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Tax Practice Group Newsletter

Tax Reform 2020

On December 9, 2019, the Decree that amends, modifies and repeals provisions of the Income Tax Law, the Value Added Tax Law, the Excise Tax Law and the Federal Tax Code was published in the Federal Official Gazette.

The amendments published and generally enforceable as of January 1, 2020, have as their main objective to incorporate into Mexican tax law the recommendations issued by the Organization for Economic Cooperation and Development (OECD) in the BEPS Project, with the purpose of tackling tax avoidance and evasion at an international level.

In addition, the tax reform seeks to establish a new regulatory framework to reinforce the ability of the tax authority to prevent tax evasion that results from aggressive tax planning, use of fraudulent invoices and outsourcing.

Finally, the reform sets forth a new tax regime applicable to the digital economy in Mexico, by including measures to tax those who perform activities in Mexico through technological platforms and digital applications, particularly those who operate from abroad.

The most important amendments of this Tax Bill are described below.

Abbreviations

BEPS: Base Erosion and Profit Shifting

CFDI: Digital Invoices

Comments: OECD Commentaries on the 2017 Model Tax Convention

FLL: Federal Labor Law

FTC: Federal Tax Code

ITL: Mexican Income Tax Law

MLI: Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

Model: 2017 OECD Model Tax Convention on Income and on Capital

OECD: Organization for Economic Co-operation and Development

PE: Permanent Establishment

REFIPRES: Preferential Tax Regimes

RFC: Federal Taxpayers Registry

SAT: Tax Administration Service

SHCP: Ministry of Finance and Public Credit

VAT: Value Added Tax

VATL: Value Added Tax Law

Permanent Establishment

Following the recommendations of Action 7 of BEPS, which were adopted by Mexico as signatory to the MLI, the definition of PE is updated to include additional cases in which a foreign resident will be deemed to have a PE in Mexico, as well as to limit the applicable exceptions to such cases.

Agency PE: Dependent Agent

The ITL already established that foreign residents would constitute a PE in Mexico when they act in the country through a dependent agent that concludes contracts in their name or on their behalf.

However, it is now also established that a dependent agent will trigger a PE in Mexico for the foreign resident if such agent concludes contracts, or habitually performs the main role that leads to the conclusion of contracts by the foreign resident, and they:

- are entered into in the name or on behalf of the foreign resident;
- relate to the transfer of ownership of, or grant the temporary use of property owned or temporarily under the use and control of the foreign resident; or
- bind the foreign resident to perform a service.

Before the tax reform, in order for a foreign resident to trigger a PE in Mexico it was required that the dependent agent through which it was acting had the legal ability to execute contracts in its name or on its behalf. However, it will now be sufficient that the dependent agent concludes or habitually performs the main role leading to the conclusion of such contracts, which does not necessarily require that such agent holds a power of attorney from the foreign resident.

The purpose of this amendment is to tackle tax schemes through which a dependent agent habitually negotiated contracts that benefited a foreign resident but such activity did not amount to a PE by itself because the dependent agent did not conclude or execute such contracts though a power of attorney formally granted by the foreign resident.

Important new terms are included in the ITL, such as the "conclusion of contracts" and "performing a main role" that leads to the conclusion of contracts in an "habitual" manner.

The scope of such terms is analyzed in the Commentaries, which already incorporate the recommendations of Action 7 of BEPS. However, the ITL reform does not establish the specific scope of such concepts, which suggests that the Commentaries could be relevant to interpret them. How these concepts are interpreted by authorities and courts will have relevant tax implications.

Agency PE: Independent Agent

The current ITL establishes how a foreign resident triggers a PE in Mexico by acting through an independent agent, i.e. when such agent does not act within the scope of its ordinary activities. However, before the tax reform, no specific parameters were in place to determine whether an agent was, in fact, independent.

Hereinafter, an agent will not be deemed to be independent when it acts "exclusively" or "almost exclusively" on behalf of a foreign resident who is its related party. This amendment seeks to combat tax schemes where taxpayers argued that an agent, through which they acted in another jurisdiction, is an independent agent without actually being so.

The scope of the terms acting "exclusively" or "almost exclusively" on behalf of a foreign resident, is also analyzed in the Commentaries. The Commentaries establish as a general parameter that, in order to conclude that an agent does not act "exclusively" or "almost exclusively" on behalf of a foreign resident, at least 10% of the sales conducted by such agent should be carried out for companies that are not "closely related".

Notwithstanding the above, the ITL reform did not incorporate such parameter, which again suggests that the Commentaries could become relevant to determine the scope of such concepts.

Finally, unlike Action 7 of BEPS, where reference is made to acting "exclusively" or "almost exclusively" on behalf of one or more foreign residents who are "closely related" to the agent, the amended ITL replaces the "closely related" concept with a "related parties" concept. Such term was already defined in the ITL and results in a broader concept than that of "closely related" as defined in the Model.

Activities of a preparatory or auxiliary nature

The ITL already established a list of activities that constituted exceptions to the creation of a PE in Mexico by foreign residents, under the automatic assumption that these activities were of a preparatory or auxiliary nature.

However, such exceptions will no longer apply automatically, as the amended ITL sets forth that they will only be applicable when the activities conducted are truly of a preparatory or auxiliary nature.

Anti-fragmentation rule

Before the tax reform, the ITL did not provide an anti-fragmentation provision applicable to the exceptions of the creation of a PE in Mexico by foreign residents.

A new anti-fragmentation rule states that the exceptions established for preparatory and auxiliary activities in the amended ITL to the creation of a PE in Mexico will not be applicable if the foreign resident conducts activities in one or more places in Mexican territory, which activities form part of a comprehensive business operation of an already existing PE of such foreign resident or of a related party to such foreign resident. Similarly, these exceptions will also not be applicable if the foreign resident or a related party has a place of business in Mexico where activities that are ancillary to a comprehensive business operation are carried on and such activities are not , considered as a whole, of a preparatory or auxiliary nature.

The foregoing is aimed to address PE avoidance by foreign residents, either on their own or in conjunction with related parties, through the fragmentation of activities which, on their own, could be characterized as having a preparatory or auxiliary nature, but when considered as whole no longer are of such preparatory or auxiliary nature and consequently would amount to a PE.

In this case, the tax reform also refers to the term "related parties", which is already established in the ITL and has a broader reach than the concept of "closely related" used in Action 7 of BEPS and defined in the Model.

Additional comments

The ITL reform seeks to tackle PE avoidance abuses by foreign residents. The inclusion of this amendment was also necessary to secure the validity of (i) amendments made to Mexico´s Tax Treaties , including those provisions adopted to broaden the cases where a PE would exist in Mexico, and (ii) the ratification of the MLI by Mexico.

Notably, in the MLI context, since there is no minimum standard for its adoption and not all signatories have adopted the totality of the recommendations of BEPS Action 7 relating to new PE cases, failure to enact domestic legislation could have left areas of opportunity for foreign residents to apply treaty benefits with the objective of avoiding triggering a PE in Mexico.

Income derived by transparent foreign entities and foreign legal vehicles

Foreign transparent (pass through) entities and foreign legal figures receiving Mexican source income must now in certain scenarios determine their own tax result, as taxpaying corporate entities separate from their members, partners, shareholder or beneficiaries, and be subject to income tax in Mexico according to the rules set forth in the ITL. This is true even if such income is considered as taxable income of their members, partners, shareholders or beneficiaries in the country of residence of such entities and legal figures.

In addition, foreign pass through entities and foreign legal figures shall be considered Mexico tax residents when the location of the principal administration of their business or the headquarters of their effective management, is in Mexico.

