

2020 TAX REFORM IN MEXICO



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Helping companies do business in Latin America®

- **Economic Policy**
- **General rules**
 - Reminders
 - Annual Revenue Law
 - General Anti-Avoidance Rule (GAAR)
 - Digital Certificates
 - Outsourcing and services
- **BEPS implementation**





Economic Policy

Code	Product	Price	Total		
			2017	2018	2019
T0001	RICE	120	1200	1320	1440
T0002	PORK	100	850	750	850
T0003	CORN	85	850	960	750
T0004	PEANUT	150	300	600	600
T0005	CHICKEN	100	2000	2500	2000
T0006	...	150	600	750	600



- **Neither new taxes nor increase of current tax rates**
- **Main objectives**
 - Strengthen tax collection.
 - Efficiency of the tax administration.
 - Easy tax compliance and payment.
 - Close gaps for tax evasion and tax avoidance.
- **Actions**
 - Elimination of tax waives.
 - Tax fraud as criminal offense.
 - Withholding on services.
 - Digital economy.



A black and white photograph of a business meeting. In the foreground, a person's hands are visible, holding a pen and a tablet. Another person's hands are also visible, holding a pen. On the table in front of them are several documents, including one with a pie chart and another with a bar chart. A red semi-transparent banner is overlaid across the middle of the image, containing the word "Reminders" in white text.

Reminders

- **Trading of bad invoices:**
 - Listed as major crime when amount exceeds US\$400,000 (\$7'804,230 MxP).
 - Endanger National Security.
 - Penalty of 2 to 9 years in jail.
- **Prison confinement before trial**
 - Upon major crime qualification.
 - Seizure of assets.





- **When MexCo has no tax domicile, unpaid withholding taxes, trading of bad invoices and tax losses:**
 - Limited liability for shareholders and members.
 - Unlimited liability for general director, general manager or sole manager.
- **Unlimited liability for liquidators.**
- **Labor Reform**
 - New definition for “outsourcing”.
 - Sham transactions.
 - Penalties.
 - Legal representative.

A grayscale photograph of a person's hands writing in a notebook. The person is wearing a dark suit jacket. The notebook is open, and the person is holding a silver pen. In the background, there are several vertical rectangular objects, possibly folders or documents. The overall scene suggests a professional or financial setting.

Annual Revenue Law

- **Annual tax incentives now incorporated into the Mexican Income Tax Law (MITL)**

- PTU deduction on monthly payments.
- 25% deduction of salaries for handicapped employees.
- Tax credit on monthly payments for investments in film production.

- **Other tax incentives**

- Conditional upon specific requirements.
- Administrative rules.



A black and white photograph of a business meeting. Several people in business attire are gathered around a table. One person is holding a smartphone, while others are looking at documents and charts. The scene is professional and collaborative. A red banner is overlaid across the middle of the image, containing the text 'General Anti-Avoidance Rule (GAAR)'.

General Anti-Avoidance Rule (GAAR)

Mexican Tax Authorities may now consider transactions lack a legitimate business purpose.

- **Elements:**
 - Economic Benefit < Tax benefit.
 - Same economic benefit through less legal acts.
- **Economic benefit, current or future.**
- **Tax benefit, direct or indirect.**
- **Unless otherwise proved by the taxpayer.**
- **Committee SHCP/MTA:**
 - 2 months / SAT rules.
 - Otherwise, it is deemed rejected.
- Shall not create a basis for criminal cases.



■ Economic benefit features:

- Create revenue.
- Reduction costs.
- Increase the value of assets.
- Improve their market position, among others.
 - Contemporary information and projected profit.
 - Supported and reasonable.

■ Tax benefit features:

- Any reduction, elimination or temporary deferral of a contribution.
 - Includes deductions, exemptions, non-collection, no inclusion income, adjustments to the tax base, tax credits, recharacterization of payments or activities, a change of tax regime, among others.

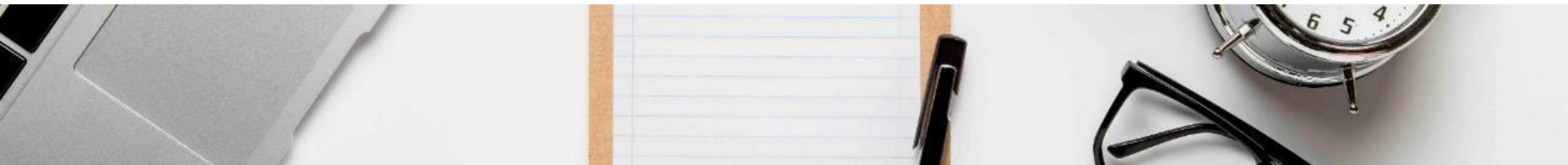


A grayscale photograph of a person in a dark suit jacket typing on a laptop keyboard. The person's hands are the central focus, positioned over the laptop. The background is a blurred office environment with a window showing a view of buildings. A solid red horizontal banner is overlaid across the middle of the image, containing the text "Digital certificates" in white. In the foreground, there are some out-of-focus objects, including what appears to be a white mouse and some papers.

