

## THE ROLE OF PRODECON IN THE PROTECTION OF TAXPAYERS' RIGHTS

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*SUMMARY: I. Introduction.- II. PRODECON as taxpayers' public advocate.- III.- PRODECON as taxpayers' Ombudsman.- IV. PRODECON as an observer of systemic tax problems.- V.- PRODECON as mediator in Conclusive Agreements.- VI. BEPS, Conclusive Agreements and taxpayers' rights.*

### I. Introduction

It is a great pleasure for me to share with you the experience of Mexico's taxpayers Ombudsman: *Procuraduría de la Defensa del Contribuyente*, PRODECON. We are an independent public body, which assumes such function to protect and promote the defense of each and every taxpayer in our country.

Previously, I would like to reflect with you about the nature of the relationship between taxpayers and Governments.

You surely agree with me that such relationship must be looking as the powerful relation which can be held between two parties.

As you know, in the remote past, taxpayers did not have any rights to oppose to the State Tax Power. In the middle years of the 19<sup>th</sup> century, constitutional regulations began to appear and disposed that the citizens have, of course,

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the duty of paying taxes, but always according to some principles such as legality and generality. Most important is that such regulations had disposed that taxes must consider the economic capacity of each group of taxpayers.

Nonetheless, these regulations were only statements, because there was not a legal mechanism to guarantee that they were effectively complied with.

Lately in the middle years of the following century, societies adopted several judicial procedures to enforce the compliance of the constitutional and legal taxpayers' rights. But at the end of the 20<sup>th</sup> century a decline of the judicial defense seems to have happened.

Ironically at the same time, the fundamental rights of the taxpayers gained more and more relevance.

In our particular vision, we think that now, it is the time for a new way to defend taxpayers. A new model to reinforce and secure their rights, is coming.

The non-judicial defense of the taxpayers' rights represents the implementation of a new sort of procedures to achieve this objective. The new pattern of defense implies the adoption of more informal, flexible, friendly, easy and accessible procedures.

Mexico has taken the first step in this area with the establishment of the new *Procuraduría de la Defensa del Contribuyente*, PRODECON, which is precisely an organism committed to develop **a non-judicial review** over the decisions, actions or resolutions of any government agency or public organism which collects taxes or any other kind of duties (social security contributions, custom duties, fees for public services).

PRODECON's mission is to ensure the right of taxpayers to receive justice in tax matters at the federal level, through the provision of free services of advising, counseling and also promoting legal defense in courts. It is very

suitable to remark that we also have important faculties to receive complaints from taxpayers, individuals and corporations, and try to find the best solution to those complaints; or in the case that a solution cannot be reachable we can issue public recommendations to the federal tax authorities, in order to expose and promote the corrections of bad administrative practices which may cause excessive or unnecessary inconveniences to taxpayers or simply violate their rights.

Additionally, PRODECON has the power to:

- Propose to the Chamber of Deputies amendments to tax and customs legal norms;
- Analyze systemic tax problems and offer to the involved authorities, suggestions to correct and prevent them;
- Act as a mediator in a new tax alternative dispute resolution mechanism, named *Acuerdos Conclusivos*, to solve the differences between audited taxpayers and tax authorities.

With such faculties, PRODECON is empowered as a truly public taxpayers' intercessor.

In this presentation, I am going to expose, with more detail, some of the mentioned attributions related to legal defense in courts, complaint process, analysis of systemic tax problems and mediation in Conclusive Agreements.

I will also share with you some relevant cases. I hope that through such cases, we can illustrate the important development of our functions and faculties in these first four years of the *Procuraduría de la Defensa del Contribuyente*.

## II. PRODECON as taxpayers' public advocate

The *Procuraduría de la Defensa del Contribuyente* acts as an advocate for taxpayers when they require legal defense in tax courts. All the taxpayers, corporations or individuals, can request this service from PRODECON, as long as the tax authority's decision does not exceed a sum of about 50,000 US dollars. If the decision does not involve a monetary value, there is no limit to act as taxpayers' advocate, not being relevant if the taxpayer is a salaried individual, a large taxpayer corporation, or even an MNE; in any case PRODECON, will take their legal defense.

