

Tax Practice Group Newsletter



Tax Bill 2020

On September 8, 2019, the Federal Executive Branch submitted to the Mexican Congress the Tax Bill for 2020, under which several amendments to the Income Tax Law, Value Added Tax Law, Special Production and Services Tax Law and Federal Tax Code are proposed.

After following the corresponding legislative process, on October 31 the Mexican Congress approved the amendments proposed by the Executive Branch, which will be published in the Federal Official Gazette and will mostly enter into force on January 1th, 2020.

In general terms, the amendments approved have as their main objective to incorporate the recommendations issued by the Organisation for Economic Cooperation and Development (OECD) to the Mexican tax legislation, establishing rules to tax the digital economy, tackle tax avoidance through aggressive tax planning and simulated acts, as well as to strengthen the faculty of the tax authority for such purposes.

The most important amendments derived from the Tax Bill for 2020 are described below:

Income Tax Law

» Definition of Permanent Establishment

The definition of permanent establishment (PE) is updated to include additional cases in which a foreign resident can constitute a PE in Mexico.

It is established that a dependent agent can constitute a PE for a foreign resident when the agent regularly performs the principal role in the conclusion of contracts executed by the foreign resident. In addition, it is considered that an agent will not be deemed to be of independent nature when the agent acts "exclusively" or "almost exclusively" on behalf of the foreign resident.

Also, it is stated that the PE exceptions applicable to the place of business or agency cases will only be applicable when the activities performed are, in fact, of a preparatory or auxiliary nature.

Finally, an extended anti-fragmentation rule is included to exclude the fragmentation of functions or activities performed by the foreign resident or its related parties from the PE exception for auxiliary or preparatory activities.

» Income obtained by transparent foreign entities and foreign legal vehicles

Transparent foreign entities and foreign legal vehicles receiving Mexican source income must determine the tax result and pay Income Tax according to the rules applicable to the tax regime for Mexican entities. This applies even if the members, partners, shareholders or beneficiaries of the entities or vehicles accrue said income in their foreign residence jurisdiction.

It is worth mentioning that transparency of foreign legal vehicles is recognized to the extent that such vehicles administer private equity investments in Mexican companies and certain information is reported to the Mexican Tax Administration Service.

» Income obtained by Mexican residents through transparent foreign entities and foreign legal vehicles

It is established that income obtained by Mexican residents through transparent foreign entities and foreign legal vehicles must be directly accrued by the Mexican residents along with any other income accrued. Thus, the possibility of deferring the payment of Income Tax under the exception of lack of control over the timing of distributions by such entities or vehicles is eliminated.

Because of this, income obtained from transparent foreign entities or foreign legal vehicles that are not deemed transparent will be determined based on the taxable profits obtained by such entities or vehicles in the corresponding calendar year, in accordance with the tax regime applicable to Mexican entities.

In addition, income obtained through transparent

foreign legal vehicles must be accrued in accordance with the tax regime applicable to the Mexican resident that participates in such vehicle and will be taxed in the same tax year in which they are generated, considering the deductions corresponding to such vehicles.

It is worth mentioning that taxes effectively paid in Mexico or abroad may be credited for Income Tax purposes.

Finally, the obligation of keeping a Net After-Tax Profits Account (CUFIN per its Spanish acronym) of preferential tax regimes for purposes of recording the amount of income that has been already taxed and that can be distributed by the entities and vehicles, as well as the obligation of filing the corresponding informative tax return, are maintained.

» **Controlled Foreign Entities subject to Preferential Tax Regimes**

The tax regime applicable to income subject to preferential tax regimes is modified, in order for such regime to be applicable only to income obtained by Controlled Foreign Entities subject to preferential tax regimes.

It is still the case that income is subject to a preferential tax regime when it is not taxed or is subject to less than 75% of the Income Tax that would be paid in Mexico. However, the basis to determine if said income is subject to a preferential tax regime will be the Income Tax that would be payable in Mexico through the application of the tax rate corresponding to Mexican individuals or entities.

Only the exceptions related to income obtained through foreign entities that perform business activities and lack of effective control over such entities are retained.

The business activities exception will not be applicable when more than 50% of the income obtained by the

foreign entity is from Mexican source or represents a deduction in Mexico.