Digital certificates

Temporary restriction if:

- Black-listed taxpayers (EFOS-EDOS);
- Wrong tax domicile;
- Wrong contact details;
- Discrepancies tax returns vs electronic invoices;
- Black-listed transfer of tax loses;
- Inconsistencies upon taxpayers ID, payment of taxes and accounting records;
- 10-day period to clarify
- Upon definitive cancellation:
 - Not possible to invoice;
 - Importer of record status
 - Possibility to obtain new digital certificates
 - Problematic and burdensome





Outsourcing and services

VAT withholding for services paid when:

- **Service provider put personnel at the disposal of the receiving party:**
 - whether under its direction, supervision, coordination or dependency; and
 - whether at the contractor premises.
 - MTA - the functions performed are utilized directly by the receiving party or its related parties.
- **Regardless of the contractual obligation put in place.**
- **6% withholding upon payment**
 - Net margins may be exceeded.
- **Applicable to payments made as of January 10th, 2020**





BEPS implementation

- **Action 1** - Digital economy.
- **Action 2** - Hybrid mismatch rules.
- **Action 3** - CFC rules.
- **Action 4** - Limitation on interest deduction.
- **Action 7** - Agency PE.
- **Action 12** - Mandatory disclosure rules.

- Elimination of tax transparency for entities and/or arrangements



Action Plan on Base Erosion and Profit Shifting



Digital Economy

350

300

250

200

150

100

50

0

JA

FE

MA

AP

MY

JU

JY

AU

SE

OC

NO

DE

75%

20%

15%

Taxation for Mexican individuals

- **Income derived from the sale of goods or rendering of services.**
 - Internet, technologic platforms, applications or equivalent.
- **Withholding obligation for:**
 - Mx entities and non-residents w/wo Mexican PE.
 - Obligated to get Mexican taxpayer ID.
 - Electronic invoices and VAT information return.

Income Tax for individuals

- Tax credit – Determined at progressive rates.
- 20% with no information.
- Final payment (tax notice) exception:
 - Income previous year > US\$15,000 or different from salaries and interests
- **June 2020 – Administrative rules January 2020.**



- **VAT taxation – Destination principle for consumers:**

- Domiciled in Mexico;
- Intermediary located in Mexico;
- IP address located in Mexico; or
- Mexican phone number.

- **Rendering of services through:**

- Applications or digital content over the Internet or other network, mainly automated, may require minimal human intervention, in exchange for a consideration.
 - Download or access
 - Pictures, movies, text, information, video, audio, music, games, including gambling, as well as other multimedia content, multiplayer environments, mobile ringtones, online news viewing, traffic information, weather forecasts and statistics (except books, newspapers and electronic magazines).
 - Intermediation with third parties offering goods or services and the users thereof (except used movable goods)
 - Online clubs and dating pages
 - Distance learning or test or exercise



■ Tax obligations for non-residents w/o Mexican PE:

- Taxpayer ID, appoint legal representative and tax domicile in Mexico.
- Quarterly information return and VAT payment 16% per month (own or withheld).
 - Lack of registration shift burden on users (importation of services).
- Collect the price plus VAT
 - 70/30 proportion when there is no break-down of taxable services.
- User records and monthly collections.
- Electronic invoices with VAT details, at the request of the user.
- Non-compliance does not create Mexican PE.

■ Tax obligations for non-residents w/o Mexican PE acting as intermediaries:

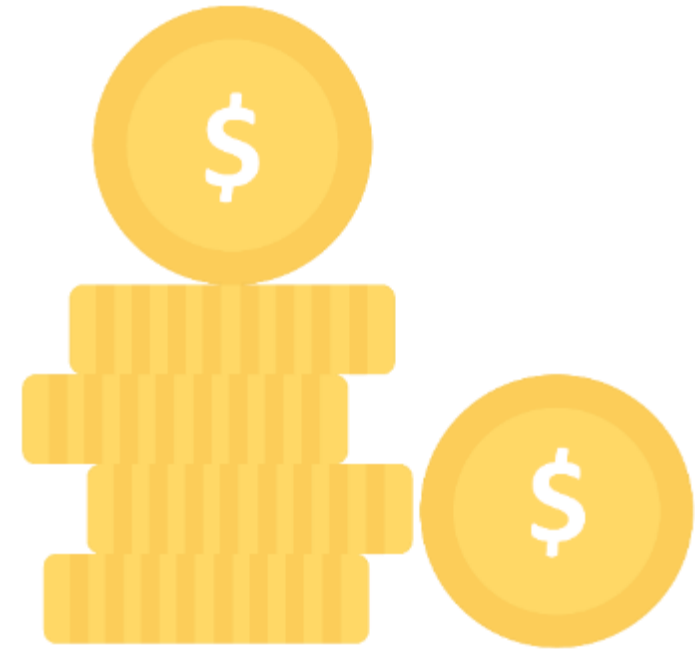
- Publish prices and VAT separately on goods or services offered.
- Withholding 8% VAT to individuals, monthly payment and electronic invoices (16% w/o tax ID).
 - Administrative rules.
- Tax registration as withholding agent.
 - Lack of registration shift burden on receiver.
- Monthly Information return of VAT customers.
- Potential use of VAT input.

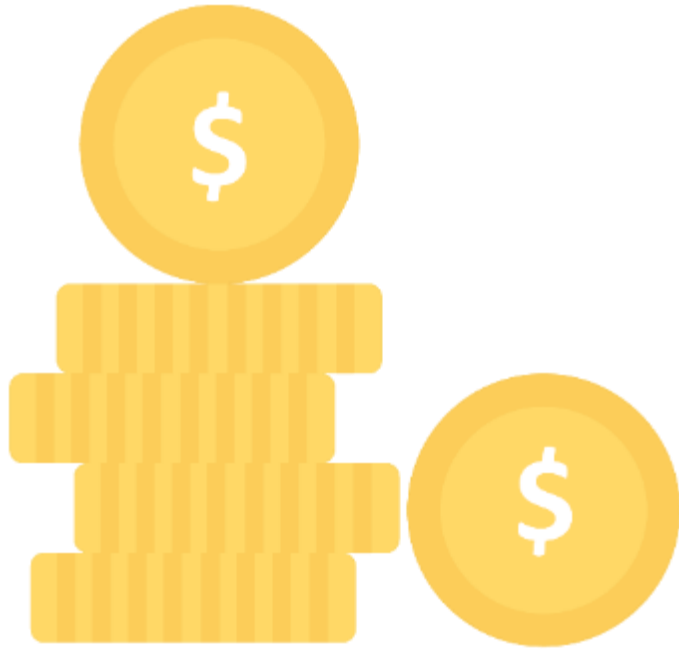


A black and white photograph of a person in a business suit sitting at a desk. The person is holding a pen in their right hand and writing on a document. Their left hand is resting on another document. In the foreground, the keyboard of a laptop is visible. A red banner is overlaid across the middle of the image, containing the text "Hybrid mismatch" in white.

Hybrid mismatch

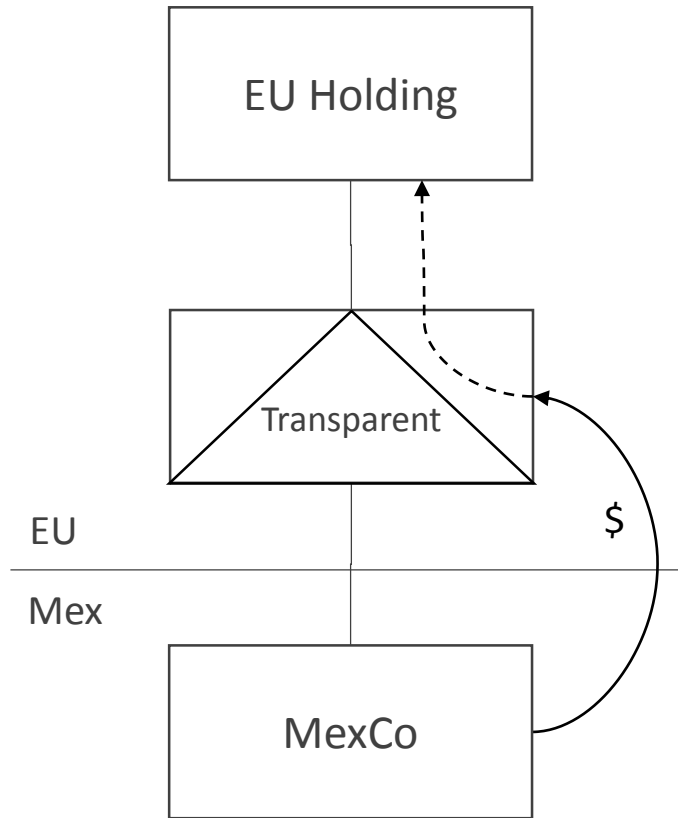
- **Expenses paid to a tax haven which is:**
 - A related party; or
 - through a “structured arrangement”
 - Any act where a taxpayer/related party gets a benefit through a payment made to tax haven.
- **Income not paid to a tax haven but:**
 - Direct/indirect recipient makes deductible payments (20%+) to a tax haven:
 - Other group member (control) or “structured arrangement”.
 - Previous payments and multiple transactions considered.
 - Administrative rules - CFC rules in other countries.





