Mexico City, August 16, 2016

Via email
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Mr, Achim Pross
Head of the International Co-operation
and Tax Administration Division OECD/CTPA

On behalf of IFA Grupo Mexicano, A.C. (Mexican branch of the International Fiscal Association), below you will find our comments on the Public Discussion Draft on the BEPS Action 4 – "Elements of the design and operation of the group ratio rule". Comments appear in italics.

2. What issues might arise for groups if countries were given flexibility to apply any of approaches 1 to 3 to determining net third party interest expense?

In case that countries were given flexibility to apply any of the approaches 1 to 3, and entities decide to apply approach 1, considering that it is the easiest approach to comply with and taking into account that it is not necessary to adjust the interest income and expense figures and payments economically equivalent to interest, this may lead to some important distortions.

The above considering that the consolidated financial statements of the group may include items additional to those included in the definition of interest and payments economically equivalent to interest, described in Chapter 2 of the Action 4 Report, derived from the particular accounting policy applied in each country.

Additionally, under approach 1, entities could manipulate the amount of their net third party interest expense, and as a consequence the net third party interest expense/EBITDA ratio could be overstated or understated.

Considering the above, it is important that the Public Discussion draft emphasize the importance to discourage the application of the approach 1, whenever the application of approach 1 causes distortions like the overstated or understated net third party interest expense/EBITDA ratio described in the previous paragraph.

Regarding approaches 2 and 3, although these are two different approaches, according to the Public Discussion Draft, after their application the same result would be obtained. Notwithstanding, considering that approach 2 is determined from the information shown in the consolidated financial statements and the approach 3 is determined from the individual accounting records of each entity to recognize the net third party interest expense, we believe that the procedure that should prevail is approach 2.

Approach 2 seems the most efficient in order to make a review of how the net interest expense with third parties is obtained, this because the information used comes from the consolidated financial statements of the group with certain adjustments.

Taking into account that under Action 4 countries may allow entities to choose one of the three different approaches, we believe that it is important that once the entity elects an option in order to determine net third party interest expense/EBITDA ratio, this must be used during the following years, in order to avoid taking advantages by changing the approach from one year to another. Alternatively, a time limit could be established (for example five years should elapse for changing the approach).

4. Are there any areas where a country´s tax policy goals should be taken into account in determining net third party interest expense which are not set out in the discussion draft?

The Public Discussion Draft establishes the guidelines to determine the group's ratio, through which it is possible to determine the net interest that will be deductible for each one of the entities of the group, considering the group's net third party interest expense/EBITDA ratio.

Considering the above, each one of the entities that are part of a group shall apply the group's ratio taking into account their individual EBITDA, in order to determine the deductible limit of the interest expenses.

However, the domestic tax legislation of some countries establishes rules in order to limit the deduction of interest, like thin capitalization rules. In the case of Mexico, the Income Tax Law establishes a limit for deducting interests derived from loans from one or more persons resident abroad and deemed as related parties, provided that the annual average of debts is greater than three times the net worth equity shown on the taxpayer's financial statement, in which case the interest corresponding to the average debt of foreign related parties in excess of the referred threshold would be nondeductible.

In the case of Mexico, the thin capitalization rules only limit the interest paid to foreign related parties, but it is possible that the foreign holding of the group obtains loans from third parties and at the same time grants loans to its Mexican subsidiaries.

Considering what is stated in the previous paragraph, in case that a subsidiary which qualifies as Mexican resident for tax purposes receives a loan from its holding which qualifies as resident abroad, the interest derived from such loan may not be deductible in Mexico according to the thin capitalization rules contained in the Mexican Income Tax Law; however, if the rules contained in Action 4 are applied, specifically the group´s ratio, then such interest may be deductible.

It is important to mention that countries which implement the rules established in this Public Discussion Draft, should adjust rules from their domestic tax legislation related to the deduction of interest, in order to make sense with the rules included in Action 4. In case that the countries do not make this adjustment to their domestic tax legislation taxpayers could be affected by this situation, since a double tax limit on the deduction of interests (local limit and BEPS limit) could be applied.

Regarding the above, Action 4 establishes that the ultimate decision as to the order in which to apply interest limitation rules is left to the countries, taking into account the design of their rules and the risks they are intended to address. Nevertheless, we believe that it is important to consider the stated in the previous paragraph.

5. Are there any other circumstances where a group's net third party interest expense should be adjusted to include interest income or expense of an entity outside the group?

In addition to the case of an associate or JVE, in the case of an entity participating in a trust which carries out business activities, and has interest expenses/ income, the group's net third party interest expense should be adjusted to include said interest.

