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Tax Practice Group Newsletter

Tax Reform 2022

On November 12, 2021 the Decree to Amend the Federal Tax Code (FTC), Income Tax Law (ITL), Value Added Tax Law (VATL), Special Products and Services Tax Law (SPSTL), among other laws (jointly referred to as ("2022 Tax Reform") was published in the Federal Official Gazette.

The 2022 Tax Reform, in force as of January 1, includes modifications to the tax regulations that may seem minor and superficial. However, several of them could result highly important and trigger relevant effects for the taxpayers, depending on their particular situation and hence our recommendation is to analyze these amendments on a case-by-case basis.

The purpose of this document is to summarize the modifications that we consider to be the most relevant, while not pretending to be either an exhaustive analysis of such modifications, or to exhaustively include every modification.

INCOME TAX LAW

Exchange rate for the determination of exchange rate gains

It is established that the exchange rate gain determined by taxpayers cannot be less than the one resulting from applying the exchange rate for the payment of obligations in foreign currency, established by the Bank of Mexico (Banco de Mexico) and published in the Federal Official Gazette on the day in which the gain is realized.

Said parameter was previously established only for purposes of determining the exchange rate loss by taxpayers. However, hereinafter it will be used for any tax effects derived from the exchange rate fluctuation from any transaction established in foreign currency.

Although determining with precision the exchange rate to be used for the calculation of exchange rate gains provides certainty and a clear parameter for taxpayers, its use could disregard or not be compatible with the financial and business reality of certain transactions. Thus, it will be important to review the possible effects for taxpayers that this reform could have in the case of transactions in which a different exchange rate have been agreed to between the parties involved.

New case of back-to-back loans

A new case for back-to-back loans is enacted, under which it is considered that any financing transaction that does not have a business reason will be deemed as such. Consequently, in these cases interest derived from such financing will be construed as a dividend for tax purposes.

For purposes of its application, the amended provision does not make specific reference to the application of Article 5-A of the FTC, which establishes some parameters to determine if a transaction has a business reason or not. Thus, a detailed analysis of the interpretation of such concept will be required, since the lack of precision on the scope of such concept could generate uncertainty for taxpayers, and derived from excessively broad interpretations by the tax authority on the level of detail required to explain the business reasons for a company's obtaining any financing, particularly with related parties.

Therefore, because of the important tax impact that having the tax authority deem a financing transaction as a back-to-back loan could trigger, i.e. of the denial of the deduction of interest and a possible income tax payment if re-characterized as dividends, it is imperative that taxpayers review their current financing transactions, to ensure that adequate business reason support them.

Finally, the new back-to-back loan case is completely unrelated to the currently existing definition of such concept, both in the Mexican tax and financial law and applicable regulations, as well as in the foreign one. This is since, typically, a back-to-back loan has been considered as a financing transaction where a company provides indirect financing to a related party through the use of third-party intermediaries, for which an analysis of the business reasons that led to such financing has not been necessary.

Thus, such analysis becomes even more relevant, considering the extremely broad interpretation that the tax authority has given, in recent times, to the definition of back-to-back loans established in the Income Tax Law.

Taxable income for consolidation of bare ownership and usufruct of goods

It is specified that the consolidation of the bare ownership and the usufruct of goods will be deemed taxable income for corporate taxpayers. Such taxable income will be equal to the value of the usufruct right at the time of the consolidation, as determined by an appraisal performed by an authorized valuator. Said income must be recognized by the bare owner of the corresponding good.

In addition, in order for the tax authority to keep an appropriate control, public notaries, brokers, judges and public attesters that issue public deeds in which the property attributes are separated must inform the tax authority of such separation within the 30 days of the date in which the transaction takes place.

Gains for the transfer of bare ownership and usufruct of goods

Aligned with the above reform, a new mechanism is created to determine the taxable gain derived from the transfer of the bare ownership or usufruct of goods. Such gain should be the result of the purchase price of the relevant attribute (bare ownership or usufruct) minus its acquisition cost, in proportion the proportion that the price of the attribute that is being transferred (determined by an appraisal performed by an authorized valuator) represents over the overall price of the good.

New requirements and business reason for corporate reorganizations

The reform imposes new requirements to request a corporate reorganization to transfer shares at cost. In addition, the reform also imposes new obligations that must be met after the granting of such corporate reorganization authorization, including the need for proving the business reasons for which the reorganization was performed.

