12 *Id.*

13 The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109 8 § 714 (April 20, 2005), 11 U.S.C. § 523(a).

14 *Id.*

15 *Id.* at 513

TAX RESIDENCY FOR ENTITIES UNDER MEXICAN LAW

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Until very recently, the Mexican tax provisions contained two clear parameters that were to be used in order to determine if an entity was to be considered as a Mexican resident for tax purposes or not. These parameters were:

a) Incorporation of the entity under Mexican law; and

b) Location of the entity's main administration or place of effective management within Mexican territory.

During the final days of June, the Official Gazette of the Mexican Government published different amendments passed by the Mexican Congress. Among these amendments, several changes were made to the Federal Fiscal Code, including a modification of the abovementioned parameters.

In accordance with this modification, the only parameter for attributing Mexican tax residency to entities is for them to have their "main administration" or "place of effective management" within Mexican territory.

This change, although consistent with international standards, and at first sight irrelevant, could lead to different unwanted consequences, because of an apparent lack of analysis by the Mexican lawmaker while discussing this amendment.

The purpose of this article is to expand on the legal consequences this change could have from a Mexican tax point of view.

Concept of "main administration" and/or "place of effective management"

First, it is crucial to understand the meaning of *"main administration"* and/or *"place of effective management"*.

Although such concepts are not defined within the Mexican tax law, the Mexican tax authorities have established, within general tax rules, that an entity will be deemed to have established its main administration or its place of effective management in Mexico when the place where the person or persons that make or execute, day by day, the decisions of control, management, operation, and administration of such entity is located within Mexican territory.

This interpretation intends to be consistent with the one set forth on the Commentaries by the Organization for Economic Co–operation and Development (OECD) to the Model Tax Convention on Income and Capital when deeming the "place of effective management" as (i) the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made; (ii) the place where the most senior person or group of persons makes its decisions; and (iii) the place where the actions to be taken by the entity as a whole are determined.

However, the wording of such rule is not accurate, as it does not refer to where the decisions are taken, but rather to the place where the person or persons who make such decisions are located. Consequently, according to the Mexican tax authorities, if the decision makers are regularly based outside of Mexico, the main administration or place of effective management of the relative entity shall be deemed located outside of Mexican territory, regardless of the fact where the actual decisions for such entity are taken.

Therefore, whenever the decision makers are not physically located in Mexico on a regular basis, according to the criterion of the tax authorities, such entity would not have its main administration or its place of effective management in Mexico.

Legal consequences

Some legal consequences which could derive from the abovementioned amendment are detailed as follows:

(a) **Migration of Mexican entities**

As previously discussed, because of the amendment, the only parameter for determining Mexican tax residency of entities is if they have within Mexican territory their *"main administration"* or *"place of effective management"*, regardless of whether they were incorporated under Mexican law or not.

An entity incorporated under Mexican law, which has its *"main administration"* or *"place of effective management"* located outside of Mexican territory, may no longer be deemed as a Mexican tax resident. If this is the case, in accordance with Mexican Income Tax Law, such an entity shall be considered to have migrated, having to apply the tax effects of a liquidation, that is, being obliged to calculate and pay the relative taxes as if its total assets were alienated.

Although the compatibility of this provision with the Mexican Constitution may be questionable, proper actions should be taken to avoid any risk of having the Mexican tax authorities consider that the entity has migrated, and consequently attribute the referred unwanted consequences.

In this regard, Mexican corporate law refers to two corporate bodies that are allowed to make management or control decisions: (i) shareholders or partners; and (ii) the administrative body that is either a Board of Directors or sole administrator. Consequently, a solution would be that, regardless of where the shareholders or partners are located, the Board of Directors or the sole administrator, as the case may be, are/is in fact based within Mexican territory, and record is kept of every decision made and/or executed by such administrative body.

(b) **Permanent establishment**

If an entity incorporated under Mexican law is no longer deemed as a Mexican tax resident, in most cases it will continue to have physical presence in Mexico, and, therefore, it may be deemed to have a permanent establishment.

As a consequence thereof, the effect of such migration would be, besides the negative tax implication referred to above, an obligation to pay taxes by having a permanent establishment.