In addition, for purposes of the lack of effective control exception, the scope of the definition of effective control is broadened, and will now include the exercise of voting and veto of decisions rights, ownership rights in case of liquidation or capital redemptions and decision-making entitlement in entities, and specific rules for multi-tier structures apply.

It is important to mention that income subject to preferential tax regimes will continue to be taxed in the year in which it is generated, in proportion to the direct or indirect participation that Mexican residents have in the foreign entity, even if said income has not yet been distributed. For this purpose, the tax result of the entity will be determined according to the rules applicable to Mexican entities. However, the applicable Income Tax rate will be the one corresponding to the Mexican resident, either as an individual or an entity.

Finally, the option of assessing the corresponding Income Tax on a consolidated basis is established, for purposes of determining the income corresponding to multi-tier structures subject to preferential tax regimes.

» **Deduction of payments to foreign related parties and crediting of foreign taxes (tackling hybrid mismatch arrangements)**

Rules are incorporated with the purpose of tackling the erosion of the taxable basis derived from the abusive use of hybrid mismatch arrangements by Mexican residents.

Thus, the deductibility of payments made to related parties or through a "structured arrangement" are denied, when such payments are deemed income subject to a preferential tax regime for its direct or indirect recipient. Likewise, the deductibility of payments deemed income subject to a preferential tax regime because of the use of a "hybrid mechanism" is denied. This applies when such payments are not taxed for the recipient.

In addition, deductions of payments that are deductible for the same Mexican resident, when deemed a tax resident in another jurisdiction, or for other members of its group, will also be denied.

Finally, the direct credit of foreign taxes paid when said taxes have also been credited in another jurisdiction, as well as the indirect credit of foreign taxes when the dividends or profits for which the taxes were paid, represent a deduction for the foreign resident, will be denied.

» **Net-Interest deduction limitation**

The deduction of the net interest obtained in the tax year that exceeds 30% of the Adjusted Tax Result is limited.





The net interest will be the result of reducing the amount of income accrued for interest from the deductible interest accrued during the tax year. In addition, the Adjusted Tax Result will be the result of adding to the taxable profits of the tax year the total amount of interest accrued for debt and the amount deducted as depreciation of assets.

The non-deductible amount of net interest for the tax year will be deductible during the following ten years, until it is entirely deducted.

The deduction limitation will not be applicable to interest that does not exceed \$20,000,000 Mexican pesos, considering the entire amount of interest deducted by the entire entities that belong to the same group; if the application of thin capitalization rules results in a higher amount of non-deductible interest or for interest derived from debt acquired to finance the development of public infrastructure, energy and hydrocarbon projects and interest paid to financial institutions.

» **Leasing of industrial, commercial or scientific equipment**

It is established that Mexican source income received by foreign residents for the lease of commercial, industrial and scientific equipment must be treated as royalties for Income Tax purposes.

» **Deduction of Employees' Profit Sharing (PTU) in estimated monthly Income Tax returns**

Mexican entities will be entitled to deduct the Employees' Profit Sharing (PTU per its Spanish acronym) paid during the tax year from the taxable profits used as the basis for the calculation of the estimated monthly Income Tax payments.

» **Individuals that sell goods or provide services through technological platforms or digital applications**

A new tax regime is created for individuals that sell goods or provide services through Internet.

Mexican and foreign tax residents that provide, directly or indirectly, the use of technological platforms or digital applications and serve as intermediaries between individuals and final customers of goods and services, must withhold a percentage of the income obtained from such activities and pay it to the Mexican tax authority as an advance Income Tax payment on behalf of the individuals.

Several tax obligations are established for foreign residents that provide the use of said platforms or applications, such as registering in the Mexican Taxpayers' Registry, issuing withholding tax receipts, and filing informative tax returns.

Individuals will be entitled to credit the withheld amount against the Income Tax payable in the annual Income Tax return.

» **Mexican IMMEX shelters**

A new tax regime is created for entities in the IMMEX Maquila Program under the shelter modality, as well as to foreign residents that perform maquila operations through shelters.

In principle, the four-year period under which foreign residents could operate through shelters without triggering a PE in Mexico is repealed. Thus, foreign residents will no longer trigger a PE while operating through shelters.