This, since the investment in the trust is regularly registered as an asset and the profits /losses it generates are recorded in the equity of the entity, without identifying interests (expenses or income).

Therefore, if the interest expense/ income of the trust is not included in the group's net third party interest, the figures would be distorted, since the profit of the trust would be included in the entity's EBITDA, and consequently in the group's EBITDA.

However, each particular case shall be carefully analyzed in order to determine if the interest/expense of the trust shall be included in the group's net third party interest expense, considering the accounting rules of each country.

12. If a country does introduce a cap on a group´s net third party interest expense/EBITDA ratio, what considerations might it take into account in setting this cap and how could the relevant information be obtained?

As the Public Discussion Draft establishes, it is necessary to consider that the group's net third party interest expense/EBITDA ratio is distorted in the case of companies members of a group with negative EBITDA or low EBITDA.

In those cases, according to what is stated in the Public Discussion Draft, an alternative could be to exclude entities with negative EBITDA in order to determine the group's net third party interest expense/EBITDA ratio or establish a cap on the deductibility of interest of the entities with positive EBITDA.

In this regard, in case that countries apply a cap on the deductibility of interest of the entities with positive EBITDA, we believe that such cap should attend to the activity in which the entity is engaged.

In this manner, one solution would be to define the economic activity in which the entity is engaged and based on it determine a cap for each entity part of the group. For example, for investment in projects that require significant leverage, establish a higher cap, for example for infrastructure projects such as oil and gas and power, residential developments, etc.

Considering the above, we believe that the cap to be set for the deductibility of interest of entities with positive EBITDA, shall be based on the economic activity in which the entity is engaged. Establishing an overall cap would be unfair considering that there are certain economic activities that require higher leverage.

13. Are there any practical issues raised by the approaches set out in the discussion draft to dealing with the impact on the group ratio rule of an entity with negative EBITDA in a group with zero or negative group EBITDA? If so, what are these issues and how could they be addressed by a country? Are there any other approaches that should be considered and, if so, what are they?

In the case of entities in a preoperative period, their EBITDA would be negative, since no income would have been received by them.

Therefore, it could be established as a general rule that the figures of entities with negative EBITDA, that are under a preoperative period, shall be excluded from the calculation of the group EBITDA.

This, in order to enable a group's net third party interest expense/EBITDA to be calculated and the group's net third party interest expense to be allocated among profitable entities in the group.

14. Do you have any other comments on any of the issues covered by this discussion draft?

a) Apply an uplift to the group´s net third party interest expense of up to 10%

According to the Public Discussion Draft, in some cases, there will be practical or legal constraints that make difficult to align the location of net interest expense and EBITDA. This situation can cause distortions that do not allow the total deduction of the net third party interest expense.

The Public Discussion Draft sets out an option for countries to allow an entity to apply and increase of the net third party interest expense up to 10%, in order to consider this amount to determine the group´s net third party interest expense/EBITDA ratio.

Although we consider that the option mentioned in the previous paragraph is a good mechanism to solve the problem, we believe that the fact that only certain countries may allow entities to apply the increase of the net third party interest expenses up to 10% to determine the group's net third party interest expense ratio, could result into an unfair situation for entities depending on the country in which they are tax residents.

In this sense, we believe that one possible solution is to establish as a general rule that all countries increase the net third party interest expenses paid up to 10% to determine the group's ratio, otherwise there would be countries that allow to applying such 10% and those where it is not allowed which may result inequitable.

b) Carry forward and carry back

In the case of carry forward and carry back of disallowed interest and unused interest capacity, rules providing the transmission of these items in the case of mergers and spin-offs could be incorporated.

This, in order to limit the transfer of such items in each particular case and considering the following premises:

- *The merger is carried out between entities of the same group*
- *The merger is carried out with a third party*
- *The entity that spins off disappears derived from such corporate act*
- *The entity that spins off gives rise to one entity or more, etc.*

Considering the above, it could be established that a country may impose limits on the transmission of the referred items in the case of mergers and spin-offs or other possible corporate acts that could derive in the transfer of such items.

Such limits shall be established in those cases which clearly derive in a BEPS risk.

The Action 4 2015 Final Report establishes in paragraph 165 certain time and value limits on carry forwards and carry backs that could be included, such as reset carry forwards to zero where a company changes ownership and also changes the nature of its economic activity.

However, in the case of mergers and spin-offs the ownership could be maintained as well as the economic activity of the entity.

Therefore, specific rules addressing the limit on the transfer of carry forward and carry back of disallowed interest and unused interest capacity, could be incorporated.

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The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA branch and in no case in the name, or on behalf, of Central IFA or IFA as whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.