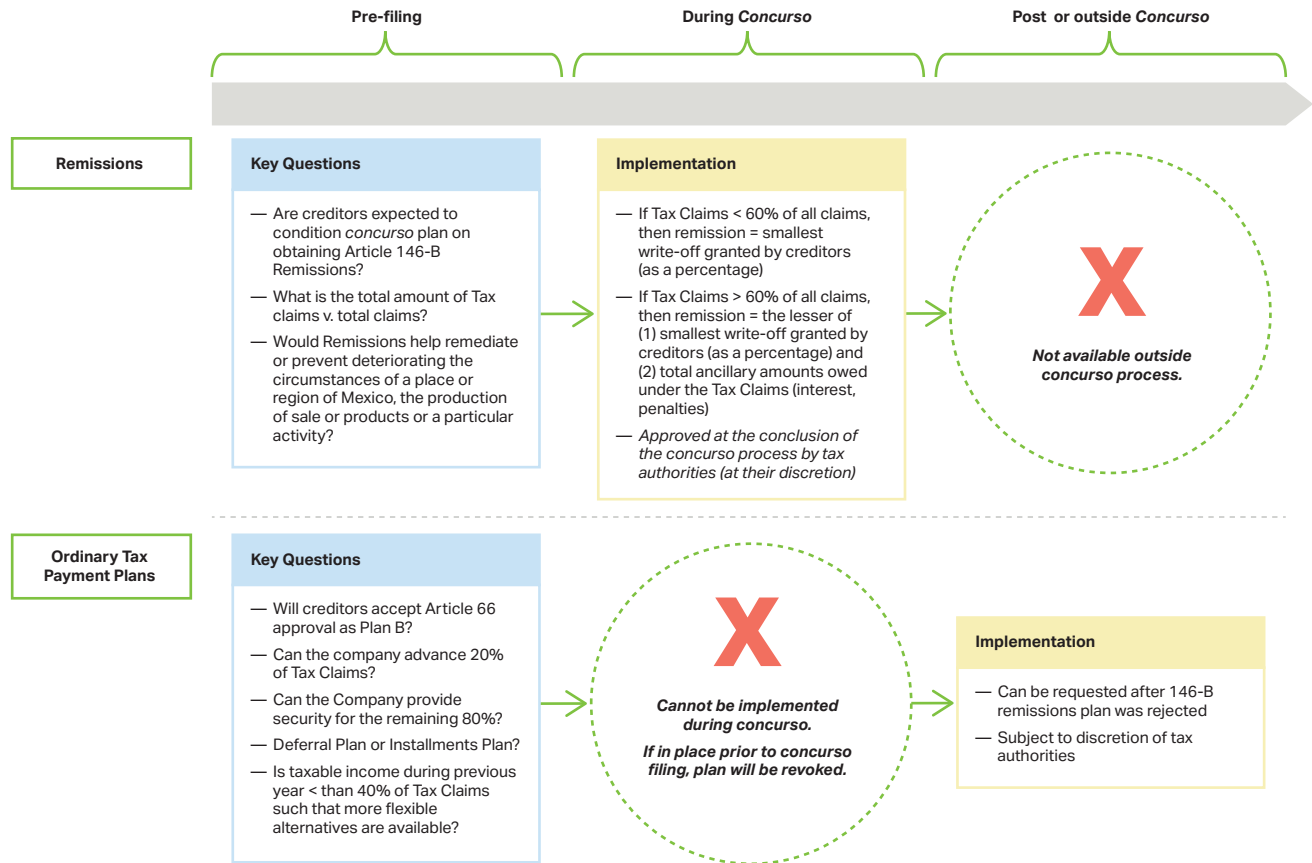
Article 146-B of the CFF also allows Mexican Tax authorities to partially remit Tax Claims against debtors following an in-court bankruptcy proceeding followed under Mexican legislation (*concurso mercantil*). Remittances are subject to the following conditions:

- a. Only Tax Claims which were accrued and defaulted before the date in which said bankruptcy proceeding was initiated may be considered for such purposes.
- b. If the Tax Claims amount to less than 60% of all the claims allowed in the bankruptcy proceeding, the remission shall be equal, in percentage, to the smallest write-off granted by creditors representing at least a 50% of allowed non-fiscal and non-related-party claims.
- c. If the Tax Claims amount to more than 60% of all allowed claims, the remission shall be computed as previously described, but shall be capped to an amount equal to all ancillary amounts derived from the principal Tax Claims. Ancillary amounts include all fines, ordinary and extraordinary enforcement and execution expenses, and any surcharges accrued in connection with the principal Tax Claims.