Determining whether a foreign vehicle has legal personality will continue to be critical to determine its tax treatment. The Tax Reform sets forth the following classifications:

» *Foreign entities:* legal entities incorporated according to Mexican law that are foreign residents, as well as legal entities incorporated according to foreign law, provided that they have a legal personality.

» *Foreign legal figures:* trusts, associations, investment funds and any other legal agreement or vehicle incorporated under foreign law that does not have legal personality.

In addition, foreign entities and legal figures shall be considered pass-through for tax purposes provided that the two following requirements are met:

» they are not tax residents for income tax purposes neither in the country or jurisdiction where they have been incorporated nor in the country or jurisdiction where they have established the principal administration of their business or of their effective management; and

» their income is automatically attributable to their partners, members, shareholders or beneficiaries.

Finally, the ITL recognizes the hierarchy of tax treaties over Mexican federal legal provisions and confirms the Mexican tax policy of non-recognition of pass-through entities or vehicles, except for certain cases where Mexico has negotiated specific positions in bilateral agreements with other countries.

Tax Incentive for Privately Placed Investment Funds

The abovementioned amendments directly affect foreign investment funds that invest in Mexico through foreign tax transparent (pass through) vehicles[1] and that typically were exempted of Mexican income tax on specific items of Mexican source income. In the absence of a special tax incentive described below, under this new provision such investment funds would be treated as opaque foreign vehicles[2] potentially subject to Mexican tax withholding.

On this note, it is worth mentioning that the Tax Reform

1 Prior law set forth that, for foreign investment funds that operated through pass-through foreign legal figures, the investors thereof were directly taxed on income generated through such funds and as such would pay income tax according to their applicable particular tax regime. As such, investors who had beneficial tax treatment could invest through such legal figures and still enjoy such beneficial treatment (for example, pension and retirement funds are exempt from income tax in Mexico).

2 In other words, tax treatment of an investment fund set up as a foreign legal figure would be the same as that of a foreign entity, i.e. it would be subject to tax as a separate taxpayer.

was justified based on the need to simplify and control income tax payment in Mexico by concentrating tax payment obligations on one party, that is, focusing on the entity or vehicle receiving the income and not on each of its members that were the beneficial owners of such income. However, the initial proposal of reform did not take into consideration that the outright implementation of such rules could result in serious adverse consequences for investors that use transparent foreign vehicles to invest and operate in Mexico.

For this reason, the initial proposal was supplemented to provide a tax incentive for pass-through foreign legal figures that manage private equity investments in Mexico through Mexican domestic entities. Pursuant to this incentive, under the approved reform, the partners and investors of such legal figures will be taxed directly according to their respective tax regime, provided that the income derived through such legal figures consists of interest, dividends, capital gains or real estate leasing income.

In order to apply the abovementioned tax incentive, the interested party must comply with the following requirements:

» each year file a registry of all partners or members investing in the fund, providing documentation to reflect their tax residency; [3]

» the vehicle must be incorporated in a country or jurisdiction with a 'broad exchange of information' agreement in force with Mexico;

» members and managers of the vehicle must be tax residents of a country or jurisdiction with a broad exchange of information agreement in force with Mexico;

» members and managers of the investment fund must be the beneficial owners of income derived through such fund;

» when income is attributed to members of the fund who are foreign tax residents, such members must accrue the income in their country of residence;[4]

» when income is attributed to members who are Mexico tax residents or foreign residents with a Mexico PE, such members must accrue their allocable income in Mexico in the year in which the income is accrued.[5]

If the above-mentioned requirements are not complied with, the investment fund will not be considered pass-through in the proportion in which such requirements are not met, and will be treated as partially or fully non-transparent.

Since the amendment regarding the new rules for foreign entities and legal figures with Mexican source income will enter into force on January 1, 2021, investment funds will have a year to implement the necessary measures to comply with the abovementioned requirements and be able to apply this tax incentive. Thus, filing of the yearly registry of its members' obligation for fiscal year 2021 shall be complied with as from February 2022.

While the amendment results in new administrative burdens that could represent additional costs for investment funds, having the ITL recognize them as pass-through vehicles through the aforementioned incentive leaves investment funds in a better position than the original bill proposal, which would have resulted in a more adverse economic impact for such investors.

In particular, if the initial proposal had been approved without the abovementioned incentive, the increased tax burden for certain investors such as: (i) pension and retirement investment funds that are exempted from income tax in Mexico, (ii) multilateral organizations exempted from income tax that invest in private equity funds and (iii) those who would have been unable to take a foreign tax credit for the income tax paid in Mexico; would have resulted in a significant decrease of investments in Mexico by such investors, which in turn would have been very detrimental to the Mexican economy.

Finally, it is worth noting that new compliance obligations imposed on investment funds will result in the SAT having the investors' information, which could be exchanged with other countries to enforce due compliance with tax obligations.

Income derived by Mexico tax residents through foreign transparent entities and foreign legal figures

Prior to the Tax Reform, income derived by Mexico tax residents through foreign entities or legal figures was regulated under the REFIPRES regime and its corresponding regulations.

The new tax law will now differentiate between income derived through foreign pass-through entities and legal figures and income obtained through foreign non-transparent entities. Only income derived through foreign non-transparent entities will remain being subject to the REFIPRES regime.

Consequently, under the amended ITL, Mexico tax residents who derive income through foreign pass-through entities and foreign legal figures, will not be subject to the REFIPRES regime but, on the contrary, shall directly recognize such income under the rules of the newly enacted Article 4-B.

3 If a member is an international organism (such as the International Monetary Fund) or a pension and retirement fund, the international organization formation deed can be provided instead.

4 Income exempted from income tax must also be accrued; however, such mechanism should not result in exempt income being considered taxable income.

5 The ITL sets forth that members who are Mexican tax residents or foreign residents with a Mexico PE shall accrue such income according to the new rules set forth for foreign entities and vehicles, or according to the REFIPRE regime.

Article 4-B now limits the ability of Mexican tax residents to defer payment of income tax on the income derived through foreign pass-through entities and legal figures by taking the position that one of the REFIPRES regime exceptions, particularly the 'lack of control' exception pursuant to which said taxpayer did not have control over the timing and manner of the distributions of dividends or profits obtained by the foreign pass-through entities or foreign legal figure, applied to them. As such, under the new provisions, income derived from foreign pass-through entities or foreign legal figures will be automatically and immediately considered taxable income, regardless of whether such entities or legal figures make distributions or whether their members, partners, shareholders or beneficiaries have control over such distributions.

Income accrual by Mexico tax residents for income derived through foreign pass-through entities or foreign vehicles, as well as for the payment of the corresponding income tax, will depend on the type of vehicle through which income was derived, as follows:

» *Pass-through entities:* income will be accrued and taxed on tax profit for the calendar year, according to the rules set forth for Mexican legal entities.

» *Pass-through legal figures:* income will be accrued in terms of the tax regime applicable to the taxpayer that has a participation in such vehicle and will be taxable in the calendar year in which the income is accrued, taking into account the tax deductions applicable for such legal figures.

» *Non-transparent[6] legal figures:* income will be accrued and taxed on the tax profit for the calendar year, according to the rules set forth for Mexican legal entities.

Income derived from foreign pass-through entities or pass-through vehicles shall be added to the other taxable income of the involved Mexico tax residents, according to their applicable tax regime, that is, as an entity or individual. The tax treatment provided by this amendment significantly differs with the REFIPRE regime that was previously applicable to income derived from such foreign entities and legal figures.

Taxes effectively paid in Mexico or abroad by the entity or legal figure can be credited against the income tax due by the underlying Mexican taxpayer.

New rules do not expressly provide for the calculation of the corresponding taxable profit in the foreign functional currency of the corresponding entity or legal figure, which could result in having to recognize foreign currency exchange gains or losses derived from foreign currency fluctuations, even if the taxpayer has a participation in a foreign entity or a non-transparent legal figure.