- **Exceptions:**
 - Income derived from business activities:
 - Staff and Assets → Functional analysis.
 - POEM and Incorporated in country with BEIA.
 - Most EU countries included.
 - No CFC if foreign tax affectively paid exceeds 22.5% threshold.
- **Non-deductible if:**
 - Deemed tax haven due to a hybrid rule (D/NI)
 - MexCo tax transparent
 - Administrative rules
 - Deemed tax haven PE w/exemption for Principal.
- **Deductible when MexCo is tax transparent for its owners but income > payments. Administrative rules.**
- **Deductible when income subject to tax in Mexico.**





Payments made to EU entities:

- **Tax transparent entities/arrangements:**
 - Direct recipient may not be subject to (sufficient) CIT
 - 22.5% threshold.
 - Effective income tax paid.
- **All payments are covered (not only passive income)**

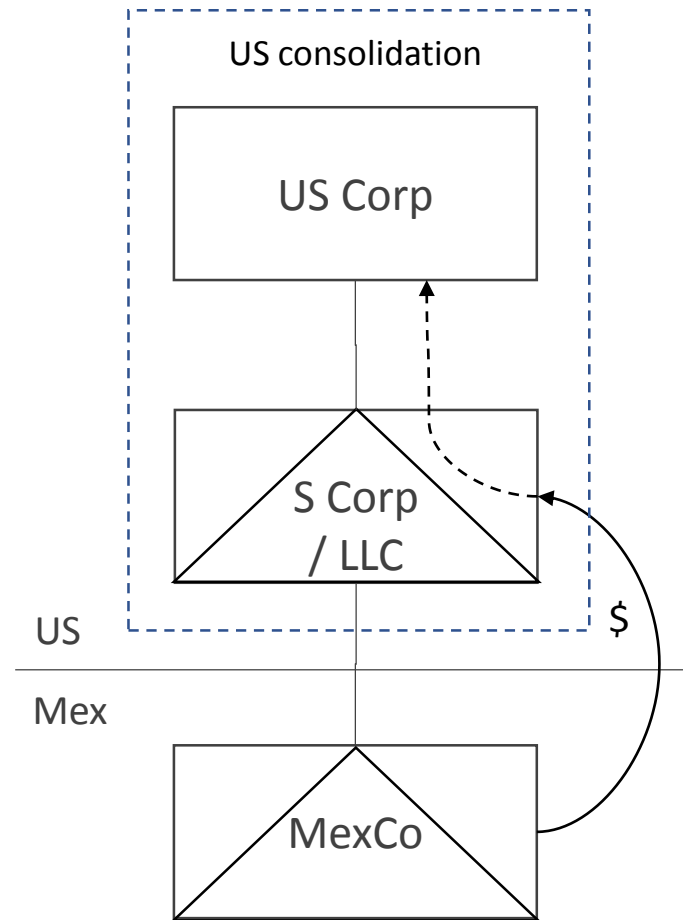
■ **Non-deductible payment for MexCo if:**

- Mex Co double-resident; or
- Deductible for other group members (control).
- Deductible for Principal having a Mexican PE.

■ **Exception for:**

- Transparency of Mex Co/Mexican PE.
 - Income > Payments.
 - Administrative rules.
- Mex Co double-resident but pays CIT in the other residence country.





Payments made to US:

- **Deduction in Mx and Deduction in US since MexCo is tax transparent in the US.**
 - Not an issue if income derived by MexCo also flows-through the US. Applicable since 2014.
- **Additional requirement as of 2020:**
 - Income > Payments.
 - Timing mismatch on income recognition ok provided such income is recognized in US within the following tax year.
- **All payments are covered (not only passive income)**

CFC rules



- **Deemed income approach** – Income derived through foreign entities.
- **Control is required (direct or indirect) together with related parties or connected persons:**
 - > 50% voting, veto or decisive vote or value of shares.
 - > 50% rights on assets or profits.
 - Both (subjective).
 - Financial consolidation.
 - Facts and circumstances lead to control of board of directors.
- **Exceptions:**
 - Direct/indirect participation in tax transparent entities or arrangements.
 - Income from business activities higher than 20% and 50%+ should not be sourced in Mexico / deduction.
 - Foreign entities with different timing for income, deductions or payment of taxes < 4-year period. Subject to authorization.