- Information required in certified public accountant report:

The certified report issued by a certified public accountant must now include information related to the accounting value of the transferred shares; a chart of the corporate group including the percentage of participation by partners and shareholders in the equity of the companies; the direct and indirect equity ownership in such companies, before and after the reorganization; the business lines and activities of the issuer and acquiring companies; and a certification that such companies consolidate their financial statements in terms of the accounting and financial regulation applicable.

It is worth highlighting the relevance of the incorporation of the requirement consisting in the consolidation of the companies involved in the reorganization since, previously, said requirement did not exist.

- Disclosure of relevant transactions related to the reorganization:

The reform sets forth that taxpayers requesting a corporate restructure authorization must disclose any relevant transactions that took place within the 5 prior years to the restructure that is subject to authorization.

For such purposes, a relevant transaction is defined as any act, despite its legal nature, through which:

i) The property, use or enjoyment of the shares, as well as the voting or veto rights on decisions of the issuer, acquirer or transferor company and the voting rights for decision-making on such companies is transferred.

ii) The rights over assets or profits of the issuer, acquirer or transferor companies, in case of a capital reduction or liquidation, is granted at any moment.

iii) The accounting value of the issuer company is reduced or increased by more than 30%, with respect to the accounting value determined at the date of the authorization request;

iv) The issuer, acquirer or transferor companies cease consolidating their financial statements;

v) The equity of the issuer, acquirer or transferor companies is reduced or increased (with reference to the capital contributed used for purposes of the authorization);

vi) A partner or shareholder increases or reduces its percentage of direct or indirect participation in the equity of the issuer, acquirer or transferor company and, as consequence, the percentage of participation of another partner or shareholder of the issuer company is also increased or reduced;

vii) The jurisdiction of tax residency of the issuer, acquirer or transferor company is changed.

viii)One or several business lines of the issuer company is transferred, as well as of the acquirer or transferor companies, if related to one or several business lines of the issuer company.

In addition, if a relevant transaction is performed within the following 5 years as of the date of a corporate reorganization, the acquirer company will have to file an informative tax return on relevant transactions, being that the non-compliance with this obligation will have as consequence the cancellation of the authorization previously granted.

- Business reason for corporate reorganizations:

Finally, and more importantly, the tax authority will be entitled to cancel any authorization previously granted if, in the case of a tax audit, it considers that the corporate reorganization had no business reason.

It is important to mention again that the law does not define the term business reason and therefore the analysis of the scope and interpretation that the tax authority could give to such concept becomes relevant.

Entitling the tax authority to review the business reasons for corporate reorganization, subsequent to the granting of the corresponding authorization, is highly questionable.

This is since, as mentioned, derived from the requirements established to apply for the authorization, as well as from the new obligation to disclose relevant transactions, the tax authority is provided with an important amount of information and documentation that can serve to prove such business reason, being that the granting of such authorization supposes that the tax authority has already analyzed and validated such information and documentation.

Requirements for the deduction of fuel

The reform imposes a new requirement to deduct the acquisition of fuel consisting in having the relevant tax invoice including information regarding the authorization granted to the fuel supplier, in terms of the Mexican Hydrocarbons Law, as well as for such authorization to be valid at the moment of the issuance of the invoice.

These new requirements represent an additional measure to combat and tackle the illegal oil and gas market. Therefore, their incorporation could be seen as positive.

However, it can also represent an important administrative burden for companies that acquire fuel in high volumes. This is mainly because of the need for ensuring that the authorization granted to the fuel supplier is valid at the moment of the issuance of the corresponding invoice, since this could be extremely complicated as it could not be a way for taxpayers to verify such information.

Payments for technical assistance, know-how and royalties

A new requirement for the deduction of payments for technical assistance, know-how and royalties is incorporated. Hereinafter, the corresponding services can be indirectly rendered by third parties only when considered as specialized services, for which the provider will have to obtain its registry with the Ministry of Labor as a specialized services provider under the newly enacted subcontracting reform.

Deduction of bad debt

In the case of bad debt losses for an amount higher than 30.000 Units of Investment (UDIS as its Spanish acronym), the deduction requirement of considering that there is a notorious collection impossibility can be materialized only upon a having definitive favorable resolution by competent authority through which the taxpayer proves that it has exhausted the entire collection process or that it was not possible to execute the definitive favorable resolution obtained.