Finally, the new provisions still require the taxpayer to (i) keep a Net After-Tax Profits Account (CUFIN per its Spanish acronym) for each of the entities or legal figures in which they participate, as per the guidelines of the REFIPRE regime, for purposes of recording the amount of income that has already been taxed and that can be later distributed by the foreign entities and legal figures without triggering an additional tax, and (ii) to file the corresponding informative tax return.

Coordination with Controlled Foreign Entities Regime subject to REFIPRES

The abovementioned rules shall be applicable if a Mexico tax resident holds a direct participation in the foreign pass-through entity or foreign legal figure, or holds an indirect participation that exclusively involves other foreign pass-through legal entities or foreign legal figures. However, if the indirect participation of the Mexico tax resident involves at least one non-transparent foreign entity, the REFIPRES regime rules will apply instead for income derived through such entity.

Controlled Foreign Entities subject to REFIPRES

The Tax Reform includes new rules for income derived by Mexico tax residents and foreign residents with a PE in Mexico that is subject to the REFIPRES regime. Such regime should now apply only to income derived by controlled foreign entities that are not transparent and in which they hold a participation that is subject to REFIPRES. As a result, this regime will no longer be applicable to income derived from foreign pass-through entities and foreign legal figures because, as was previously mentioned, these will be subject to the new tax regime set forth under Article 4-B.

For such purposes, income is considered to be subject to a REFIPRE (or preferential tax regime) when it is not taxed or is subject to a tax that is less than 75% of the income tax that would be paid in Mexico.

However, in order to determine if said income is subject to a preferential tax regime, it will now be necessary to consider the income tax that would have been paid in Mexico by applying the tax rate corresponding to Mexican individuals or entities, as the case may be. The latter is in contrast with the tax regime applicable prior to the 2020 tax reform, which indicated that the basis for this 75% calculation was the 30% corporate tax rate, regardless of whether the Mexican tax resident that participated in the foreign vehicle was an individual or a corporate body.

Pursuant to the above, determine if income derived from foreign entities is subject to a preferential tax

6 Vehicles that are considered as taxpayers on their own in the country in which they were incorporated or formed.

regime, the new rule sets forth that the tax rates that should be considered for the calculation are the following:

	Legal entities	Individuals
Mexican income tax rate	30%	35%
75% of the applicable income tax rate in Mexico	22.5%	26.25%

After the reform, the only exceptions to the REFIPRE regime that remain are the active business exception and the lack of effective control exception. Below a brief description of such exceptions:

» Active business exception: The REFIPRES regime will not apply to income derived through foreign entities subject to a preferential tax regime that carry on an active trade or business, provided that any passive income derived by such entity does not represent more than 20% of the foreign entity's total income.

This exception will not be applicable in cases where more than 50% of the income derived by the foreign entity is Mexican source income or represents a direct or indirect deduction in Mexico.

» Lack of effective control exception: The REFIPRES regime will not apply to income derived through foreign entities subject to a preferential tax regime where Mexico tax residents do not exercise effective control over the entities in which they hold an interest.

However, with the amendments in comment, the scope of the definition of effective control is significantly broadened by adding several legal hypothesis where a Mexico tax resident shall be deemed to have control. Below a brief description of such new hypothesis:

i. The average daily participation of the taxpayer in the foreign entity (i) represents more than 50% of the total voting rights, (ii) represents more than 50% of the value of the entity's shares, or (iii) grants veto rights or requires its affirmative vote for the decisions of the entity.

ii. Pursuant to any agreement or security other than stock, the taxpayer is entitled to more than 50% of the assets or profits of the foreign entity in the event of any type of capital redemption or liquidation, at any time during the calendar year.

iii. If the percentages set forth in the scenarios of sections a) and b) above are not met individually, both scenarios should be jointly considered in order to determine the 50% of the referenced rights.

iv. The taxpayer and the foreign entity consolidate their financial statements based on the applicable accounting standards.

v. When considering the facts and circumstances, or any type of agreement or applicable financial instrument, the taxpayer has the right, directly or indirectly, to unilaterally determine the resolutions of the meetings or the management decisions of the foreign entity, including through an intermediary.

The foregoing will be applicable to both direct and indirect participations in a foreign entity. In addition, in the case of multi-tier structures, the amended definition of effective control for REFIPREs provides that the taxpayer shall be deemed to have effective control in the following scenarios:

i. When the taxpayer has a direct or indirect right to exercise more than 50% of the total vote or share value of each of the intermediate foreign entities that separate such taxpayer from the foreign entity;

ii. When the taxpayer has the right, directly or indirectly, to more than 50% of the assets or profits of each of the intermediate entities that separate such taxpayer from the foreign entity in the event of any type of capital redemption or liquidation.

iii. If the percentages set forth in the scenarios of sections a) and b) above are not met individually, both scenarios should be jointly considered in order to determine the 50% of the rights.

Taxpayers shall determine their taxable income according to how their effective control over the foreign entity was determined, pursuant to the following:

» If the existence of effective control was determined pursuant to subsections "i" above, the taxpayer's direct or indirect average daily participation in the foreign entity during the taxable year shall be considered.

» In the case of having effective control pursuant to subsections "ii" above, the percentage of control that the taxpayer has over the assets and profits of the foreign entity shall be considered in the event of a capital redemption or liquidation. If the percentage fluctuates during the year, the highest percentage shall be considered.

» When the existence of effective control is determined pursuant to subsections "iii" above, the taxpayer's participation shall be considered based on the two previous rules.

» In cases in which effective control derives from subsection "iv" above, the controlling participation shall be considered in accordance with the applicable accounting standards.

- When effective control derives from subsection "v" above, the taxpayer's daily average participation in the foreign entity in the taxable year and the percentage of control that the taxpayer has over the assets and profits of the foreign entity in the event of any type of capital redemption or liquidation due to an agreement or security other than shares shall be considered.
- Finally, in the event of having control in accordance with subsections "i" or "ii" above, taxpayers must add up their indirect participations, even if any of them on its own does not result in having effective control.

Income subject to REFIPRES will continue to be taxed in the year in which it is accrued, 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 profit of the entity will be determined according to the rules applicable to Mexican legal entities. However, the applicable income tax rate will be the one corresponding to the Mexican tax resident, as an individual or an entity.

Additionally, the Tax Reform allows assessment of income tax on a consolidated basis whenever Mexico tax residents elect to consolidate income from multi-tier structures subject to REFIPRES.

Finally, amendments to applicable to provisions of REFIPRES reference general foreign tax credit rules for income taxes paid abroad, it is possible that the authorities consider that this cross-reference limits available foreign tax credits to the taxes paid by second-tier level entities . The latter would be in contrast with the tax credit rule in force before the reform, which did not set forth a limit on the corporate levels for which the foreign tax credit was allowed.

Deduction of payments and crediting of foreign taxes (tackling hybrid mismatch arrangements)

Following BEPS Action 2 recommendations, several provisions of the ITL were amended with the purpose of tackling the erosion of the taxable basis derived from the abusive use of hybrid[7] mismatch arrangements by Mexican tax residents.

In general terms, this amendment aims to prevent Mexican taxpayers from:

- Deducting payments made to foreign related parties that are not subject to taxation abroad (deduction and non-inclusion);
- Deducting payments that are considered as deductible for the taxpayer or its related parties abroad (double deduction);
- Getting direct foreign tax credits for taxes paid abroad that are also credited in another country (double direct credit); and
- Getting indirect foreign tax credits for taxes paid abroad, when distributed dividends or profits are also deductible for the distributing foreign resident (abusive indirect credit).

Deduction and non-inclusion

Before the Tax Reform, payments subject to REFIPRES would not be deductible unless such payments were agreed to at arm's length.