Income subject to CFC when:

- Not taxable abroad; or
- Subject to a tax below 75% of the Mexican tax levied and paid:
 - 22.5% (@30%) o 26.25 (@35%).
 - CIT effectively levied and paid abroad.
 - Include all taxes paid by the foreign entity in different countries and/or jurisdictions.
 - Taxes paid through tax credits or incentives are excluded.
 - Possibility to consider statutory tax rate subject to BEIA.
- For purposes of other chapters, transaction-by-transaction.

The background is a blurred image of a document. On the left, a white pen tip is visible, pointing towards the center. The document features a line graph with several data points connected by lines. Below the graph, there is a table with columns of numbers. The text 'Limitation on interest deduction' is overlaid in white on a dark red horizontal band.

Limitation on interest deduction

- **Net interest deduction = Adjusted Tax Profit @30%**
 - Adjusted Tax Profit = Fiscal EBITDA.
 - *De minimis* rule \$20mMxP (approx. 1 million Euro).
 - Net Interest deduction = Debt interest - Interest income - \$20m MxP threshold (proportional basis, if any).
 - Exceptions
 - Mexican CFC rules.
 - Public infrastructure; construction; oil & gas, energy and extraction industry; and public debt instruments.
 - State owned and financial sector.
 - Carry-forward
 - 10-year period and FIFO.



Agency PE

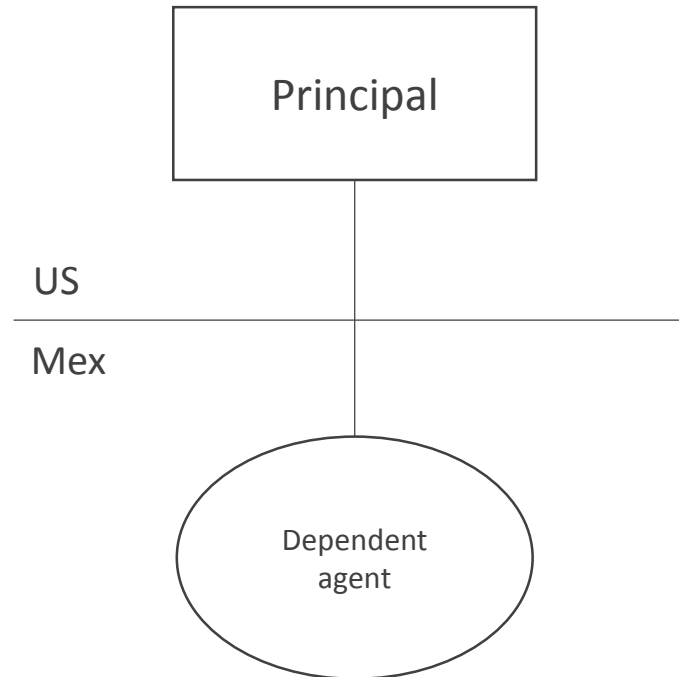
- **Broader scope**

- Dependent agents – creation of Mexican PE.
- Independent agents – loses independent status only.

- **Exception rule**

- All activities should be of preparatory or auxiliary character.
 - Anti-fragmentation rule:
 - Cohesive business operation.
 - Complementary functions.
 - Closely related enterprises.

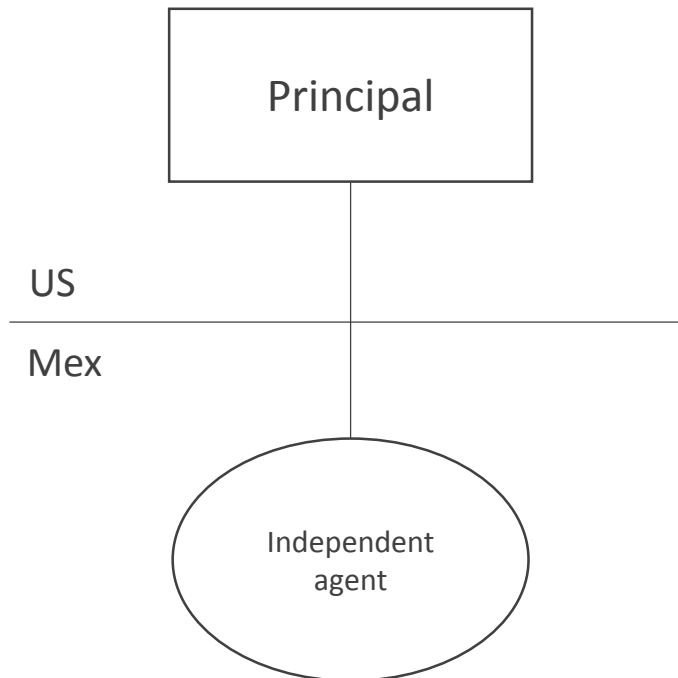




Foreign resident creates a Mexican PE if:

Dependent agent:

- Habitually concludes contracts; or
- Habitually plays the principal role leading to the conclusion of contracts and:
 - In the name of / on behalf of.
 - Transfer of ownership;
 - Granting of the right to use; or
 - Provision of services.
- Except for preparatory or auxiliary activities.