It is also important to highlight that PRODECON has the faculty to promote both, ordinary and constitutional court actions, as public defender of taxpayers. In other words, we can defend taxpayers even against a federal tax law, if, prior assessment, PRODECON considers that some law provisions violate fundamental taxpayers' rights.

Having said that, let's see how PRODECON defends taxpayers' rights when acting as a public advocate.

### Case 1

In Mexico we had a very important tax reform in the year 2014. Some provisions of the reform were not of the liking of a group of individual taxpayers, because they established a deduction cap: individuals can only make personal deductions (medical, dental, hospital or funeral expenses; school tuition, interest for home loans) for the equivalent of 10% of their annual income, or the equivalent of 4 annual minimum wages (about one hundred thousand pesos (6,000 US dollars)).

PRODECON offered the taxpayers to promote a constitutional court action against such provision and we filed a thousand suits.

The main argument in these claims is that the new provision tax law does not obey the constitutional rulings that sets forth that taxes must be in proportion to the wealth of each taxpayer. Besides, the tax imposed ignores relevant human rights such as the right to health, the right to home and the right to education.

The defense focused on individuals with annual incomes below one million pesos (approx. 60,000 US dollars), which is where the inequality of the norm is most perceived, since the lower the income, the higher the economic impact of the deduction cap on personal and family finances.

So far, we have obtained 55 favorable rulings from 11 District Courts. Finally, it is the Supreme Court of Justice which will issue the final decision.

## **Case 2**

As a public advocate, PRODECON has known many cases where tax authorities deny taxpayers' deductions of personal expenses.

In an interesting case, a male individual incurred on medical expenses for an infertility treatment, but the Tax Administration rejected the deduction of such expenses.

PRODECON took the case and filed the suit before the Federal Administrative Tax Court (TFJFA), which ruled in favor of the plaintiff, since it was considered that the right to human reproduction is undoubtedly a human right. Therefore all the expenses should be considered as valid deductions.

## **Case 3**

According to Mexican transparency law, all government agencies must disclose the information required by the INAI (Mexico's national transparency agency).

In an unexpected decision, INAI ruled PRODECON to reveal the names of the taxpayers who subscribed a Conclusive Agreement, without considering that this kind of data is personal information covered by the human right to confidentiality.

In order to protect the names of individuals and companies from being revealed, PRODECON promoted a judicial action before a federal judge representing the collective interest of the taxpayers.

The Ombudsman argued that the taxpayers have the human right to confidentiality and protection of personal data.

The action was admitted. We are very satisfied, because the federal judge recognized that the taxpayers' Ombudsman is a genuine representative of the collective interest of such taxpayers.

The case is awaiting its final resolution at the Supreme Court of Justice.

### III. PRODECON as taxpayers' Ombudsman

The *Procuraduría de la Defensa del Contribuyente* can act as an Ombudsman, defending, verifying and reviewing the effective compliance of taxpayers' rights.

As an *Ombudsman*, PRODECON can receive tax related complaints in order to verify and investigate the behavior of federal tax authorities, and issue if applicable, public but no binding recommendations.

So, through a non-formal process, taxpayers can complain at PRODECON, about tax authority actions which go against their fundamental rights. PRODECON receives the complaint and makes a formal request to the

specific tax office involved. During the following 72 hours the tax office must justify its action.

PRODECON will always look forward to offer the best solution for the taxpayer, always in accordance with the involved tax authority. If the tax authority does not accept the solution proposed, the taxpayers' Ombudsman will make a Public Recommendation exhibiting the name of the related public official in order to prevent further similar violations.

In the first nine months of this year, we have received more than 18,000 complaints in Mexico.

Let me tell you about some achievements in this issue. Through the complaint process, the relationship between taxpayer and tax authorities has been noticeably enhanced. Tax authorities also understand the complaint process as a new opportunity to correct and amend their actions under law, and so, in many cases, the taxpayers find an acceptable and satisfactory solution to their cases, avoiding further litigation before the tax courts.