In addition, the 2014 Tax Reform had already established a limit to the deductibility of payments made to a foreign entity that controlled or was controlled by the taxpayer for royalties, technical assistance and interest, when:

- The foreign legal entity was considered pass-through for tax purposes (except in the case where the shareholder, member or partner was subject to income tax for income derived through such foreign entity);
- Payment was considered as non-existent for the residence country of the foreign entity; or
- Payment was not considered as taxable income in the residence country of the foreign entity.

Treasury Regulations established that if a payment was considered as non-existent or was not considered as taxable income in the country of residence of the foreign entity that received it, such limit would not be applicable in the proportion in which income of the Mexico tax resident was considered as taxable income for the foreign legal entity in the same fiscal year or the following year.[8]

Thus, payments made to related parties subject to REFIPRES would generally be deductible if they were agreed to at arm's length except in the case of royalties, technical assistance and interest, whose deduction was additionally limited as per the rules mentioned above. This illustrates the efforts made by Mexican tax authorities, inspired in the then unfinished BEPS project, aimed to limit payments that have different tax treatments in different jurisdictions; that is, payments through hybrid mismatch arrangements.

The Tax Reform eliminates the prior provision that limited the deductibility of payments of royalties, technical assistance and interest, and modifies the provision that limits payments made to related parties subject to REFIPRES. These cases of non-deductibility of payments of royalties, technical assistance and interest are no longer be applicable as of January 1st, 2020.

7 Hybrid mismatch arrangements are those where domestic and foreign tax legislation characterize a legal entity, legal vehicle, income, owner of an asset or a payment differently, resulting in a deduction in Mexico and part of the totality of the income not being taxed abroad.

8 Rule 3.3.1.30 of the Treasury Regulations in force during 2019.

On the other hand, while deductibility of payments made to related parties subject to REFIPRES was restricted unless they were agreed to at arm's length, the reform extends significantly this limitation to any payments made abroad in certain cases. As a result, taxpayers will have to conduct a case by case analysis of payments made abroad in order to determine whether this new rule will effectively limit or not their deductibility.

The amended ITL sets forth that payments made abroad will no longer be deductible in the following cases:

i. Limitation to direct payments. If the recipient of the payment is subject to REFIPRES, payment will not be deductible in the following scenarios: (i) payments are made to related parties, or (ii) payments are made through a "structured arrangement"[9]; and

ii. Limitation to indirect payments. If the recipient of the payment ("first payment") is not subject to REFIPRES, such payment will not be deductible if the direct or indirect recipient of the payment uses the proceeds to conduct other deductible payments ("second payment"): (i) to another "member of the group[10]" that is subject to REFIPRES; or (ii) through a "structured arrangement" and that payment is income subject to REFIPRES[11].

iii. Hybrid arrangements. Payments deemed to be income subject to REFIPRES by virtue of the use of a hybrid arrangement.

The amendment established several exceptions to the application of the limit to payments mentioned above, as follows:

» Business activities exception

There is an exception for payments referred to in items (i) and (ii) above, under which the deduction limitation will not be applicable to payments which, even if subject to REFIPRES, derive from business activities performed by the recipient of the payment, to the extent that the recipients can prove they have the necessary assets and personnel to perform such activities (substance of the material performance of activities).

Where the payment is attributed to a PE or branch of a "member of the group", or by virtue of a "structured arrangement", the business activities exception will only apply if such payment is taxed to the recipient of such payment either where the PE or branch is located, or in its country of residence.

» Foreign Branch Exception

In addition, an exception for payments referred to in item (iii) above was established. Under this exception, the deduction limitation will not be applicable to payments, even if made through a "hybrid mechanism", to the extent that the legislation of the country of residence of the members, partners or shareholders of the taxpayer that receives the payment considers said payment to be disregarded or non-taxed, because the Mexican taxpayer is deemed pass-through in terms of said foreign legislation[12]. This exception will only be applicable if the following requirements are met:

◇ The recipient of the payment accrues the income derived by the taxpayer in proportion to its participation in the capital or equity of the taxpayer, and to the extent that said income is not subject to REFIPRES; and

◇ The amount paid by the taxpayer does not exceed the total taxable income of its recipient. Any excess payment not accrued as taxable income by the recipient will not be deductible. For this purpose, the SAT will issue general rules to allow the deduction of payments made in excess, when said excess is triggered by the disparity in the moment of accrual of income between the taxpayer and its members, partners or shareholders.

The purpose of this exception is to recognize the effects of the U.S. check-the-box rules, under which members, partners or shareholders of non-U.S. entities (i.e., a Mexico tax resident entity) can elect to treat said entity as a foreign branch for U.S. tax purposes.

» Tax Regime Exception

Finally, a general exception is established, applicable to the non-deductibility cases described in items (i), (ii) and (iii), above. Through this exception, payments will be deductible in the same proportion in which they are indirectly taxed, in any of the following cases:

◇ Payments derived through foreign pass-through entities and foreign vehicles that are accrued in Mexico.

◇ Payments derived through controlled foreign entities subject to the REFIPRES regime that are accrued in Mexico;

◇ By the application of provisions similar to the two mentioned above, which are established

9 Any arrangement or agreement entered into by the taxpayer or its related parties, when consideration is agreed upon payments that are subject to REFIPRES that benefit the taxpayer or its related parties or, when based on the facts and circumstances, it can be concluded that the arrangement was made for such purposes.

10 Members are considered as being part of the same group when one member has "effective control" over another, or when a third member has "effective control" over both of them. Said definition refers to the new definition of "effective control" established in the amended ITL.

11 For these purposes, it would not be relevant that the second payment is made before the first payment. This means that the deduction of the first payment can be denied even if the recipient made the second payment before the taxpayer conducts the first payment. In addition, the ITL provides a rebuttable presumption that consists in deeming the second payment subject to REFIPRES if such payment is equal or 20% higher than the first payment, unless the taxpayer can prove otherwise, and if not re-butted, then the first payment will not be deductible in an amount equal to the second payment.

12 This exception was already in place, with some differences, in the context of now abolished section XXXI (limit to the deductibility of royalties, technical assistance and interests) of the ITL, through rule 3.3.1.30 of the Treasury Regulations in force during 2019.

in foreign tax legislation, in terms of the general rules to be issued by the SAT; and

- Payments subject to the special 40% withholding tax rate, set forth in the ITL for income derived by foreign tax residents subject to REFIPRES.

The tax regime exception seeks to avoid the possible double taxation that could result from a parallel application of the abovementioned tax rules and the non-deductibility cases established in items (i), (ii) and (iii) described in this section.

Double deduction

As of the 2014 Tax Reform, payments made by taxpayers to Mexican or foreign related parties would not be deductible when such payments were also deductible for such related parties, except when the related party that received the payment also accrued the income accrued by the taxpayer within the same or the following fiscal year.

The amendment to ITL substantially modifies this limit, and includes additional cases in which the deduction of such payments will be limited.

The amended ITL sets forth that payments that are deductible for both payer and recipient will not be deductible in the following cases:

- Payments made by Mexican taxpayers when they are also deductible for another member of the group, or for the same taxpayer in a foreign country in which the taxpayer is also considered a tax resident; as well as payments made by a PE in Mexico of a foreign tax resident, when they are also deductible for the foreign tax resident in its country of residence.

Notwithstanding the above, these payments shall continue to be deductible for taxpayers when:

i. Recipient of the payment deducted by the taxpayer is a member of the group, or a foreign tax resident, that accrues income derived by the taxpayer on the proportion of its participation in its capital or equity;

ii. The taxpayer who is also considered a tax resident of a foreign country accrues in such foreign country the income derived from the deductible payment; and

iii. Total amount of the payments made by the taxpayer does not exceed taxable income accrued by the recipient of the payment or by the same taxpayer, as any excess will not be deductible. Again, the SAT will issue general rules to allow the deduction of excess payments, when said excess is triggered by the disparity at the moment of accrual of income.

