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Legal Challenges Filed Against Tax Reforms, Particularly Higher Value-Added Tax, in Border Communities

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A tax revolt of sorts is brewing in communities along the US-Mexico border, with residents in Tijuana filing a legal challenge against a tax reform promoted by President Enrique Peña Nieto and easily ratified by Congress in 2013 (SourceMex, Oct. 23, 2013). Among other things, the measure created a uniform value-added tax (impuesto al valor agregado, IVA) of 16% throughout the country, overriding the preferential rate of 11% applied to sales in border communities. The tax changes were approved primarily with overwhelming support from the governing Partido Revolucionario Institucional (PRI) and some backing from the center-left Partido de la Revolución Democrática (PRD).

Critics of the tax reform, including many members of the pro-business opposition Partido Acción Nacional (PAN), argued that the higher IVA would greatly increase the cost of goods in border communities. The Peña Nieto administration countered that the increased revenues from the increase in IVA and other taxes were necessary to boost the government coffers so that more money could be available to spend on social programs and infrastructure.

To placate border residents, the administration and Congress included a special fund for border communities, ensuring that the tax dispute did not derail the 2014 budget (SourceMex, Nov. 20, 2013).

Federal District judge agrees to review Tijuana complaint

Still, business organizations said they would not accept the federal mandate without a fight. In Tijuana, the Consejo Coordinador Empresarial (CCE) launched a drive to gather enough signatures from residents in Baja California to bring the issue to a federal court. In mid-February, the CCE presented a petition with more than 58,000 names to a Federal District Court. The petition contained enough valid signatures for District Judge Blanca Evelia Parra to agree to review the case.

The petition in Tijuana made it clear that the increased IVA had reduced the competitiveness of businesses along the Mexican side of the border relative to their counterparts in the US. "We want to make it clear that we are in a unique situation," said CCE Tijuana president Juan Manuel Hernández Niebla. "We are competing against other interests along the border and not against the national industry."

Administration officials point out, however, that the burden of proof is on the plaintiffs. "[The businesses] have to demonstrate that they are truly being hurt [by the increase] in the IVA," said Diana Bernal, director of the office that handles the rights of taxpayers (Procuraduría de la Defensa del Contribuyente, PRODECON).

Judge Parra was scheduled to review the case sometime in March and issue an initial ruling. The case could eventually end up in the nation’s highest court (Suprema Corte de Justicia de la Nación,
SCJN), which would issue the final determination on whether the plaintiffs are truly hurt by the tax increase.

**Opposition members in Congress bring issue to Supreme Court**

The SCJN is already considering a separate challenge to the border IVA increase brought by opposition members of the Mexican Senate in late 2013. The effort is led by Sens. Ernesto Ruffo Appel, Víctor Hermosillo, and Roberto Gil Zuarth of the PAN; Manuel Camacho Solís of the PRD; and Manuel Bartlett Díaz of the Partido del Trabajo (PT). Ruffo Appel, who represents Baja California, said the administration used false arguments to justify the IVA increase.

There is a parallel effort in the Chamber of Deputies to challenge not only the increase in the IVA for border communities but also other aspects of the tax reform. A complaint signed by 172 members of the lower house was brought to the high court in early March. The brief alleges that several changes that followed the tax reform are unconstitutional. The effort, led by Deputy Ricardo Mejía of Movimiento Ciudadano (MC), has challenged the IVA increase in the border states, the new income-tax rate (Impuesto sobre la Renta, ISR), and a new set of taxes on small-scale contributors.

Mejía said the center-left legislators are also pushing to eliminate the tax on junk food and soft drinks contained in the tax reform. The administration and supporters in Congress had viewed this tax not only as a revenue measure but also as an effort to improve the health of the Mexican population (SourceMex, Sept. 18, 2013). "We believe that the high court is obligated to make its decision based on the rule of law and not succumb to pressures from the federal government," said Mejía Berdeja.

**Price increases documented**

Business organizations have some justification in bringing their case to the courts. Studies by consumer associations along the border show that prices in January and February increased about 30% relative to December. "This January is being particularly tough," Jorge Escalante, president of the Tijuana chapter of the Confederación Patronal de la República Mexicana (COPARMEX), said in an interview with the online news site International Business Times. "We predicted consumer spending would drop 20% and more than 20,000 jobs would be lost with the new law—and it looks like we are on our way there."

The increase in IVA was also beginning to have an impact on sales of motor vehicles during the first two months of the year. In a report released in early March, the Asociación Mexicana de Distribuidores de Automotores (AMDA) said auto dealers along the border were reporting a reduction of about 40% in January and 20% in February (relative to the end of last year) because of a higher value-added tax.

"The tax reform is having a clear impact on commercial activity, particularly along the northern border, where a higher IVA is now in place," said AMDA director Guillermo Rosales Zárate.

At the national level, sales in January and February were up about 0.6% from the same period last year, but activity was nevertheless disappointing. With national sales increasing only 0.3% from December, AMDA has reduced its projection for domestic sales this year. Increases in other taxes as part of the tax reform measure and a lack of consumer confidence are contributing to the sluggish outlook, said Rosales Zárate.
Ciudad Juárez and other border communities were also feeling the impact of the higher IVA. While higher taxes were contributing to higher federal tax collections, municipal governments were beginning to see lower revenues. Because of a tighter budget, authorities in Juárez said they were forced to lay off 205 employees in January and February. "We will continue to review the situation to determine if we can stay afloat with the revenues that we have at the moment," city financial officer José Alfredo Aguirre Carrete told the Mexico City daily business newspaper El Financiero.

The increase in prices on the border is not entirely related to the higher IVA, and some consumer advocates point out that retailers bear some responsibility for higher costs. Several businesses in border communities have taken advantage of the situation to raise prices beyond what is justified by the higher IVA and to increase the cost of goods that are not even taxed.

The Procuraduría Federal del Consumidor (PROFECO) has sanctioned at least 50 businesses in Tijuana since the first part of the year for price gouging, including increasing prices for food items that are exempt from IVA, such as eggs, milk, and tortillas.

PROFECO inspectors found violations in seven of 20 supermarkets in Tijuana, and the businesses were issued a warning. "We will sanction all violators without exception, regardless of whether they are local or belong to a national chain," Óscar Zárate Chávez, head of the PROFECO regional office in Baja California, said at a press conference in early March.

The higher prices have led many residents to cross the border to the US to do their shopping. "Mexicans then began a temporary exodus in search of cheaper daily shopping," said International Business Times. "People who used to cross the border only occasionally now go three or four times a week, cramming security posts at several points along the border. Where the wait to enter the US was just minutes, now it is hours."

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