Previously, collection impossibility was evidenced simply with the filing of the corresponding claim before the judicial authority or by initiating the arbitration procedure agreed. Going forward taxpayers will have follow the entire litigation or arbitration procedure requires and the relevant judicial collection process, in order to be entitled to deduct bad debt losses. This will certainly translate into a much longer period to deduct such bad debts.

Thin capitalization

- Inclusion of losses

The option to consider as Shareholders' Equity (the "Shareholders' Equity Option") the average of the balances of the Capital Contribution Account ("CUCA") and Net After Tax Profit Account ("CUFIN") is amended. Onwards, the NOLs not considered in taxable income calculations must now be subtracted from such average. The effect of this amendment is to reduce Shareholders'

Equity value to be considered in the event that this option is exercised to measure the 3 to 1 ratio (debt vs. capital) corresponding to the thin capitalization rules.

- Limitation for applying the Stockholders' Equity Option

The reform also established that the Shareholders' Equity Option may not be exercised if the CUCA and CUFIN average (subtracting the NOLs) is 20% greater than the stockholders' equity, except when there is a business reason for such and, in a tax audit, the correct determination of the tax attributes and its supporting documentation is evidenced.

We consider that this limitation and exception will create uncertainty for taxpayers, since the term 'business reason' is not defined in the law. Therefore, it may be subject to different interpretations, leaving a wide range of subjectivity to the tax authority.

- Adjustment to the exceptions by sector

From now on, the exception of not considering debts incurred for the construction, operation or maintenance of productive infrastructure related to the Country's strategic areas or for the generation of electricity, will only be applicable to the holder of the legal authorization issued by a competent authority that evidences that such holder can directly perform that activity.

The policy argument is that those who provide services to license holders should not be entitled to apply this exception, as it applies only the taxpayer who directly performs the activity. This rule has been applied in practice by the tax authority, so this amendment simply aligns the ITL with it, without taking into account the economic reality. It is common that in the supply chain agents from these sectors acquire debt to finance operations, regardless of whether they are the license holders.

- Thin capitalization for non-regulated multiple purpose financial companies

It is established that contracted debts from non-regulated multiple purpose financial companies (SOFOM ENR) for their operational compliance will now be considered for the application of the thin capitalization rule, as long as they carry out activities mostly with their domestic or foreign related parties for the fulfillment of their business purpose.

Notice for the disposal of assets that are no longer useful

The reform reintroduces the obligation that was in force until 1997 regarding the notice for the disposal of assets that are no longer useful to deduct the pending depreciation amount.

The above is due to the fact that, even though this obligation was repealed for administrative simplification, the tax authorities noticed that several taxpayers continue depreciating goods that were already deducted because they are no longer useful, duplicating the deduction, or they improperly deduct goods that were still useful in advance.

Real estate usufruct rights

After considering as an improper tax practice the separation of usufruct to bare property in order to depreciate it as a deferred expense at the 15% rate, the law is amended to explicitly establish that the usufruct right constituted over real estate must be considered as a fixed asset subject to a depreciation rate of 5%.

This amendment intends to avoid considering usufruct as a deferred expense subject to the 15% rate or as expenses, and instead, as a fixed assets subject to a 5% depreciation rate.

Mining sector investments

Expenses for intangible assets that allow the exploration or exploitation of public property be treated as a deferred expense, which implies the application of the corresponding depreciation rate to the number of years for which that right was granted. The latter is to avoid the mining sector taxpayers deduct expenses made for the acquisition of concessions as an expense made during the pre-operational period, which implies a greater depreciation (10%) than that of the concessions, which last the useful life of such.

It also clarified that installations, additions, repairs, improvements, adaptations, as well as any other constructions made in a mining lots must be characterized as construction subject to the 5% depreciation rate, to avoid that such taxpayers take the deduction as if they were expenses.

Deduction of technical reserves

For insurance companies to be able to deduct: (i) the creation or increase, only of reserves for risks in progress, for obligations pending fulfillment due to claims and maturities, and (ii) reserves for catastrophic risks, these must be created in accordance with the general provisions issued by the National Insurance and Bonding Commission. This is so that the authority may verify that such reserves are correctly established and are strictly indispensable.

Informative tax return for the financial sector

The filing periodicity changed for the informative tax return for financial institutions containing information of cash deposits whose accumulated monthly amount exceeds $15,000.00 pesos, as well as for cash acquisitions from cashier's checks, will be filed on a monthly basis no later than the 17th day of the immediately following month.