Double direct credit and abusive indirect credit

Finally, aiming to tackle abusive crediting of foreign-paid taxes by the use of hybrid arrangements, the Tax Reform now includes a new limit to general rules of foreign tax credits, denying foreign tax credits in the following cases:

- Direct tax credit of foreign-paid taxes, when said taxes have also been credited in another country or jurisdiction, by means other than an indirect tax credit, except in the case where the income that resulted in the payment of foreign taxes was also accrued in the country or jurisdiction in which it was credited.
- Indirect tax credit of foreign taxes paid at the corporate level, when the dividend or profit distribution made by a foreign tax resident results in a deduction or reduction for such foreign tax resident.

Net interest deduction limitation

Following the recommendations of BEPS Action 4, and aiming to avoid abusive tax schemes that made use of debt and the deduction of interest, the new amendment includes a limit to the deduction of net interest that exceeds 30% of the “adjusted tax profit” of the fiscal year.

For these purposes, “net interest” is the interest expense, less taxable interest income and less the “applicable threshold” (as such concept is below described). Any “carryover interest” (as such concept is below described) should also be added to the net interest of the relevant year.

“Adjusted tax profit” is the fiscal year’s tax profit, plus interest expenses, depreciations, amortizations and preoperative expenses from such fiscal year.

As such, calculation of the net interest amount whose deduction is disallowed would be as follows:

	Tax profit
(+)	Interest expenses
(+)	Depreciations and amortizations
(=)	**Adjusted tax profit**

	Adjusted tax profit
(x)	30%
(=)	**Net interest deduction limit**

	Interest expenses
(-)	Interest taxable income
(-)	Applicable threshold
(+)	Carryover interest
(=)	**Net interest**

	Net interest
(-)	Net interest deduction limit
(=)	**Non-deductible net interest**

If this rule results in a non-deductible net interest, the taxpayer can carryover such amount for the following 10 fiscal years ("carryover interest"). In that case, the carryover interest (namely the interest that was not deducted in the fiscal year it was accrued), should be added to the net interest of the relevant fiscal year.

The net interest deduction limitation will not be applicable to interest that does not exceed 20 million pesos ("applicable threshold"). Groups of entities must compute the applicable threshold collectively, by attributing the 20 million pesos among them, based on their individual share in the group's total taxable income corresponding to the prior fiscal year.

In addition, the net interest deduction limitation will not be applicable to the following cases:

» When the application of thin capitalization rules results in a greater interest deduction limit;

» Interest is derived from debt negotiated for financing public infrastructure or infrastructure construction work in Mexico;

» Interest derived from financing oil and gas, hydrocarbons or other energy projects;

» Yields derived from public debt; and

» Interest accrued by State productive companies (empresas productivas del Estado) or by members of the financial system in the ordinary course of their activities.

» The following rules apply to the net interest deduction limit:

» Accrued interest only includes deductible interest;

» Taxable interest income only includes taxed interest;

» Adjusted tax profit and interest taxable income arising from abroad[13] shall be included in the proportion that it is taxed in Mexico, after crediting foreign paid taxes;

» Interest taxable income and interest deduction for controlled foreign entities subject to REFIPRES should not be included; and

» Exchange gains and losses accrued from foreign-currency fluctuations should not be considered as interest.

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 the internet through technological platforms or digital applications.

Those who, directly or indirectly, provide the use of technological platforms or digital applications, and act as intermediaries between individuals and final consumers of goods and services, must withhold a percentage of the income derived by such individuals for the activities performed through such platforms or applications and pay it to SAT as an advance income tax payment on behalf of the individuals.

Such withholding should be done over total effectively derived income, without including VAT. The percentage of such withholding will vary, depending on the activity performed through the platform or application, according to the following rules[14]:

» Passenger ground transportation and delivery of goods and services:

Monthly income	Withholding rate
Up to $5,500	2%
Up to $15,000	3%
Up to $21,000	4%
More than $21,000	8%

» Lodging services:

Monthly income	Withholding rate
Up to $5,500	2%
Up to $15,000	3%
Up to $35,000	5%
More than $35,000	10%

» Disposition of goods and provision of services:

Monthly income	Withholding rate
Up to $1,500	0.4%
Up to $5,000	0.5%
Up to $10,000	0.9%
Up to $25,000	1.1%
Up to $100,000	2.0%
More than $500,000	5.4%

Since the withholding is considered as an anticipated income tax payment, individuals should credit the amounts withheld against their payable income tax in their corresponding income tax return.

This new regime sets forth several tax obligations for those who provide the use of said technological platforms or digital applications, such as the following:

» Foreign tax residents with no PE in Mexico must comply with VATL tax obligations;

» Issue the corresponding withholding tax receipt (CFDI) to individuals from whom they withheld;

13 That is, interest paid by a foreign tax resident with no PE in Mexico over loans granted abroad.

14 The amounts must be annually indexed.

- Provide to the SAT the individual's information required by the VATL;
- Withhold and pay to the SAT, according to the applicable rates, no later than on the 17th day of the month immediately following that in which the withholding was made;
- In the case of individuals that do not provide their RFC, a general 20% withholding rate should be applied over derived income; and
- Keep accounting records pertaining to the withholding and payment of the corresponding income tax.

The new tax regime applicable to technological platforms and digital applications, as well as the abovementioned tax obligations, will enter into force on June 1st, 2020. The SAT will issue general rules that will apply to this new regime on January 31st, 2020, at the latest.

The foregoing means that technological platforms and digital applications will have a five-month grace period to make the necessary adjustments to comply with these new tax obligations.

Entities operating through an IMMEX maquila program under the shelter modality

The applicable tax regime for entities in the IMMEX maquila program under the shelter modality, as well as for foreign residents that perform maquila operations through shelters, is modified.

In this regard, the four-year period under which foreign residents could operate through shelters without triggering a PE in Mexico is repealed. Thus, hereinafter, foreign residents will no longer trigger a PE while operating through shelters, regardless of the time during which they operate under the shelter modality, provided that they are tax residents of a country having a broad exchange of information agreement in force with Mexico.

However, the foreign residents will now be obliged to comply with several Mexican tax obligations through the Mexican shelters. Some of these obligations are the following:

- Register in the Federal Taxpayers' Registry (RFC);
- File monthly estimated income tax returns and yearly income tax returns;
- File an annual informative tax return before the SAT related to their maquila operations by June of the following year;
- File a notice before the SAT when they stop performing maquila operations through shelters, within the following month.

It is important to mention that, hereinafter, Mexican shelters must identify the operations performed by each foreign resident and determine the taxable profit corresponding to each of them, through the application of safe harbor rules set forth in the ITL, or by obtaining an advanced pricing agreement (APA) before the SAT. The taxable profit calculated for each foreign resident will be subject to the 30% corporate income tax rate applicable to Mexican entities.

The abovementioned is relevant since, before the Tax Reform, Mexican shelters were not obliged: (i) to differentiate between the operations performed by each of the foreign residents that operated through them, or (ii) to determine the taxable profit corresponding to each of the foreign residents according to special rules. This is because the shelters were considered service providers and as such they would only determine their own taxable profit according to the general rules applicable to Mexican legal entities.

As a consequence, foreign residents that perform operations through Mexican shelters will now be subject to a tax regime similar to that applicable to Mexican legal entities that perform maquila operations.

Finally, foreign residents will not be able to dispose of products manufactured in Mexico through shelters, unless such manufactured products are physically or virtually exported. Similarly, foreign residents will not be able to transfer their assets or assets of their related parties or foreign clients to Mexican shelters, before or during the time in which they perform maquila operations through such shelters.