(c) **Dual residency**

Entities that have not been incorporated under Mexican law must also take proper measures in order to avoid any risk of having the Mexican tax authorities consider that their *"main administration"* or *"place of effective management"* is located within Mexican territory, and, consequently, that they are deemed as Mexican tax residents.

The foregoing because, even though the parameter of *"main administration"* and/or *"place of effective management"* for the attribution of Mexican tax residency was already foreseen before the amendment, the main criterion followed for such purposes used to be the fact of whether the entity was incorporated under Mexican law or not.

Therefore, because of the amendment, it could be expected that Mexican tax authorities will focus with special heed on the parameter in force for the purpose of detecting entities where decision makers are located within Mexican territory, and, therefore, deem such entities as Mexican tax residents with the unwanted tax consequences that such situation would imply (dual residency).

In this regard, it would be advisable that decision makers of entities not incorporated under Mexican law are not physically located within Mexican territory, and to have this situation properly documented if regular business is to be carried out in Mexico.

The comments contained herein express a general view of its authors and shall not be considered as legal opinion.

ENDNOTES

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"THE UPIA TWINS: ARE THEY EVIL OR SIMPLY CONJOINED"?

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I. On January 1, 2004, the Texas versions of the Uniform Principal and Income Act (Texas Probate Code Ann. Chapter 116) and the Uniform Prudent Investor Act (Texas Probate Code Chapter 117) became the law of Texas. The Uniform Principal and Income Act ("UPAIA") has been adopted in 39 states and the U. S. Virgin Islands, and the Uniform Prudent Investor Act ("UPIA") has been adopted in 41 states, the District of Columbia and the U.S. Virgin Islands. Both Acts represent a sea of change in the law of trusts in this state. They are sometimes collectively referred to as the "Acts". UPAIA is designed to allow changes in accounting required by the investment changes dictated by UPIA. It is important to remember that these Acts are default rules, which may be overridden by the terms of the instrument, and are designed to work together.

II. **SCOPE.** This article analyzes selected provisions of the Uniform Acts (as adopted by Texas) that change the way trusts are drafted and administered. It also explores the duties and responsibilities now imposed *by statute* on trustees, which formerly existed under the common law. Because of the change in basic philosophies, new issues of trustee liability and how a trustee may avoid liability also will be explored. While drafting issues may be mentioned, drafting suggestions are beyond the scope of this article as are detailed discussions of accounting issues raised by UPAIA.

III. **PRINCIPAL CHANGES (NO PUN INTENDED).** There are several changes wrought by these Acts that require a change in attitude by estate planners, trustees, and those who become involved in fiduciary litigation. In an attempt to aid in interpreting the Acts, the Real Estate Probate and Trust Law Section of the Bar (with the invaluable assistance of Professor Stanley M. Johanson) was able to persuade West Publishing Company to publish the Comments of the National Conference of Commissioners on Uniform State Laws and the comments of the Real Estate, Probate and Trust Law Section (the "Section") where the Bar made changes or where peculiarities of Texas law required explanation beyond the Uniform Laws Comments. These Comments are *usually* helpful in interpreting the statute. They are somewhat like Revenue Rulings in that they have no force of law, but may aid practitioners, trustees and the courts in applying these new laws uniformly.

A. UPIA. Although UPIA's dictate that the Trustee invest for overall return in keeping with Modern Portfolio Theory[2] is probably its central change, it is important to note that UPIA implements that dictate by requiring the trustee to focus on the terms and purposes of ***the*** specific trust being administered rather than on a list of approved trust investments.

1. Application. UPIA applies *only* to trusts and it applies to trusts existing on January 1, 2004, and those created thereafter. Thus it applies to all trusts, but only to the extent of acts or decisions after the effective date.

2. Fundamental Changes. The Uniform Act Prefatory Note lists five fundamental changes made by UPIA.

a. Standard of prudence is applied to any investment as part of the overall portfolio, rather than to individual investments. This represents a change to the common law that determined whether a trustee had breached his duty of prudence on an asset by asset basis.[3]

b. Tradeoff in all investing between risk and return is identified as the trustee's central consideration.[4]