Amortization of tax losses in corporate spin-off

It is added as a requirement for NOL transmission in case of a corporate spin-off, that the spun off company must be engaged in the same type of activities as the original company, having to prove this situation in a tax audit. From the tax authority's point of view, taxpayers were improperly interpreting the applicable law by considering that for the case of spin-offs it was not necessary for both companies to engage the same type of activities, ignoring that it was always the legislator's intention for such restriction to apply as well for corporate spin-offs.

This limitation appears to be in opposition to the usual objective of spin-offs, where the segregation of business activities between different companies is precisely what it is aimed at, so that it would make difficult to achieve that all companies involved in a spin-off are engaging in the same type of activities, thereby, limiting the transmission of NOLs.

Change of partners or shareholders in companies with NOLs

Prior to this amendment, the change of partners or shareholders who had control over a company with NOLs would derive under certain circumstances in limitations for the application of such NOLs only against profits corresponding to the exploitation of the same activities.

It should be understood that there was be a change of partners or shareholders by changing them, directly or indirectly, for more than 50% of the shares or interest with voting rights, in one or more acts carried out within a 3-year period.

According to the amendment, in addition to the last scenario, it will also be considered that there is a change of partners or shareholders, when one or more transactions conducted within a 3-years period after a corporate merger result in any of the following hallmarks: **(i)** the direct or indirect shareholder that has the right to impose decisions in the general shareholders' meetings, to remove management bodies, or to oversee the management of the company are changed, **(ii)** the direct or indirect shareholders that have the right to direct the management, strategy or main policies of the company are changed, or **(iii)** the company and its partner or shareholder cease to consolidate financial statements in accordance with the provisions that regulate them in accounting and financial matters.

It also provides that if corporate actions subject to a suspensive condition or term, it will be considered that the change takes place as of the execution of that corporate act.

The same provision prior to the amendment prevails with respect to the situations in which this restriction to the NOLs for the change of shareholders will not apply, namely: i) when the change is a consequence of inheritance or donation, ii) or when the change is made due to a corporate restructuring, merger or spin-off that may not be considered]alienation (as long as the partners or shareholders that had control maintain it after the change). Nonetheless, it clarifies that they will not be considered for these purposes the shares placed in the stock market.

Removal of individuals from the agricultural, livestock, forestry and fishing activities regime

Due to the fact that they may now access the trust reliance regime (preserving some of the tax benefits granted under such regime), the agricultural, livestock, forestry or fishing activities regime for individuals who are exclusively engaged in such activities is now repealed.

Obligations regarding transfer pricing

It is clarified that these obligations will be applicable to transactions made with any related party, regardless of its tax residence.

On the other hand, several adjustments are made with respect to the scope of the supporting documentation that taxpayers will obtain to evidence the correct application of the arm´s length principle, including, among others, the obligation of taxpayers to have the comparability elements of transactions or companies and with the detail on the application of the adjustments that, in such case, have been made for the purpose of comparability analysis.

Likewise, the filing date for the informative return of transactions with related parties and the local informative return of related parties is aligned with the report filing deadline, which is May 15 of the following fiscal year.

Notice of transfer of shares between foreign residents

A new obligation is imposed on Mexican resident companies to inform the tax authorities of the transfer of shares or interests within the month following the transfer, when it occurs between foreign residents with no permanent establishment in Mexico. This was imposed so that the tax authorities have a mechanism to identify changes of foreign resident partners or shareholders in Mexican companies, as well as the date of transfer and payment of the income tax, since it was identified that in those transactions between foreign residents where the acquirer is not obliged to withhold the income tax, the payment was left to the discretion of the seller, without the tax authority being able to demand its payment.

Failure to file the notice will result in the legal entity being considered jointly liable for the calculation and payment of the income tax. Therefore, the original scope of joint liability established in article 26, section XI, of the Federal Tax Code, in charge of the Mexican tax company whose partners or direct shareholders change, was extended. This is because, prior to this amendment, the joint liability of the issuer only materialized in the cases established by said legal provision.

This amendment leaves unresolved the other case of transfers of stocks or interest between foreign residents of foreign companies with ownership in real estate located in Mexico, where the transferor also tends to fail to comply with the obligation to pay the corresponding tax.