Elimination of Private REITS

The tax incentive granted to Real Estate Investment Trusts (REITS), 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 until such real estate or the corresponding participation certificates are transferred, as it formerly happened. Likewise, the exemption from filing monthly estimated income tax returns for income derived from such vehicles is eliminated.

According to the bill's explanatory memorandum, such measure was necessary since the lack of regulation for private REITS has led to abusive use of such vehicles by family investment portfolios who differ payment of taxes and obstruct tax authorities' audit of such operations, without authentically contributing to the development of the real estate market.

For such purposes, transitory 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 capital gains derived from the transfer of the real estate property contributed to such vehicles that has not been previously accrued.

Reporting obligations for Public REITS

The reform includes in the statute itself the reporting obligations for Public REITS that were previously established in the Treasury Regulations in the ITL.

Thus, Trustees will continue filing, before February 15 of each year, the necessary information to identify: (i) its beneficiaries, (ii) real estate property contribution and transfer operations, and (iii) participation certificate issuance.

This amendment was made with the purpose of bringing legal certainty to taxpayers, in addition to allowing continued identification of the beneficiaries of such tax incentive, as well as of the assets that form part of the REITS.

Value Added Tax Law

Provision of digital services in Mexico by foreign residents

Foreign residents providing digital services to recipients in Mexico

A new tax regime applicable to foreign residents that provide digital services to recipients located in Mexico is created. Hereinafter, foreign residents that provide digital services in Mexico must calculate and pay 16% VAT on a monthly basis for the consideration received for their activities.

Digital services are defined as services provided by foreign residents through digital applications or digital content through the internet, specifically:

- Downloading or accessing images, movies, text, information, videos, audio, music and games, among others;
- Intermediation between third parties who offer goods or services and consumers of such goods and services;
- Online clubs and dating sites; and
- Remote learning services, exercises and tests.

The recipient of the service shall be considered to be in Mexico when the recipient:

- Establishes as his domicile in the platform, a domicile located in Mexico;
- Pays the service provider through a Mexican financial intermediary;
- Uses in his electronic devices an IP address whose range of addresses pertains to Mexico; or
- Registers a number with Mexico's country code.

Foreign residents that provide the abovementioned services in Mexico must comply with the following tax obligations:

- Register in the Federal Taxpayers' Registry. For these purposes, the SAT will publish a list of registered foreign residents;
- Offer and charge, in conjunction with the price for their services, the corresponding VAT, expressly and separately;
- Inform the SAT of the number of services or operations performed each month with recipients located in Mexico, on a quarterly basis;
- Calculate and pay the 16% VAT rate corresponding to digital services performed in Mexico;
- Issue and electronically send to recipients of digital services, CFDIs that expressly and separately include VAT;
- Appoint a legal representative before SAT and provide a domicile in Mexico for Mexican tax authorities to send notices and audit compliance with their tax obligations; and
- Obtain an advanced electronic signature.

For these purposes, a provision is included that sets forth that foreign residents who register in the RFC and comply with the other tax obligations described above will not trigger a PE in Mexico.

When services include both digital and non-digital services, VAT shall be calculated by applying the 16% tax rate exclusively to digital services. The foregoing applies as long as the corresponding CFDI differentiates between each of the services provided and the consideration paid for each of them. If the CFDI does not include the required differentiation, then 70% of the consideration shall be considered as paid for digital services.

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

Similarly, 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 by third parties.

Hereinafter, foreign residents that collect consideration and applicable VAT 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. When individuals do not so provide, VAT withholding will occur for 100% of the VAT.

In addition, foreign residents subject to this tax regime must comply with the following tax obligations:

- Publish on their online web page, technological platforms or digital applications, the corresponding VAT for the prices of each of the taxed activities they offer, in which they operate as an intermediary;

- Pay the corresponding VAT, at the latest, on the 17th day of the month following the withholding;
- Issue a CFDI of Withholding and Payment Information to each individual from who they withheld VAT;
- Register in the Federal Taxpayers' Registry as a withholder; and
- Provide a monthly list with the information on the recipients of their services[15] to SAT.

Enforceability of new tax regime for digital services

The abovementioned amendments will enter into force on June 1st, 2020. Additionally, the Tax Reform sets forth that SAT must issue the corresponding Treasury Regulations by January 31, 2020, at the latest.

Therefore, technological platforms and digital applications should generally have a five-month grace period to make the necessary adjustments to comply with their new obligations.

Tax withholding for subcontracting services

Legal entities and individuals with business activities that hire personnel subcontracting services must withhold and pay to the tax authority a VAT equal to 6% of the consideration effectively paid for such services.

For these purposes, taxpayers must consider as subcontracting services those where personnel is provided to perform activities in the payor taxpayer's facilities or in those of its related parties, or even outside of these facilities, whether or not such personnel works under the taxpayers' direction, supervision, coordination or dependency, and notwithstanding the name under which the contract is agreed on.

The ITL was also amended to add as a requirement for the deductibility of such payments for income tax purposes, the obligation to withhold and pay VAT.

It is important to mention that the obligation of VAT withholding, which was previously exclusive to payments of subcontracting services as such were defined under article 15-A of the FLL, is now required for any and all kinds of subcontracting services that fall under the mentioned new provision.

Finally, the amendment repealed VAT crediting and income tax deduction obligations that were previously in place for subcontracting services in terms of article 15-A of the FLL. Under the obligations previously in place, recipients of subcontracted services.

15 Technological platforms and digital applications that act as intermediaries for lodging service providers must provide information on the corresponding real estate property.

Federal Fiscal Code

General Anti-Avoidance Rule

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

Legal acts performed by taxpayers can now be re-characterized when they lack a business reason and were only performed seeking a tax benefit, either directly or indirectly. In this case, legal acts will be re-characterized as those that would have been performed to obtain the economic benefit that would have been reasonably expected by the taxpayer.

For these purposes, there is a presumption that there is no business reason whenever the economic benefit that can reasonably be expected is less than the tax benefit. Similarly, there is a presumption that a series of legal acts lack a business reason whenever the same economic benefit could have been obtained through the performance of fewer legal acts and the tax consequences of those fewer acts would have been greater.

The tax authority will only be able to consider legal acts as inexistent by initiating a tax audit to the involved taxpayer and disclosing the intent to apply such presumption of inexistence to the taxpayer in the last partial audit report or provisional resolution issued within such audit. The latter so that the involved taxpayers can present arguments in their defense, and produce the information and documentation deemed necessary to rebut such presumption.

Before issuing the corresponding resolution, the tax authority must present the case at hand to a collegiate body composed of public servants from SAT and the Ministry of Finance and Public Credit. Such collegiate organ must issue a favorable opinion for such presumption to proceed.

"Tax benefit" is defined as any reduction, elimination or temporary deferral of taxes.

Similarly, a "reasonably expected economic benefit" will be deemed to exist when the taxpayer's operations seek to derive income, reduce costs, increase the value of its assets, and improve its positioning in the market, among other benefits. To quantify the reasonably expected economic benefit, the information relating to the operation, including the projected economic benefit, will be considered, as long as such information has material support and is reasonable. Additionally, the term "business reason" will apply, independently of the legal provisions that regulate the reasonably expected economic benefit.

Finally, it is established that the application of this general anti-avoidance rule by tax authorities will never result in criminal penalties.

Measures to tackle the use of digital invoices for inexistent transactions

Several measures related to matters of racketeering, national security and forfeiture are implemented, in order to prevent and sanction the use of digital invoices that support inexistent or fraudulent transactions and sham acts that result in tax avoidance.