Foreign resident creates a Mexican PE if:

- Independent agent acting outside the ordinary course of business, such as:
 - Delivery of goods or merchandise belonging to the enterprise (OECD MC);
 - Taking risks of the enterprise (economic);
 - Subject to detailed instructions or general control of the enterprise (legal);
 - Executing activities that economically belong to the enterprise (economic);
 - Remuneration paid regardless of performance (economic);
 - Transactions outside arm's length principle (economic).
- Not independent when the agent acts exclusively or almost exclusively on behalf of related parties.



Mandatory Disclosure Rules

Obligation to disclose tax schemes deriving a tax benefit in Mexico.



Parties



Tax Advisor



Taxpayer



Tax advisor means any entity or individual that, in the ordinary course of their activity, renders tax services and is responsible for, or **involved in**, the design, marketing, organization, implementation or administration for an **entire** reportable scheme, or who makes available the **entire** reportable scheme for implementation by a third party. Nonresidents having a Mexican PE or related parties are obliged, in certain cases.



Performed directly by the taxpayer, participates a non-tax advisor, participates a non-resident tax advisor, impossibility due to **attorney-client privilege**; and lack of report/information from the Mexican tax advisor, and **legal agreement for the taxpayer to report**.



- **Tax scheme: Any plan, project, proposal, advice, instruction or recommendation expressed or tacitly or explicitly in order to materialize a series of legal acts.**
 - Standardized: Mass marketing with no or minimal customization;
 - Customized: Adapted to specific circumstances.
- **Reporting obligation: any scheme that generates, or may generate, directly or indirectly, a tax benefit in Mexico.**
 - 14 hallmarks plus any other mechanism avoiding a reporting obligation.
 - Broader than arrangements perceived as cross-border/aggressive/abusive transactions.
 - Tax procedures before Mexican Tax Authorities and Tax Controversy services are excluded.
- **Administrative Rules are expected.**
- **Harsh penalties.**



Tax scheme hallmarks:

- Tax schemes leading to avoid:
 - Exchange of information with foreign authorities;
 - Use of transparent entities or CFC regime;
 - Creation of Mexican PE;
 - Identification of the beneficial owner, even through foreign entities or arrangement without beneficial owners; and
 - 10% WHT on dividend distribution to non-residents and individuals.





Tax scheme hallmarks:

- Traditional pressure points:
 - Transfer of tax losses;
 - Transfer of assets;
 - Reimbursement of funds through circular transactions;
 - DTC leading to double non-taxation or reduced taxation;
 - Transfer pricing;
 - Hybrid mismatches;
 - Refresh of tax losses;
 - Sale & lease back;
 - Book-to-tax mismatches > 20%