On the other hand, by way of administrative simplification, it may be advisable that, by means of miscellaneous rules, this obligation may be considered to be complied with through the timely filing of the notice to update partners or shareholders, specifying only the additional information that is now required in terms of the new notice.

Determination of the net after-tax profits

It is clarified that, for purposes of calculating the net taxable income ("UFIN"), the Employees' Statutory Profit Sharing ("PTU") may not be reduced. Article 9, second paragraph, section II, of the ITL, already establishes that the PTU must be reduced for the determination of the tax result.

Although this issue was already resolved though criterion 36/ISR/N, we believe its incorporation into the ITL was appropriate.

Elimination of concepts considered as deemed salary payments

Before the tax bill, individuals who received income, individually or as a whole, of more than $75,000,000 pesos were allowed to consider their income as salary payment when they carried out one or some of the following activities:

i) mainly providing services to a specific service provider;

ii) providing independent services when he/she requests to pay taxes in such manner; and

iii) income received from business activities when he/she requests to pay taxes in such manner.

From now on, such individuals will have to pay taxes under the corresponding chapter of Title IV (Mexican tax resident individuals), as of the month following the date on which they obtained income in excess of $75,000,000 pesos.

Now, with the intention of extending the possible application of the simplified trust regime to this type of taxpayer, it is clarified that, as of the following year in which they obtain income greater than $75,000,000 pesos, they must pay taxes in accordance with the provisions applicable to the regime for individuals with business and professional activities. This is because only those individuals who carry out business or professional activities or grant the temporary use or enjoyment of goods can be taxed under the simplified trust regime.

However, it also includes the possibility for the tax authority to update ex officio the economic activities and obligations of taxpayers to the corresponding tax regime, when they do not pay taxes under the business and professional activities regime.

Electronic accounting records of individuals with entrepreneurial and professional activities

The exception of not keeping accounting records for individuals with business and professional activities whose income does not exceed two million pesos is repealed. This is because under the Trust Reliance Regime such taxpayers would not be obligated to comply with that obligation.

Tax Incorporation Regime and Trust Reliance Regime

The Tax Incorporation Regime is repealed, because this regime will be replaced by the Trust Reliance Regime.

Obligation of keeping accounting records for individuals who grant the use or temporary enjoyment of real estate

The obligation to keep accounting records for individuals that receive rents from real estate that have opted to apply the 35% blind deduction is imposed.

Individuals. Personal deductions. Donations and voluntary contributions to retirement plans

Non-remunerative donations granted to authorized donees and other specific entities, as well as complementary or voluntary retirement contributions, are included in the general limitation that applies to all personal deductions consisting of the lesser of 5 minimum wages per year (the reform replaces wages with UMA's) or 15% of the total income of the taxpayer, eliminating the independent limitations that applied to such concepts.

The above causes an effect as a reduction in the deductions that individuals may take for such concepts.

Also, investment fund stock companies are included as institutions that may manage personal retirement plans, and it is stated that such institutions must comply with the requirements and conditions to maintain their validity, in terms of the general rules issued by the SAT.

Comparable transactions. Transfer pricing obligation applicable to foreign residents

It is established that foreign residents without a permanent establishment in Mexico are required to comply with transfer pricing standards such as determining their income, gains, profits and deductions derived from transactions with related parties, considering prices, amounts of consideration or profit margins that they would have used with independent parties in comparable transactions.

Before the reform, the Income Tax Law did not establish this obligation, when the person making the expenditure was a Mexican tax resident. Such obligation was already applicable since it was subject to Mexican jurisdiction. Likewise, the treaties to avoid double taxation based on the OECD model already establish in its Article 9 the need to comply with transfer pricing.

In that sense, the addition of such obligation for foreign residents could become relevant only in those cases in which both the payer and the beneficiary are foreign tax residents, as in the case of a purchase and sale of shares of a Mexican company between foreign residents.

Income from the acquisition of goods by foreign residents

It is established that when a foreign resident obtains income from the acquisition of goods with source in the country, (if the appraisal performed by the tax authorities shows a value that exceeds by more than 10% the agreed consideration) the transferor, if he is a Mexican tax resident or a foreign resident with a Permanent Establishment in Mexico, is the one who must pay the corresponding tax. Previously only the foreign resident acquirer was obligated to pay the tax.