### **Case 1**

Frequently, in our country, tax authorities secure the totality of the funds of taxpayers' bank accounts, in order to guarantee tax debts. In such cases, the taxpayer cannot face other commitments for example workers' wages or even payments of other contributions and fees.

In addition, the taxpayer doesn't always identify the causes of the distraint and even ignores the specific tax office which ordered such measure.

Thanks to PRODECON's participation, the securing of funds, if applicable, shall be removed. If not, our agency takes part to allow taxpayer to guarantee

tax debts in a different way, so he can make necessary bank transactions to operate his business.

## Case 2

In other occasions, some tax authorities practice tax audits to Mexican manufacturing companies and review the documentation of the equipment they imported in order to produce the goods they commercialize.

In some occasions, tax authorities find some minimal discrepancies between the code numbers of the equipments described in the purchase receipts and their import entry declarations (pedimento). As a matter of fact, they are looking for that sort of inconsistencies.

Consequently, tax authorities secure the equipment by imposing tax seals, and the company cannot continue with its production or manufacturing process.

PRODECON had shown these actions as bad administrative practices of tax authorities and strongly recommended them to not secure equipment or machinery essential for the manufacturing process, especially when the company has begun legal actions before courts to reverse the decision of the tax authority.

## Case 3

Talking about bad administrative practices, through the complaint process, PRODECON has identified that some of them take place in tax audit procedures, violating the right of taxpayers to due process and causing incorrect determinations of their tax duties. For example:

- Tax authorities are not auditing taxpayers' operations through a selective review of their documents and accounts. They misuse their faculties by requesting the full exhibition of all documents and accounts referred to all operations of the audited taxpayers.
- Tax authorities reject in a general way the documentation and accounts of the audited taxpayers; they not specify the operations which show precisely the tax inconsistencies.
- Tax authorities ignore that taxpayers have a presumption of good faith. They wrongly assume that the taxpayers must face the burden to prove that their accounts do not reflect simulated operations.

#### IV. PRODECON: Analyze systemic tax problems

##### ***Other bad audit practices***

In the analysis of systemic tax problems, PRODECON has also identified other bad administrative practices, such as:

- Tax authorities perform audit procedures with standardized rules, not paying attention to the nature and operations of the taxpayers' business model;
- In order to verify that the operations are not simulated, tax authorities over require documentation.
- Tax authorities are making excessive and unnecessary requirements of documents or information that they already have.

##### ***Persuasive collection: bad practices of tax authorities***

Persuasive tax collection is referred to as a sort of action, which the tax authorities use to inform taxpayers of the best way in which they may comply

with their tax obligations. Such actions can be performed through invitation letters, e-mails, text messages, interviews, etc.

Since this kind of actions are simple “invitations”, they are considered extra-official approaches to taxpayers, therefore there is no court action against them. Consequently, taxpayers are legally defenseless.

Concerned about the problems that these persuasive collection actions could bring to taxpayers, PRODECON pointed out the bad administrative practices in this issue and worked persistently with Mexican Tax Administration in order to establish simple and clear regulations for ensure the effective respect of taxpayers’ rights, guarantying that they will be able to express their arguments to the tax authorities referred to their tax situation or, if applicable, comply voluntarily with their tax obligations.

As a result, Mexican Tax Administration drafted general rules for persuasive tax collection, which have been reviewed by Prodecon. Such new rules are: 1) tax authorities must not use threatening language in their actions, 2) taxpayers shall be provided with clear and understanding information, 3) taxpayers must be informed that there are no legal consequences if they do not attend the invitations, and, finally 4) taxpayers must be informed that they can approach PRODECON as a public defender of their rights.

I would like to point out that PRODECON is not against actions which may improve tax collection through voluntary compliance mechanisms, but only as long as they respect the taxpayer’s rights.

### ***Tax Black List***

One of the most controversial measures that was approved in the 2014 Mexican tax reform, is a new faculty given to the Tax Revenue Service (SAT)

to publish the names of the taxpayers who, according with its official records, have ongoing tax problems.

Until 2013, it was illegal to reveal the name of any taxpayer, no matter the kind or “size” of the problem that he or she was involved in.