Pre-trial detention

Several crimes will now qualify as meriting official pre-trial detention and considered as threats to national security. As a result, whenever such crimes are committed, the presumptive guilty party will not be entitled to bail benefits. These crimes are as follows[16]:

- Contraband and equated contraband;
- Tax fraud and equated tax fraud; and
- Purchase and sale of CFDIs that support inexistent or fraudulent operations, as well as sham acts.

Organized Crime

Similarly, the amendment sets forth that organized crime shall be considered to occur whenever three or more individuals jointly commit the following crimes[17]:

- Tax fraud;
- Declaring false deductions or taxable income, or undervaluing acts or activities;
- Falsifying one or more legal acts, thereby obtaining an undue benefit that results in tax avoidance; and
- Purchase and sale of CFDIs that support inexistent or fraudulent operations, as well as sham acts.

For the sanctions of organized crime to be applicable, the defrauded amount must exceed $7,804,230.00 pesos.

Forfeiture

Finally, the amendment sets forth that whoever commits the above-mentioned crimes is subject to forfeiture.

During the process, assets owned by taxpayers may be seized, and funds, assets, accounts and other securities or financial assets may be temporarily and immediately frozen, if deemed to be linked to illegal acts. Seized assets may be auctioned and sold in advance, prior to the resolution of the corresponding proceeding, and the proceeds shall be deposited in a special account, where they shall be kept until the definitive resolution of the proceeding is issued.

The District Attorney's Office may start forfeiture proceedings through a civil-law proceeding. For such purposes, as long as there is a solid and reasonable standing that suggests the existence of illegally owned assets, the District Attorney will be able to exercise its powers to initiate forfeiture proceedings.

Temporary restriction on the use of digital seal certificates

The new law includes several novel situations in which the use of the digital seal certificates for invoicing can be temporarily restricted. In general, such cases refer to non-compliance with tax obligations by taxpayers.

Before digital seal certificates are nullified or cancelled, tax authorities may temporarily restrict their use whenever:

- They find that a taxpayer, during a fiscal year and being obliged to file it, fails to file its yearly tax return within the month following that in which the taxpayer was obliged to file, or two or more monthly or final tax returns, whether they are consecutive or not;
- During the administrative execution proceeding, they cannot find the taxpayer, or the taxpayer vanishes;
- During the course of an audit, a taxpayer cannot be found in its tax domicile or vanishes or evacuates its tax domicile without filing the corresponding change of address notice before the Federal Taxpayers' Registry, or it is known that the CFDIs issued by such taxpayer were used to support inexistent or illegal operations, or sham acts.
- They find that the issuer of a CFDI did not overcome the legal presumption of the inexistence of the transactions supported by those CFDIS;
- They find that a taxpayer did not provide enough evidence to prove the effective acquisition of assets or receipt of services, or did not correct such situation;
- Based on a tax domicile verification procedure, tax authorities find that the tax domicile registered in the RFC is not the place where the taxpayer's principal administration is located;
- They find that the taxpayer's declared taxable income or withheld taxes that were filed with tax authorities through monthly estimated tax returns, withholding tax returns or yearly tax returns, do not match those established in CFDIs, files, documents or databases at the disposal of tax authorities;
- They find that, for reasons attributed to taxpayers, the means of contact set forth by the SAT through general rules, registered for

16 Article 167 of the National Code of Criminal Proceedings, and Article 5, first paragraph, section XIII of the National Security Law.

17 Article 2, first paragraph, sections VIII, VIII Bis and VII Ter of the Federal Law against Racketeering.

the use of the digital tax mailbox, are incorrect or are not authentic;

- They find the commission of several infractions related to: the RFC; payment of tax obligations, filing of tax returns, requests, documentation, notice of certificates and submission of information through SAT's webpage, and infractions related to the obligation of bookkeeping; and
- They find taxpayers that did not overcome the legal presumption of unduly transferring tax losses and, as a result, being listed in the final list of taxpayers that unduly transferred tax losses.

If the use of a digital seal certificate is temporarily restricted, the taxpayer may file before the SAT an explanatory procedure to offset the detected irregularities or override the causes that motivated such restriction. Tax authorities must restore the use of such digital seals without further procedure, on the next day at the latest, so that the taxpayer may use its digital seal during the proceeding and until tax authorities issue the corresponding final resolution.

In this regard, the FFC is amended to set forth as a cause for the restriction or cancelation of digital seal certification of taxpayers, the failure to self-correct or overcome, during the established procedure, the formal irregularities or situations observed by tax authorities that resulted in the temporary restriction of such digital seal certificates.

Joint and several liability

Additional assumptions are established under which those who exercise the general direction, general management or sole administration of legal entities, as well as their partners or shareholders, will be considered jointly and severally liable for the omitted taxes, whether incurred or withheld, by such legal entities. Likewise, the exceptions to the joint and several liability of liquidators and receivers for the contributions they had to pay on behalf of the liquidating or bankrupted entity are eliminated.

Partners or shareholders, as well as general directors, general managers and administrators

Previously, the partners or shareholders of legal entities, as well as the general directors, general managers and administrators, were only considered jointly and severally liable for the contributions omitted by such legal entities, when they had not requested the legal entity's registration in the RFC, did not file the notice of change of tax domicile, did not keep accounting records, or when these were hidden or destroyed or when the legal entity had vacated the tax domicile without filing the corresponding notice.

As such, hereinafter joint and several liability will come into play when the corresponding legal entities:

- Fail to pay withheld or collected taxes;
- Are definitively listed for failing to rebut the legal presumption of having issued CFDIs supporting non-existent operations stipulated in article 69-B;
- Fail to demonstrate the effective acquisition of goods or receipt of services, or do not correct their tax position, when in a specific fiscal year such legal entity received CFDIs from one or more taxpayers who are listed for issuing invoices that cover non-existent operations for amounts greater than $7,804,230 pesos;
- They are definitively listed for failing to rebut the legal presumption of improperly transmitting tax losses as stipulated in article 69-B Bis; and
- Reducing, by over 50%, their material capacity to carry out their preponderant activity, in fiscal years subsequent to the one in which a tax loss was declared, as a result of the transfer of all or part of its assets through restructuring, spin-off or merger of companies, or because these assets were sold to related parties.

In this case, the partners or shareholders of the entity that acquired and unduly reduced the tax losses will also be held jointly and severally liable, provided that, on the occasion of a restructuring, spin-off or merger of companies or a change in partners or shareholders, the company no longer forms part of the group to which it belonged.

Liquidators and Receivers

The exceptions to the joint and several liability of liquidators and receivers for the contributions that had to be paid by the liquidating or bankrupted entity, as well as those incurred during their management, are repealed.

As such, the liquidators and receivers will be jointly and severally liable for such contributions, even if the liquidating entity complies with the obligations to file notices of liquidation and cancellation in the corresponding RFC by liquidation.

Thus, since these exceptions are repealed, liquidators and receivers will be considered jointly and severally liable for the entity in question, when it is not possible to guarantee tax assessments made to the entities they liquidate with the assets of such legal entities.

Limit to joint and several liability

In the context of partners and shareholders, joint and several liability is still limited to the percentage of the participation they have in the capital of the legal entity, at the time of the unpaid taxes, for the portion not covered by the assets of such entity, and regardless of whether such amounts exceed the amount of capital actually contributed.

On the other hand, the joint and several liability of liquidators, receivers, and of the people in charge of the general direction, general management or the sole administration of the legal entities, continues without an established limit.

Disclosure of Reportable Schemes

A new obligation is established requiring disclosure to the tax authorities of certain tax schemes that are considered relevant.

Hereinafter, taxpayers and tax advisors are obliged to disclose reportable schemes, which are defined as those that generate, or may generate, directly or indirectly, a tax benefit in Mexico.

At the same time, a "scheme" is defined as any plan, project, proposal, advice, instruction or recommendation, expressly or tacitly expressed, with the purpose of materializing a series of legal acts.