The treatment of the tax payment made by the Mexican tax resident or the foreign resident with a Permanent Establishment in Mexico must be analyzed both for the foreign resident acquirer and for the afore-mentioned transferor.

Disposal of shares with a source of wealth in Mexican territory

Several changes are made to the income from the sale of shares with a source of wealth in Mexican territory.

<u>Option of tax on net profit</u>. In order to exercise this option, taxpayers must submit a report prepared by a public accountant registered with the tax authorities. In the case of transactions between related parties, the accountant was previously required to report the manner in which he/she considered the transfer pricing elements to determine differences between comparable transactions.

Now, after the reform, the accountant must not only indicate the manner in which he/she considered such elements but must also include the supporting documentation that proves that the price of the shares sold corresponds to the price that would have been used between independent parties in comparable transactions, that is to say, the corresponding transfer pricing study must be included.

<u>The exception to withholding by securities intermediaries.</u> The possibility is established for the SAT to issue general rules establishing in which cases securities intermediaries are not required to withhold income tax at the 10% rate applicable to the sale of shares in the stock exchange.

<u>International restructurings.</u> i) It is established that in connection with restructurings the taxpayer must certify that the issuing and acquiring companies consolidate their financial statements. Consequently, it is established that the shares must remain outside the corporate group when the issuing and acquiring company ceases to consolidate its financial statements.

ii) It is established that the authorizations for restructurings are null and void if through the exercise of its verification powers the tax authority detects that the restructuring of the relevant transactions related to the restructuring, entered into within the 5 years prior or subsequent to the restructuring, lack a business reason or that the exchange of shares generated income subject to REFIPRE.

iii) An enabling clause is established so that requirements for authorizations can be established in a miscellaneous resolution.

iv) An obligation is established for the company acquiring the shares or its legal representative so that in the event that within five years after the restructuring a relevant transaction takes place, they must submit the corresponding information (article 31-A, paragraph d) of the Fiscal Code). In addition, a transitory provision is established which states that such obligation will be applicable to taxpayers that already have a current authorization, and that the 5-year term will be computed from the date the Income Tax Law becomes effective.

Withholding rate for interest for foreign residents

Concerning the exception to the application of the lower withholding rates for interest received by foreign residents (4.9% y 10%), which consists of applying the maximum rate for individuals instead of the lower rates, the reference to the fact that the interest must come from debt securities is eliminated, and the concept "issuer" is exchanged for "debtor", to make it clear that such exception applies to any type of interest regardless of whether it comes from debt securities.

Income of foreign residents from indemnification for damages or losses

It is established that concerning income from indemnification for damages and/or penalty clauses or conventional penalties, when a judgment or arbitration award orders to make payments for indemnification, without distinguishing which part corresponds to damages, the payer must withhold on the totality of the payment, leaving the right of the foreign resident to request the refund of the tax withheld in excess for the portion that corresponds to indemnification for damages.

Legal representation of foreign residents

It is established that the representative appointed by foreign residents with income from a Mexican source of wealth must assume joint liability for the taxes payable by the foreign resident, and the representative must have sufficient assets to be jointly liable.

As a consequence of the above, most of the time in transactions between related parties, the related party resident in Mexico is appointed as the legal representative of its related parties' resident abroad, being exposed to the contingency that may arise from taxes owed by the foreign resident.

Preferential tax regimes. Inflationary adjustment and exchange rate fluctuation

It is stated that to determine the income subject to REFIPRES when comparing the tax that would be caused and paid in Mexico with the tax paid abroad, the annual adjustment for inflation and the exchange rate fluctuation must be left out. Likewise, it is established that to determine the tax payable in Mexico these concepts must also be left out.

The above is for clarification purposes since, in consideration of the legislator, the inflationary adjustment and exchange rate fluctuation rules have never been directed to the REFIPRES regime.

Simplified Trust Regime

A new fiscal regime called the Simplified Trust Regime ("RESICO" per its acronym in Spanish) is created, applicable to individuals and legal entities, and is intended to replace the Tax Incorporation Regime ("RIF" per its acronym in Spanish), and the Regime of Agricultural, Livestock, Forestry and Fishing Activities ("AGAPES") established in ITL.

- <u>Individuals</u>

This regime is aimed at individuals who obtain income from **(i)** Business Activities, **(ii)** Professional Services, **(iii)** Leasing of immovable property, and **(iv)** Agricultural, Livestock, Forestry, and Fishing Activities; which do not exceed $3,500,000.00 M.N (Three million five hundred thousand pesos 00/100) during the fiscal year.