Now, as a result of the changes applied to the Federal Tax Code, this “absolute reserve” disappeared, and the Tax Revenue Service can disclose a list referring the names of the taxpayers (individuals or companies) who:

1. Have definitive unpaid tax debts.
2. Have been identified as non-reachable at their tax addresses.

The first black list was posted on the website of the Tax Revenue Service; just one day after tax reform becomes effective.

Some Mexicans taxpayers woke up on January 2<sup>nd</sup> 2014 surprised about finding their names in the “Unreliable Tax Payers List”; politicians, intellectuals, TV stars, a major soccer team, and even the Roman Catholic diocese in Acapulco were included, among others.

PRODECON promptly reacted. While we were drafting the official document in which we were going to criticize that hastily made publication, this organism received several complaints from taxpayers who felt insulted by being identified as “unreliable”.

PRODECON analyzed two involved aspects:

1. The legal structure of this new regulation, under humans rights perspective, and
2. The procedure and criteria that were considered by the Tax Revenue Service to apply this new measure

It is important to highlight the strong public reaction after the list divulgation; social media played an important role by an intense broadcasting of this information, especially of those taxpayers who are famous or remarkable persons.

During this systemic investigation, we realized that the taxpayers were being exhibited for reasons that they ignore. The blacklist only pointed out the name of individuals or companies, but it was remiss explaining which legal assumption is present in the case of each taxpayer, in order to justify the publication of his name.

Besides, PRODECON found out that the criteria used by the authority to identify taxpayers as “non-reachable” at their addresses was inappropriate.

If you ask me, why? Because the authority wrongly considered that one failed intend to locate the taxpayer at his tax address means the same as if he were absent permanently from it.

In this context, PRODECON pronounced a Public Recommendation to the Tax Revenue Service asking to adopt the following actions in order to stop the violations committed by the blacklist:

1. If the taxpayer appears in the blacklist as a debtor, the tax authority must modify it, and include the necessary information to identify precisely the origin and kind of the debt. So taxpayers could clarify the situation, or if they decide so, pay to be removed from the list.
2. For “non-reachable” taxpayers, PRODECON asked the authority to reconsider its criteria and publish exclusively the names of taxpayers that, in addition to their absence in tax address, present an ongoing unfulfilling tax behavior. Then, all cases must receive different treatment.

Finally, the Tax Revenue Service accepted the Recommendation and modified the list according with the actions proposed by PRODECON.

## V. PRODECON as mediator in Conclusive Agreements

Conclusive Agreements are the first alternative tax dispute resolution mechanism in Mexico, that allow Tax Administration and taxpayer to agree on the assessment of the facts or omissions identified by tax authorities during inspection procedures, before a tax debt is imposed.

With the Conclusive Agreement Procedure, PRODECON facilitates and promotes agreements between the parties involved. PRODECON acts as a monitoring body to ensure that the agreements are carried out with transparency; and assures the compliance of the tax provisions, mainly those referred to the taxpayers' rights.

It is important to note that this new procedure suspends the audit. Also, by signing the Conclusive Agreement the taxpayer acquires legal certainty, since the agreement cannot be modified or even challenged in any further legal or court actions. As well, the adoption of the Agreement excludes the imposition of penalties related to the tax debts which are the matter of the Conclusive.

### Case 1

Several years ago, a large company –multinational enterprise–, through a business restructuring, completed a reallocation of risks: the leading company, resident in Switzerland, gained more functions; therefore, profits earned by the subsidiary resident in Mexico, were mainly transferred to the head company.

Mexican tax authorities questioned the business restructuring and started several inspection procedures.

When the subsidiary company requested a Conclusive Agreement, a number of trials and judicial actions, promoted against the decisions of tax authorities, still awaited in courts for final ruling.

By the Conclusive Agreement, both parties settled a transfer pricing adjustment, and, through the payment of an agreed on amount, closed, as well, all the tax consequences of the restructuring business.

It is very important to highlight how in this case, the taxpayer ended all the previous discrepancies with tax authorities.