In terms of timing, authorizations of Article 146-B remissions can only be obtained after the judicial authorization of a restructuring plan and the conclusion of the in-court bankruptcy proceeding, with two important consequences:

1. creditors should negotiate, and will likely insist on including in the restructuring plan to be judicially approved, a provision prescribing the effective approval of such remissions as a condition precedent to the enforceability of the restructuring plan against them; and
2. authorizations of Article 146-B remissions should be considered as administrative and fiscal acts, issued by administrative and tax authorities, subject to administrative and tax law, and obtained after the conclusion of an in-court proceeding (as opposed to judicially approved rulings, issued by a judicial authority, subject to judicial bankruptcy law and obtained within an in-court proceeding).

Although unclear from the text of Article 146-B, Mexican tax authorities consider they are not authorized to grant Article 146-B remissions over Tax Claims derived from taxes withheld by a debtor from third parties.



### How both mechanisms work together

These two mechanisms allow Mexican tax authorities to (a) grant a debtor additional time to satisfy its Tax Claims and (b) reduce said Tax Claims consistently with the debtor's restructuring plan, as approved by non-fiscal creditors. The usefulness and importance of these two provisions in financial restructurings are patent.

Furthermore, request of, and denial thereafter, of an Article 146-B remission does not preclude debtors from requesting an Article 66 payment plan. Therefore, debtors and their advisors can prepare, and negotiate with creditors, restructuring plans that provide for an Article 66 payment plan as a fallback option should an Article 146-B remission be denied.

Nonetheless, both mechanisms are discretionary to Mexican tax authorities, which means that their implementation is not warranted. *De facto* circumstances, such as governmental policies, may alter the Mexican tax authorities' willingness (or unwillingness) to make use of the powers granted by Articles 66 and 146-B of the CFF.

We believe that tax policies embraced by Mexico's current Government could pose a challenge to efforts seeking the application of these restructuring mechanisms.

### Current Governmental Tax Policy

As part of its political strategy to gain and maintain favor of its voter base, Mexico's current Government, led by Andrés Manuel López Obrador, pledged through its electoral campaign, and has sustained, that he will not increase existing taxes nor create new ones in the short and medium terms. Simultaneously, his Government has adopted several cash-intensive policies and has enacted various onerous, governmentally-funded social programs, such as pensions and stipends for the elderly, youth and unemployed, among others.

As a result, Mexico's legislative and executive branches of Government, both controlled by the governing political party, have turned their attention and efforts to increasing tax collection and restricting and reducing tax remissions and

deductibility. The purpose is to increase the Government's total gross revenues and to balance the public budget. As a result, many legislative and executive orders (*decretos*) seeking to increase tax revenues have been proposed in the past few months, and a number have now been adopted, including:

1. amendments to the CFF, the VAT Law, and the Income Tax Law, to, among others: (a) compel tax payers to inform the Mexican tax authorities of aggressive tax reduction structures; (b) allow Mexican tax authorities, under certain circumstances, to pierce the corporate veil of corporations to collect unpaid taxes or prosecute tax fraud, in order to hold shareholders, managers, liquidators and bankruptcy trustees responsible, under certain circumstances, for defaulted and unpaid Tax Claims; (c) impose a cap on the deductibility of interests incurred by tax payers; (d) impose taxes upon services and products sold in national territory through internet by alien businesses; and (e) authorize the taxation of the overall economic, financial and business consequences of step transactions engineered with the intention of avoiding certain taxes that would otherwise arise if the transaction was not structured in several steps; and
2. an executive order issued by Mexico's President on May 20, 2019 (a) revoking previous executive orders authorizing tax regularization programs, which included certain tax remissions; and (b) through which the executive branch committed to avoid granting total or partial tax remissions, with the only exception being those intending to remediate or prevent deteriorating the circumstances of a place or region of the country, the production or sale of products, or a particular activity, or to remediate catastrophes caused by natural disasters, plagues and epidemics.