The above is intended to simplify the administrative burden of taxpayers, establishing that the calculation of taxes will be carried out on according to the Digital Tax Receipts ("CFDI" per its acronym in Spanish) issued during the month, without applying deductions or tax losses, up to the 17th day of the following month, and according to the following table:

Income effectively received from CFDI's, excluding VAT (monthly)	Applicable rate
Up to $25,000.00	1.00%
Up to $50,000.00	1.10%
Up to $83,333.33	1.50%
Up to $208,333.33	2.00%
Up to $3,500,000.00	2.50%

Likewise, it is established that **(i)** partners or shareholders of legal entities or related parties, **(ii)** residents abroad with permanent establishment, **(iii)** individuals with income subject to Low Tax Regimes ("REFIPRES" per its acronym in Spanish), **(iv)** individuals deriving certain types of income assimilated to salaries, may not be eligible for the benefits of this new tax regime.

Among the obligations of individuals who pay taxes under this regime, the following are established:

- Obtaining and issuing CFDI for the transactions they perform.
- Filing the tax advanced payments.
- Filing the annual tax return for the fiscal year.

Taxpayers must file during April of the year following the annual tax return corresponding to the previous fiscal year, without applying deductions or tax losses, and in accordance with the following table:

Income effectively received from CFDI's, excluding VAT (per month)	Applicable rate
Up to $300,000.00	1.00%
Up to $600,000.00	1.10%
Up to $1,000,000.00	1.50%
Up to $2,500,000.00	2.00%
Up to $3,500,000.00	2.50%

The following are causes to be excluded from the RESICO regime:

- Obtaining income in excess of $ 3,500,000.00 in a given fiscal year.
- Omitting three or more the advanced payments in a calendar year, consecutive or not.
- Failure to file the annual tax return.
- Not issuing the CFDI or filing any advanced payment during the fiscal year.

It is important to mention that if the taxpayer does not meet its tax obligations, it must leave the regime and pay taxes under the corresponding chapter of the ITL according to its taxable income, with no possibility of returning to the benefits of this regime, except when the reason for leaving is to exceed the income cap allowed during the fiscal year, since in this case, as soon as the taxpayer complies again with the established requirements, he may continue paying taxes under the terms of this new tax regime.

Likewise, it is established that individuals who decide to pay taxes under the RESICO will not be obliged to file monthly returns during the 2022 tax year and will be in compliance with their tax obligations if they file their annual tax return for the same fiscal year on time.

- Legal Entities

A new regime is established in Title VII of the ITL, "Tax Incentives", aimed at legal entities constituted solely by individuals and that obtain income that does not exceed $35,000,000.00 M.N (Thirty-five million pesos 00/100) during the fiscal year.

This new regime facilitates the recognition of income and the deduction of incurred expenses on a cash flow basis, thus abandoning the accrual system and the use of the profit coefficient in the calculation of the provisional tax returns for the fiscal year.

In contrast to the regime applicable to individuals, for legal entities, the ITL establishes that the application of authorized deductions (excluding **(i)** bad debts and **(ii)** cost of goods sold), is permitted.

Additionally, it is important to bear in mind that in the case of investments, higher percentages are established for their deduction; however, this benefit may be applied if the total acquisition cost of investments during the fiscal year does not exceed $3,000,000.00. If this amount is exceeded, the percentages of Title II of the Income Tax Law must be applied.

Legal entities paying taxes under this regime will determine their taxable income by deducting from their income the authorized deductions, employee profit sharing ("PTU" per its acronym in Spanish), and, if applicable, tax losses from prior years pending offset, applying to the result obtained the 30% rate contained under Article 9 of the ITL, allowing the possibility of crediting the withholding taxes, as well as the tax advance payments made prior to the month in which they are being calculated.

Legal entities with the following characteristics will not be eligible for the benefits of this new regime: **(i)** legal entities with partners who are individuals that participate in other companies, controlling the moment in which income is distributed; **(ii)** legal entities performing activities through a Joint Venture or a trust; **(iii)** legal entities paying taxes under a particular regime for legal entities, such as financial system institutions, taxpayers subject to the optional regime for corporate groups, taxpayers subject to coordinated regime, and non-profit charitable organizations; **(iv)** cooperatives, and; **(v)** taxpayers who are no longer paying taxes under this regime at some point in time.