As mandatory conditions for the endorsement, the subsidiary company withdrew from all judicial actions, whereas Mexican tax authorities voided the old tax debts.

## **Case 2**

A Mexican company has a ruling issued by the Federal Administrative Tax Court (TFJFA), which allows it to sell at 0% rate (VAT), one of the products that the company commercializes.

Mexican tax authorities were concerned because this kind of special tax treatment distorts the economic market.

The company and the tax authorities agreed on the convenience of putting an end to this problem. Therefore, they accorded to proceed as follows:

1. A tax inspection ordered to review, through an audit, the special VAT treatment, to allow the taxpayer company to request for an immediate Conclusive Agreement.
2. Since the time of the inspection, and due to the agreement, the company would pay the VAT general rate (16%).

3. Tax authorities would not claim any VAT debts for previous years.

### Case 3

In an audit, the tax authorities rejected the deduction of expenses related to certain services, since they considered they were not necessary to operate the business.

The audited taxpayer went to PRODECON to require a Conclusive Agreement and stated that such services were really necessary because they were related to:

- Hire a professional individual who designed the production process related with a newly acquired brand.
- Contract an enterprise which provides all the indispensable consultation to start the production process.

PRODECON held various meetings with both parties, taxpayer and tax authority and, after an extensive exchange of arguments, they signed the Conclusive Agreements under the following conditions:

1. The hired services were essential for the business activity of the taxpayer.
2. The amounts paid to the professional were fully deductible as expenses according to the yearly Mexican Income Tax Law.
3. The amounts paid to the company are not deductible as expenses, but definitely can be deductible as investments, according to the year depreciation percentage permitted by law.

## VI. BEPS, Conclusive Agreements and taxpayers' rights

Now let's talk about the Conclusive Agreements and BEPS Action Plan. The BEPS Action Plan could produce a severe disproportion between the taxpayers and the Tax Administrations.

Undoubtedly it is necessary to adopt new models of information exchange and no one can argue the fair demand that MNEs should pay taxes in the different countries according their real economic capacity.

Nevertheless it seems that the standards recently recommended by the Final 2015 BEPS Package do not have the appropriate balance for taxpayers' interest. This is where the taxpayers Ombudsman comes into play, we must face the challenge to create conditions of balance between tax collection needs and taxpayers rights' protection.

Today it is necessary to emphasize taxpayers' rights protection and promotion, as well as all kinds of strategies for its effective defense. In this context, taxpayers' Ombudsman has an undeniable role to play. We cannot stay at the domestic level. We must look forward to new ways to solve the common problems of an economically globalized society.

As I already mentioned, we're totally convinced of the need to adopt more informal, accessible and easy-going procedures that encourage legal certainty as well as voluntary compliance on the basis of trust and respect of taxpayers' rights.

In PRODECON's experience, the Conclusive Agreements have proven to be an effective mechanism to solve the disputes between taxpayers and Tax Administration before tax assessment is imposed.

This domestic procedure can actually contribute to bring fairness to each party by providing tax certainty and proportional tax collection.

It is also important to mention that several MNEs are now changing their tax regime in Mexico, previous requirement of Mexican Tax Administration. In many cases they choose to celebrate a Conclusive Agreement in order to assure their new way to pay taxes in Mexico.

The Conclusive Agreements have a positive and increasing acceptance among taxpayers. While in 2014 PRODECON received 982 requests for Conclusive Agreements, up to September this year, we have received 1,228 requests.

Finally, I would like to finish mentioning that the defense model of the *Procuraduría de la Defensa del Contribuyente*, and especially the Conclusive Agreements, could be a trendsetter which probably can be replicated in other countries involved in the development of a global taxpayers' defense.

Actually, the 2015 version of the CIAT (Inter-American Center of Tax Administrations) Model Tax Code, presented at the 49th CIAT General Assembly held in Lima, Peru, on May of this year, inserts the new mechanism.

I am very grateful for having been invited to share experiences with other taxpayer's advocates in this international conference. It is a singular opportunity to exchange ideas for the improvement of taxpayer's protection in a globalized society and work together towards new models of non-judicial defense of taxpayers' rights.