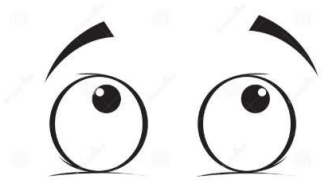
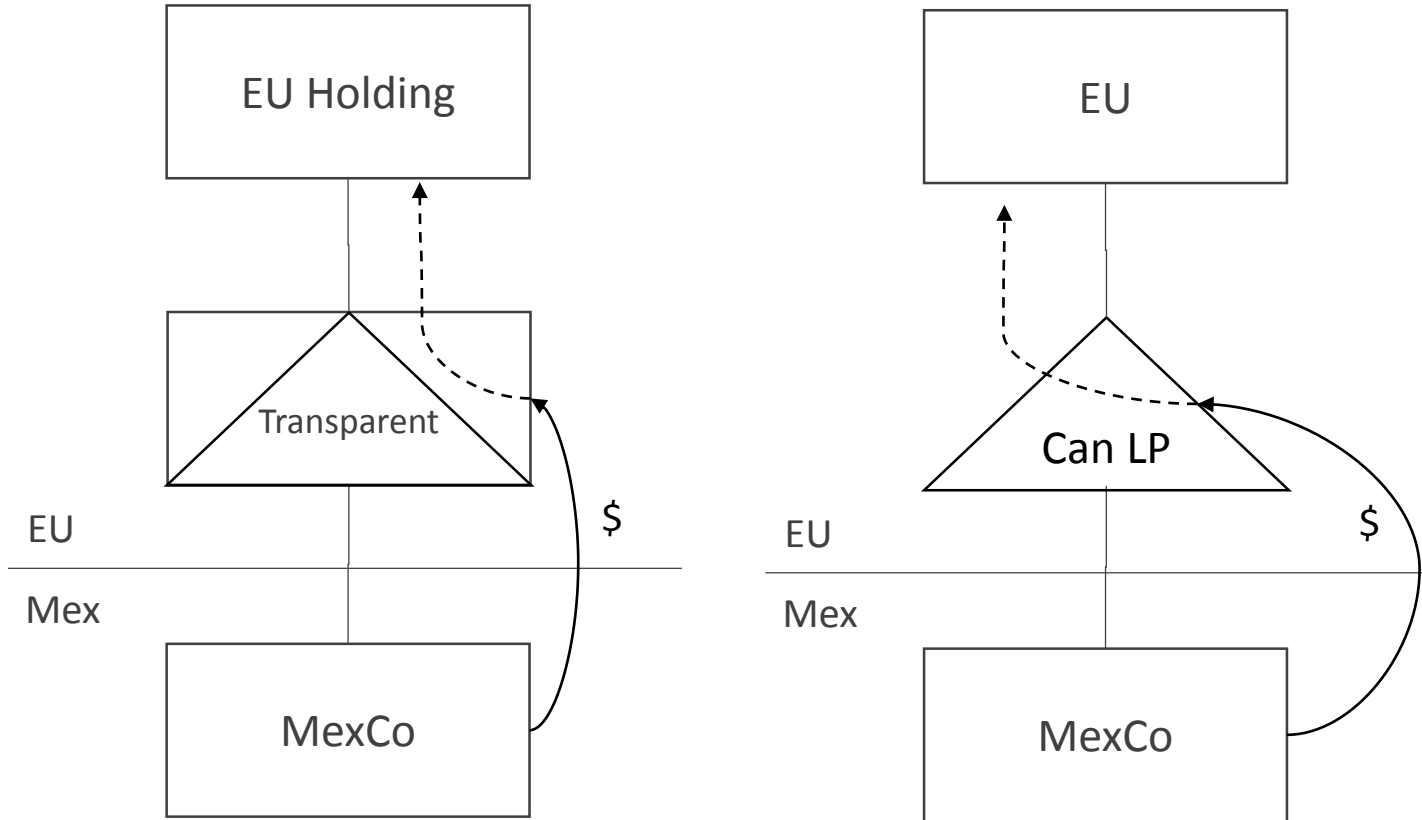
- Name and Tax ID of the tax advisor / taxpayer.
- Tax advisor's / Legal Representative's name.
- Detailed description of the tax scheme including references to domestic and/or foreign law.
- Each of the stages of scheme to materialize the tax benefit.
- Detailed description of the obtained/ expected tax benefit.
- Fiscal years in which the scheme is to be implemented.
- Applicable as of 2021.
 - Including transactions implemented since 2020



A magnifying glass is positioned over a financial spreadsheet. The spreadsheet contains various numerical values, including dollar amounts and percentages. The text "Tax transparency" is overlaid in white on a dark red horizontal band across the center of the image. The background is a blurred view of the spreadsheet, with the magnifying glass focusing on a specific section of data.