Not all of the abovementioned policies are applicable to Tax Claim restructurings; and as of this date, there is no public information available on the application (or absence thereof) of those acts that might be applicable to Tax Claims restructurings. However, in its pursuit to limit abuses by previous Governments together with corporations and businesses, these policy changes seem to restrict the Government official's ability to agree to restructure Tax Claims.

As of this date, Articles 66 and 146-B of the CFF and their corresponding ancillary articles have not been modified, and such proposal has not been included in any formal legislative process. Therefore, both Articles are still in full force and effect, which means that their use by Mexican tax authorities to support restructuring efforts is still legally and formally feasible. Nonetheless, certain special considerations and precautions are in order.

First, although an executive order constitutes an inadequate means to generally restrict powers granted by a law, it can still govern how certain discretionary powers are used in practice. Due to the vague language of the May 20, 2019 executive order, it is unclear whether the President's commitment to avoid granting remissions is strictly limited to remissions that must be granted directly by the President, or if, on the contrary, this commitment considers all remissions to be granted by any member or entity pertaining to the executive branch of Government. Should the latter be the case, it is unclear whether or not the remissions authorized by Article 146-B of the CFF and its ancillary articles should be considered as remissions intending to "remediate or prevent deteriorating the circumstances of a place or region of the country, the production or sale of products, or a particular activity."

In light of such circumstances, and given the discretionary nature of the powers granted by Article 146-B of the CFF and its ancillary articles, it is not unreasonable to expect officers within the Mexican tax authorities to be reluctant to exercise those powers without an express clarification or instruction arising from the higher levels of Government. Thus, even if the May 20, 2019 executive order should turn out not to be a formal constraint to Article 146-B of the CFF and its ancillary articles, its existence could result in a *de facto* obstacle for their application by Mexican tax authorities.

Second, while Mexican tax authorities have not ceased authorizations of Ordinary Tax Payment Plans in terms of Article 66 of the CFF and its ancillary articles, nor any suggestion or evidence of such intent has come to light, the prevailing circumstances invite to caution when assessing the request to, and potential authorization by, the Mexican tax authorities of Ordinary Tax Payment Plan regarding outstandingly sizeable Tax Claims, as often is the case in restructuring processes.

## Key Takeaways

Although the Tax Claims restructuring mechanisms previously described – which have been used in several of the most important restructurings in Mexico in the last years – have not been formally modified or revoked, their discretionary nature, the current Government’s tax policy and the executive acts issued as of this date might pose a relevant *de facto* threat for their usage. This could, in turn, result in a significant challenge for in-court restructuring and work-out efforts in Mexico.

Debtors with operations and/or assets in Mexico who seek to successfully restructure their debts, especially those analyzing an in-court proceeding, should consider the following:

1. Structure reorganization plans, to the extent possible, (a) to reduce the amount and number of the Tax Claims to be restructured; (b) whose viability is not conditional on successfully obtaining authorization of an Article 146-B remission or an Article 66 Tax Claims payment plan; and (c) providing for an Ordinary Tax Payment Plan under Article 66, at least as a fallback option, given the existing uncertainty of debtors being able to secure remissions under Article 146-B.
2. If an Article 146-B remission or an Article 66 Tax Claims payment plan are to be requested, receive advice and assistance from experts with proven ability to negotiate similar authorizations with the Mexican Government and tax authorities; and
3. Assess the social benefits of the intended restructuring and the social losses that could derive from a failed restructuring so as to provide the Government with strong and measurable arguments to structure any authorization thereto as a social measure. ■



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