For these purposes, it is considered that a scheme must be reported if it:

» Avoids the exchanging of tax or financial information from abroad;

» Avoids the application of rules applicable to foreign legal pass-through entities or foreign legal vehicles;

» Avoids the application of the rules applicable to controlled foreign entities subject to REFIPRES;

» Consists of one or more legal acts that allow the transfer of tax losses pending to be used against tax profits, by taxpayers other than those who generated them;

» Consists of a series of payments or interconnected operations that return all or part of the amount of the first payment that forms part of such series, to the taxpayer that made it or any of its partners, shareholders or related parties;

» Involves foreign residents who apply a tax treaty signed by Mexico, with respect to income that is not taxed in the taxpayer's country or jurisdiction of tax residence, or when it is taxed at a reduced rate compared to the corporate tax rate in the taxpayer's country or jurisdiction of tax residence;

» Involves transactions between related parties in which: intangible assets that are difficult to value are transferred; business restructurings are carried out in which no consideration is paid for the transfer of assets, roles and risks, or which causes the legal entity in Mexico to reduce its operating profit by more than 20%; the transfer or temporary grant of use or enjoyment of goods and rights is made for no consideration or unremunerated services or functions are provided; there are no reliable comparables because they are unique or valuable functions or assets, or a unilateral protection regime is used (transfer pricing);

» Avoids triggering a PE in Mexico;

» Involves the transfer of an asset that has been depreciated, in whole or in part, allowing it to be depreciated by another related party;

» It involves a hybrid arrangement;[18]

» Avoids identifying the beneficial owner of income or assets;

» If there are tax losses whose term to be offset against taxable income is about to expire in accordance with ITL, and operations are carried out to derive tax profits against which tax losses can be reduced, and such operations result in an authorized deduction for the taxpayer that incurred such losses or to a related party;

» Avoids the application of the additional 10% income tax rate applicable to individuals on dividends or profits distributed by legal entities;

» Grants the temporary use or enjoyment of an asset, and the lessee in turn grants the temporary use or enjoyment of the same asset to the lessor or a related party; and

» Involves operations whose accounting and tax records show differences greater than 20%, except for those arising from differences in the calculation of depreciation.

Parties obliged to disclose reportable schemes will be the tax advisors and taxpayers, in accordance with the following rules:

Tax Advisors

Tax advisors will be required to disclose reportable schemes by filing an informative tax return within 30 days following:

» The first marketing contact, in the case of generalized reportable schemes;

» The day the scheme is available to the taxpayer for its implementation, or the first legal act or event that forms part of the scheme takes place, whichever comes first, in the case of personalized reportable schemes.

A "tax advisor" is defined as any individual or legal entity that, in the ordinary course of its business, performs tax advisory activities and is responsible for or involved in the design, marketing, organization, implementation or administration of a reportable scheme as a whole, or who makes available for implementation by a third party a reportable scheme as a whole.

18 A "hybrid arrangement" is defined to exist when domestic and foreign tax legislation characterize a legal entity, legal vehicle, income, owner of an asset or a payment differently, resulting in a deduction in Mexico and part of the totality of the income not being taxed abroad.

Taxpayers

However, cases are also established in which taxpayers themselves will be responsible for disclosing such schemes, such as:

- When the tax advisor does not provide the identification number of the reportable scheme issued by SAT, or does not give a statement that shows that the scheme is not reportable;
- When the scheme has been designed, organized, implemented and administered by the taxpayer;
- When the taxpayer obtains tax benefits in Mexico from a reportable scheme that has been designed, commercialized, organized, implemented or administered by a person who is not considered a tax advisor;
- When the tax advisor is a foreign resident without a PE in Mexico;
- When the tax advisor is legally prevented from disclosing the scheme;
- When there is an agreement between the tax advisor and the taxpayer so that the latter is obliged to disclose the reportable scheme.

For these purposes, SAT will grant the tax advisor or the taxpayer an identification number for each of the reported schemes disclosed.

When several tax advisors are obliged to disclose the same reportable scheme, they will be considered to have complied with the disclosure obligation if any one of them discloses such scheme in the name and on behalf of all of them. Similarly, when the tax advisor is an individual who provides tax advisory services through a legal entity, such individual shall not be required to disclose the schemes if the legal entity discloses the reportable scheme.

On the other hand, whenever a scheme generates tax benefits in Mexico, but is not reportable in terms of the applicable provisions, or there is a legal barrier to its disclosure, the tax advisor must issue a statement to the taxpayer setting forth the reasons why the scheme is not reportable or cannot be disclosed.

Note that the tax authority may request additional information from taxpayers and tax advisors who disclose reportable schemes, and they must comply with such request in a timely manner.

The disclosure of a reportable scheme must include the following information:

- Name, business or corporate name and RFC of the tax advisor or taxpayer who discloses the scheme;
- Name and RFC of individuals being released from the obligation to disclose;
- Name of the legal representatives of the tax advisors and taxpayers;
- In the case of customized reportable tax schemes: name, business or corporate name and RFC of the benefited taxpayer;
- When the taxpayer is the one disclosing the scheme: name, business or corporate name of the tax advisors, if any;
- Detailed description of the reportable scheme and the applicable domestic or foreign legal provisions;
- Detailed description of the tax benefit obtained or expected;
- Name, business or corporate name, RFC and any other tax information of the legal entities or legal figures that are part of the disclosed reportable scheme;
- Fiscal years in which the scheme is expected to be implemented or has been implemented;
- When the reportable scheme prevents the exchange of tax or financial information with other countries, this must be included on its disclosure;
- In the case of complementary informative tax returns of reportable schemes, the identification number of the scheme that has been disclosed by another tax advisor and the relevant information must be indicated, in order to correct or complement the submitted informative tax return;
- Any other information that the tax advisor or taxpayer considers relevant;
- Any additional information that may be requested by the tax authority.

Tax advisors must submit before the SAT, during the month of February of each fiscal year, an informative tax return that includes the data of the clients who were advised with reportable schemes. Likewise, tax advisors who have disclosed reportable schemes are obliged to provide the identification number of the latter issued by SAT, to each of the taxpayers who intend to implement such scheme.

On the other hand, the taxpayer that implements a reportable scheme is obliged to include the identification number of such tax scheme in its annual tax return corresponding to the fiscal year in which the first event or legal act for its implementation takes place, as well as in the tax returns of the subsequent fiscal years in which the scheme continues to produce tax effects.

It is important to clarify that the new provisions expressly indicate that the disclosure of reportable schemes will not constitute a violation of the obligation to secrecy under any profession.

Additionally, the Ministry of Finance and Public Credit will issue parameters on minimum amounts for which the provisions concerning reportable schemes will not be applied.

Failure to comply with the obligations regarding reportable schemes shall be considered an infraction, the fines for which are in the range of $15,000.00 to $20,000,000.00 Mexican pesos for tax advisors and from $50,000.00 to $2,000,000.00 pesos for taxpayers.

Finally, the obligations relating to the disclosure of reportable schemes will come into force as of January 1st, 2021. Reportable schemes that must be disclosed are those designed, marketed, organized, implemented or administered as of fiscal year 2020, or prior to that year, when the scheme continues to have effects in the following fiscal years beginning in 2020. Taxpayers are the only ones obliged to disclose schemes designed, marketed, organized, implemented or administered prior to fiscal year 2020.

Sánchez Devanny is a leading Mexican law firm that provides **full-service legal advice** both to Mexican and international clients.

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Tax

This practice pragmatically advises clients on tax planning, federal and local tax optimization for new or existing operations and expansion projects, national and international corporate reorganizations, tax treaties, transfer pricing, private wealth management, and provides representation during complex tax audits and litigation.

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