

Mexican Tax Reform 2020

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Agenda

- Economic Policy
- Annual Revenue Law
- General Anti-Avoidance Rule (GAAR)
- Mandatory Disclosure Rules
- Agency PE
- Digital Certificates and Taxpayers' ID
- Outsourcing and services
- Digital Economy
- BEPS implementation





Economic Policy

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Economic Policy

- **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.



Tax Indicators

- **Surcharge rates maintained**
  - 0.98% general.
  - 1.47% late payment.

- **Banks withholding rate**
  - Increase from 1.04% to 1.45% annual basis.





Annual Revenue Law

Tax incentives

- **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.





General Anti-Avoidance Rule (GAAR)

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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.



GAAR

- **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.





Mandatory Disclosure Rules

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Tax Schemes

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 Schemes

- 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 Schemes

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 Schemes

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%





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Details

- 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



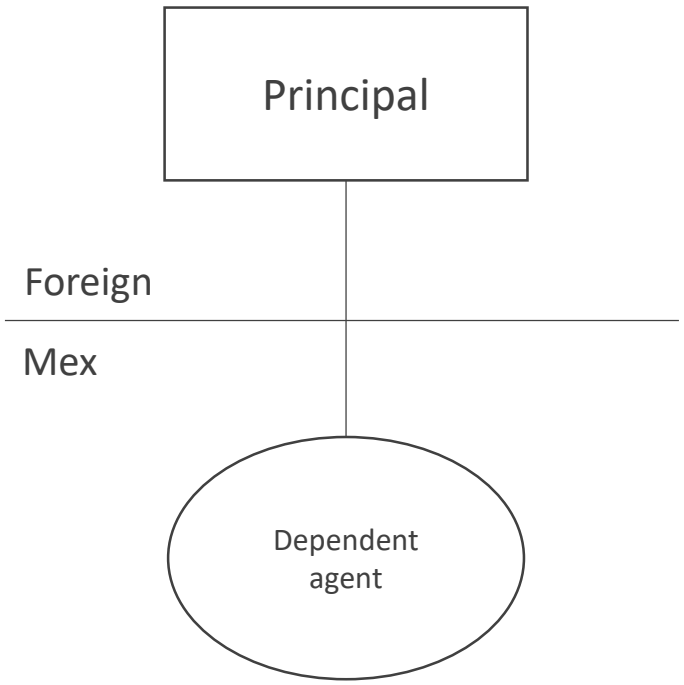


Agency PE

Permanent establishment

- **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.

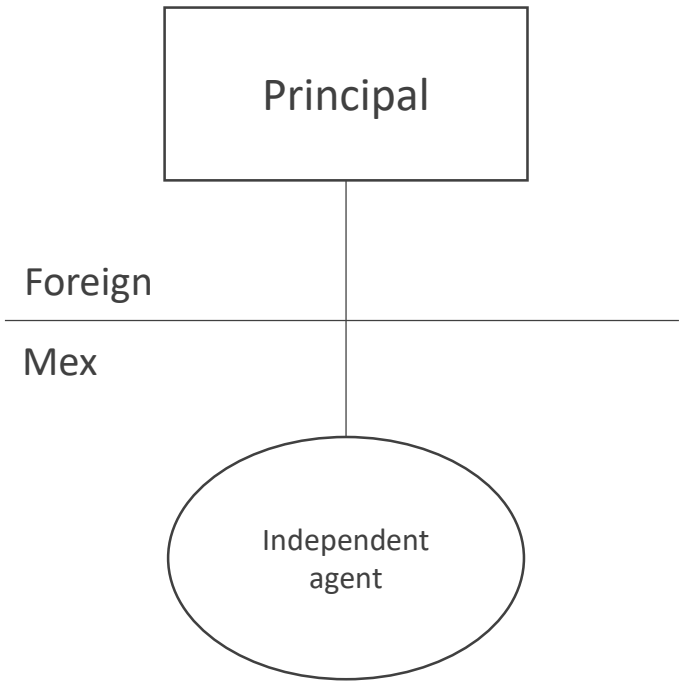
Agency PE



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.

Agency PE



Foreign resident creates a Mexican PE if:

- Independent agent acting outside the ordinary course of business, such as:
  - Delivery of godos 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 activitidad that economically belong to the enterprise (economic);
  - Remuneration paid regardless of performance (economic);
  - Transactions outside arm's lenght principle (economic).
- Not independent when the agent acts exclusively or almost exclusively on behalf of related parties.



Digital certificates

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Digital certificates for electronic invoicing

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





Taxpayers' ID

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New Structure



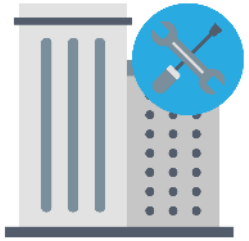
Section A

Subjects and Obligations



Section B

General Obligations List



Section C

Tax Authority Powers



Section D

Special Cases



Relevant Information

Mexican Tax Authority's powers

- Validation to confirm taxpayer ID.
  - Not deemed a formal audit.
- Design a fiscal geographic framework.
- Simplified registry for non-residents without Mexican PE in Mexico (Digital Economy).
- Update registries based on third party information.
- Enforcement on Public Notaries to share information.

Special Cases

- Registration for non-residents without PE in Mexico (Digital Economy).
- Deadlines for filing notices for changes in tax domicile.
- Additional details for corporate documents for shareholders and partners.





Outsourcing and services

Withholding obligation when:

- Contractor makes available staff for the contracting party, under its direction, supervision, coordination or dependency.



- Regardless of the name given to the contractual obligation.

- **<u>6% WHT upon payment for services.</u>**
  - Net margins may be exceeded.





Digital Economy

Digital Economy

- **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.
      - Obliged 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.



Digital Economy

- **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

Digital Economy

- **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.

Digital Economy

- **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.



BEPS implementation

- 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

Action Plan on Base Erosion and Profit Shifting

- Elimination of tax transparency for entities and/or arrangements

Tax transparency

- **No transparency when taxing foreign residents**
  - All foreign entities/arrangements are deemed opaque.
  - Potential high-level taxation.
  - Exceptions with DTCs / MLI effect.
    - 61 DTCs but only 18 w/pass-through clause.

- **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.



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.

CFC rules

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.**



Hybrid expenses (D/NI)

- **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.



Hybrid expenses (D/NI)

- **Exceptions:**
  - Income derived from business activities:
    - Staff and Assets.
    - POEM and Incorporated in country with BEIA.
      - USA included in Mx list.
    - Review under US rules.
      - No CFC if foreign tax exceeds 22.5% threshold.
    - Non-deductible if:
      - Deemed tax haven due to a hybrid rule (D/NI).
      - Deemed tax haven PE w/exemption for Principal.
  - Deductible when Mex Co is tax transparent for its owners but income > deductions. Administrative rules.
  - Income subject to tax in Mexico.



Hybrid expenses (DD)

- **Non-deductible payment for Mex Co 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.





Limitation on interest deduction

- **Net interest deduction = Adjusted Tax Profit @ 30%**
  - Adjusted Tax Profit = Fiscal EBITDA.
  - *De minimis* threshold $20M MxP (approx. $US1 million).
  - 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.



Reminders

Criminal activities

- 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.

Jointly liability

- When Mex Co 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.

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Q&A



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