In addition, hereinafter the foreign residents will have to comply with their Mexican tax obligations and pay the Income Tax derived from their maquila operations through the Mexican shelter.

Among the tax obligations that foreign residents will have to comply with through the shelters are registering in the Mexican Taxpayers' Registry and filing Income Tax and informative tax returns related to their maquila operations.

Finally, it is established that Mexican shelters must identify the operations performed by foreign residents and determine the taxable profits corresponding to each of them, through the application of safe harbor rules or by obtaining an advanced pricing agreement (APA), which will be subject to the 30% corporate Income Tax rate applicable to Mexican entities.

» **Elimination of Private REITS**

The tax incentive granted to Real Estate Investment Trusts (REITS), of which certificates are not publicly traded in a securities exchange (Private REITS), is repealed. Hereinafter, accrual of income derived from the contribution of real estate property to these vehicles will not be deferred, as formely happened before such real estate or the corresponding participation certificates were transferred. Likewise,

the exemption of filing monthly Income Tax returns and paying advanced Income Tax for income obtained from such vehicles is eliminated.

For such purposes, transitional rules allowing the divestment or reorganization of real estate property investments made through Private FIBRAS are established. Thus, taxpayers will have until December 31, 2021, to transfer the corresponding real estate or certificates. Otherwise, they will have to accrue the taxable income derived from the transfer of the real estate property that has not been previously accrued.



» **Reporting obligations for Public REITS**

The reporting obligations for Public REITS that were previously established in the Tax Miscellaneous Resolution were introduced to the Income Tax Law. Trustees will continue filing, before February 15 of each year, information related to beneficiaries, real estate property contributions and participation certificates issues.

Value Added Tax Law

» **Provision of digital services in Mexico by foreign residents**

i. Foreign residents providing digital services to receivers in Mexico

A new tax regime applicable to foreign residents that provide digital services to recipients located in Mexico is created.

Digital services that will be subject to this regime will be the downloading of digital content, intermediation between suppliers and customers of goods or services, access to online clubs and dating sites, and distance learning.

Hereinafter, foreign residents that provide digital services in Mexico must calculate and pay 16% Value Added Tax (VAT) for the consideration received for their activities on a monthly basis.

Several tax obligations are established for the foreign residents, such as registering in the Mexican Taxpayers' Registry, collecting the corresponding VAT, keeping a record of the Mexican recipients of services, issuing invoices, and filing VAT and informative tax returns. In addition, foreign residents must appoint a legal representative for tax purposes in Mexico.

Services provided by foreign residents will be deemed rendered in Mexico when the recipient of such services is located in Mexican territory. The criteria established to determine if the recipient of digital services is effectively located in Mexico will be the registered domicile, the location of the financial institution through which the payment is made, the IP address of the electronic devices used and the area code of the registered telephone.

ii. Foreign residents that provide digital intermediation services between third parties in Mexico

In addition, a special tax regime is created for foreign residents that provide digital intermediation services between suppliers and customers of goods or services, when they act as intermediaries in activities carried out between third parties.

Now, foreign residents that collect the consideration and VAT applicable on behalf of individuals that sell goods, provide services or grant the temporary use or enjoyment of goods must withhold and pay to the tax authority 50% of the VAT corresponding to those individuals.

In addition to the previously mentioned obligations, foreign residents subject to this tax regime must register in the Mexican Taxpayers' Registry as tax withholders, issue withholdings invoices corresponding to those made and provide to the SAT a report regarding third parties and the operations carried out by them.

» **Tax withholding for subcontracting services**

The obligations for taxpayers that hire subcontracting services of calculating, withholding and paying in to the tax authority a VAT amount equal to 6% of the consideration effectively paid for such services is established.

The VAT obligations of collecting and providing information and documentation related to such services that were previously in force for providers and recipients of such subcontracting services were repealed.

» **Universal tax offsetting**

The possibility for taxpayers to offset favorable VAT balances against other Federal taxes is definitively repealed. Taxpayers will only be entitled to offset VAT favorable balances generated in the monthly VAT returns against the VAT payable during the following months until it is entirely offset.

Federal Fiscal Code

» General Anti-Avoidance Rule

A general anti-avoidance rule is established allowing the tax authority to re-characterize or consider non-existent legal acts performed by taxpayers.