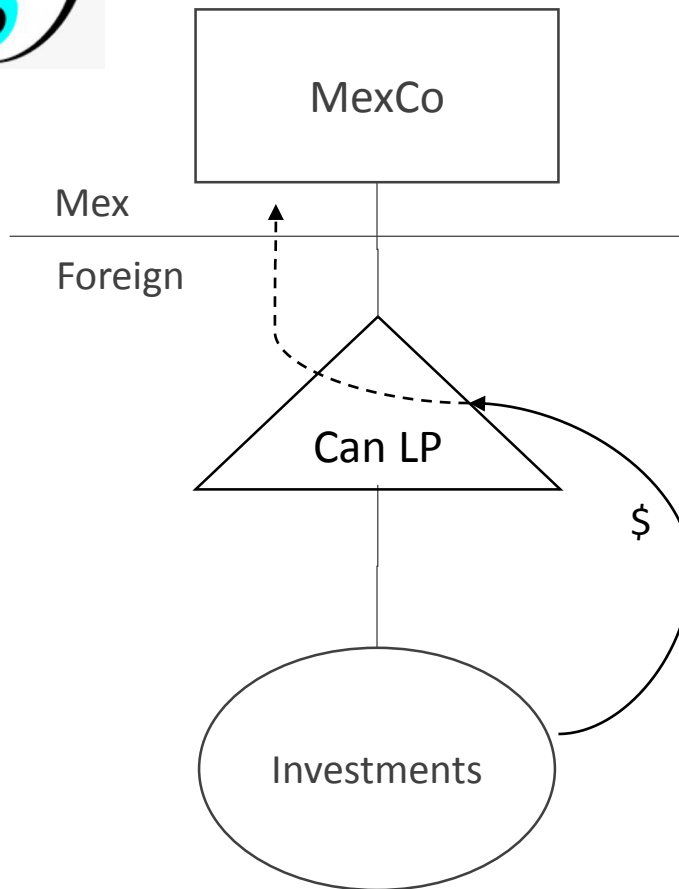
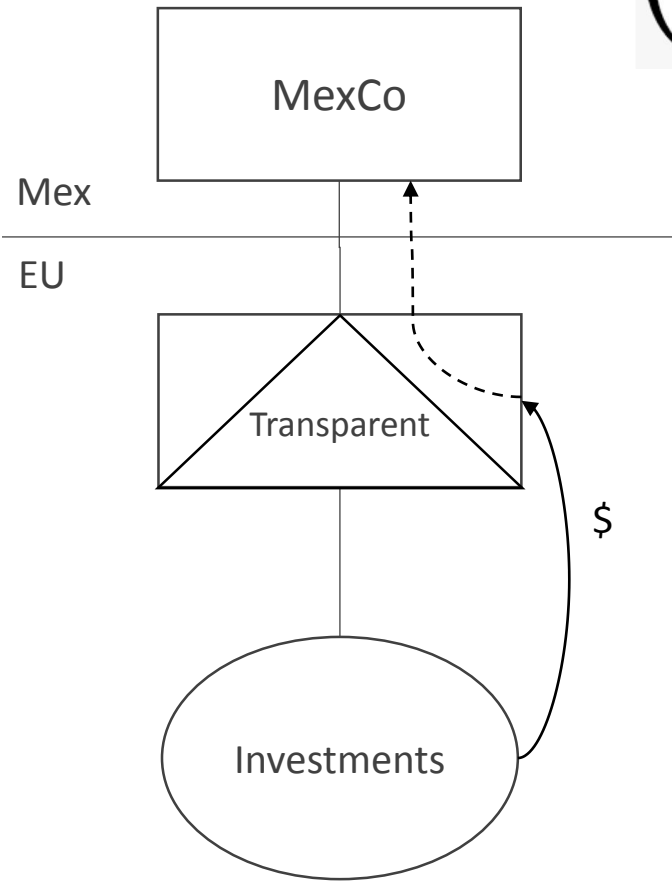
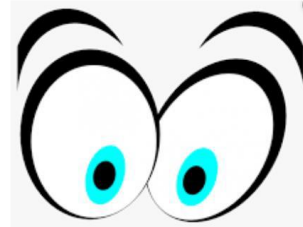
Tax transparency

- **No transparency when taxing foreign residents**
 - All foreign entities/arrangements are deemed opaque.
 - Potential high-wht tax under domestic law.
 - Exceptions with DTCs / MLI effect.
 - 61 DTCs but only 18 w/pass-through clause.
- **Applicable as of 2021**
- **Full transparency for Mexican residents:**
 - Income derived through:
 - Tax transparent entities (total or partial).
 - Annual Tax Profit.
 - Tax transparent arrangements.
 - Transparent: Income-deduction.
 - Opaque – Annual Tax Profit.
 - Tax credit for income taxes paid.
 - Mexico and/or abroad.
 - No double taxation upon distribution.
 - Accounting records must be available.
 - Information return.
 - No filing leads to CFC rules.



- **As of 2021**
 - All tax transparent entities or arrangements are deemed opaque.
- **Consequences**
 - Simplification?
 - High wht rates under domestic law.
 - 25% general rate;
 - 35% in certain cases;
 - 40% to tax havens w/o DTC
- **Unless DTCs w/flow-through approach**
 - 61 DTCs
 - US*
 - 18 other countries
 - Australia, Austria, Barbados, Brazil, Czech Republic, Denmark, Germany, Iceland, Indonesia, Israel, Kuwait, Malta, Poland, Russia, Singapore, South Africa, Sweden, and Uruguay.

* https://www.irs.gov/pub/irs-utl/restatment_mex_llc_map_12_22_05_final.pdf



■ **As of 2020**

- Any income derived through tax transparent entities or arrangements flow-through

■ **Discrepancies vs. Look-up approach**

- Simplification
- Avoiding aggressive tax planning
- Mexico's position abroad
- Ordinary income in the hands of Mx residents
- Full FTC





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Thank you!