Legal acts may be re-characterized when they lack substance or business reason and generate a tax benefit. In this case, legal acts will have the tax effects corresponding to the acts that would have been performed by taxpayers to obtain the expected economic benefit. It will be deemed that a series of legal acts lack a business reason if the economic benefit reasonably expected could have been achieved through the performance of fewer legal acts and the tax effect would have been higher if performed in said manner.

In addition, legal acts may be declared as non-existent when they effectively have not existed.

» Measures to tackle the use of digital invoices for non-existent transactions

Several measures related to matters of organized crime, national security and extinction of ownership are implemented, in order to establish a prevention and sanction regime aimed to tackle the use of digital invoices that support non-existent transactions and tax evasion through the use of said invoices.

For these purposes, it is established that crimes of contraband, tax fraud, and the purchase and sale of digital invoices that support non-existent or simulated transactions are deemed crimes for which preventive prison apply.

In the case of tax fraud and the purchase and sale of digital invoices, for the corresponding sanctions to be applicable, the defrauded amount must exceed \$7,804,230.00 pesos.

In addition, it is also established that crimes of tax fraud and certain equivalents, as well as the purchase and sale of digital invoices can be deemed organized crime when committed by three or more persons. In order for this case to be brought, the defrauded amount must also exceed the one referred to above.

It is specified that a tax fraud crime can be deemed organized crime when false deductions or lesser income are declared in tax returns and when one or more acts or contracts are simulated to obtain an undue tax benefit.

Finally, taxpayers that commit any of the mentioned crimes may be subject to a process of dominion extinction. During the process, assets owned by taxpayers may be seized and funds, assets, accounts and other securities or financial assets may be frozen, if deemed to be linked to illegal acts. Seized assets may be auctioned and sold in advance, prior to the resolution of the process, and the proceeds shall be deposited in a special account, where they shall be kept until the definitive resolution to the process is issued.

» Digital seal certificates

Several cases in which the use of the digital seal certificates for invoicing can be temporarily restricted to taxpayers are included.

In general, such cases refer to the non-compliance with tax obligations by taxpayers, such as the timely filing of annual and estimated monthly tax returns, localization of taxpayers at the tax domicile, issuance and use of digital invoices that support non-existent or simulated transactions, differences between income declared and supported by digital invoices, illegal transfer of tax losses, among others.

» Joint liability of administrators and partners or shareholders

In addition, several situations are established in which directors, managers or administrators of Mexican entities, as well as their partners or shareholders, can be deemed jointly liable for omitted contributions by the entities.

Hereinafter, joint liability will materialize in cases such as the omission of payment of withheld taxes, the issuance of invoices deemed to support non-existent or simulated transactions, not evidencing the substance or business reasons of performed transactions and the illegal transfer of tax losses, among others.

» Mandatory disclosure of tax schemes

The obligation of disclosing tax schemes that may be relevant to the tax authority is established. Now, taxpayers and tax advisors are required to disclose reportable schemes, which are deemed to be any scheme or arrangement that generates or could generate, directly or indirectly, a tax benefit in Mexico. For these purposes, specific cases under which it is considered that a scheme must be reported are detailed.



It is considered as a reportable scheme any plan, project, proposal, counselling, instruction or recommendation communicated, either expressly or implicitly, with the purpose of implementing a series of acts.

In addition, tax advisors will be any individual or entity that, in the ordinary course of activities, performs activities related to tax advising or consultation, and that is responsible or involved in the design, commercialization, organization, implementation or administration of reportable schemes, or that makes them available to be implemented by a third party.

The main obligation to disclose reportable schemes is for the tax advisors, through the filing of an informative tax return with the tax authority. However, several cases under which taxpayers must directly disclose reportable schemes are established.

The tax authority will be entitled to audit tax advisors to review the compliance with the obligations related to the disclosure of reportable schemes. In addition, it is established that disclosure of reportable schemes shall not constitute a violation of professional secrecy.

Non-compliance with reporting obligations will result in the commission of an infraction sanctioned with fines for up to \$20,000,000 pesos for tax advisors and between \$50,000.00 to \$2 million pesos for taxpayers.

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Tax

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