- Transitory Provisions

Individuals and legal entities that were paying taxes under another tax regime prior to the reform, and that choose to pay taxes under the RESICO must apply pending credits and deductions no later than July 1, 2022, as well as request any pending tax refund balances in favor that they had pending.

Taxpayers that until August 31, 2021, were paying taxes under the RIF, as of January 1 may continue paying VAT and IEPS in accordance with the RIF (bi-monthly payments), until December 31, 2021, or until the term of ten consecutive fiscal years as a permanence period in the RIF is completed.

Taxpayers that as of August 31, 2021, are taxed under the RIF may continue to apply the VAT and IEPS tax incentives, as long as they are within the ten consecutive fiscal years and comply with the requirements of such regime.

Transfer Pricing

- Multiple Informative Return ("DIM" per its acronym in Spanish)

Article 76 of the ITL is amended to establish the obligation of taxpayers to file no later than May 15th of the year immediately following the end of the corresponding fiscal year, the DIM concerning transactions entered with related parties regardless of their country of residence.

Likewise, the aforementioned article establishes the obligation to submit the local informative return of related parties no later than May 15th of the immediately following year with respect to those taxpayers who carry out operations with residents abroad.

- Transfer pricing obligations

The reform requires that all transfer pricing studies must contain all information related to functions, assets used and risks assumed not only by the taxpayer but also by the party or parties related to which operations are held. The above is for each operation carried out.

- Transactions between related parties

Another of the changes is the modification to the fourth paragraph of article 179 of the ITL, so that taxpayers consider in their study of transfer prices the information of comparable operations, corresponding to the year subject to analysis when business cycles or commercial acceptance of a taxpayer's product cover more than one fiscal year.

Likewise, the possibility of considering the information of comparable operations corresponding to two or more previous or subsequent years is also established.

- Interquartile method for obtaining the price range of the amount of consideration or profit margins in comparable transactions.

The second paragraph of article 180 of the ITL is modified to establish that the price ranges will be adjusted by applying the interquartile method established in the Regulations of the ITL or otherwise, establish a method based on the framework of a friendly procedure indicated in the treaties to avoid double taxation to which Mexico is party, or an authorized method in accordance with the general rules issued by the Tax Administration Service for this purpose.

- Maquiladora Industry

The amendment of the third paragraph of article 182 of the ITL is eliminated, which contemplated the possibility that the maquiladora companies obtained a particular resolution under the terms of article 34-A of the FFC in which the tax authority confirms that they meet the requirements contained in the articles 179 and 180 of the ITL (Advanced pricing Agreement "APA", per its acronym in Spanish), since all maquiladora companies as a general rule must perform the calculation in accordance with the provision related to the Safe Harbor procedure for determining their tax profit, so that the persons residing abroad for whom they act do not constitute a permanent establishment in the country.

VALUE ADDED TAX LAW

0% VAT rate

The following operations are added to the 0% VAT scope:

- Sale of products destined to feed domestic animals and livestock;
- Sale of menstrual hygiene products such as tampons, menstrual cups and sanitary towels.

Concerning the first point of the list, it is important to mention that the addition is for clarification purposes, as the 0% VAT treatment was already applicable based on the administrative criteria 11/IVA/N.

Non-VAT activities. Limitation of crediting

The decision 2a/J.170/2015(10a) issued by the Second Chamber of the SCJN, developed the principle called "continuity of the productive chain", based on the internationally recognized principle "financial deduction method". This principle holds that a taxpayer that engages in non-taxable activities should not benefit from the crediting mechanism, since it is considered virtually as a "final consumer".

To incorporate this principle into the Value Added Tax Law, Article 4-A is added, which defines the term "non-object activities" as those carried out outside the national territory, as well as those carried out in national territory other than those listed in Article 1 of the LIVA.

The purpose of such incorporation is to restrict the crediting of the VAT transferred to the taxpayer with expenses, investments, or import operations, which result in obtaining income from "non-object activities" of the Law. As a result of such restriction, Article 5, Section V, paragraphs b) and d) are amended.

The mechanism to determine the proportion of non-creditable VAT for non-object activities in a transaction where the taxpayer also performs taxable transactions may considerably affect the tax crediting; therefore, it is of vital importance an adequate registration and control of expenses, investments, and import transactions that are identified with taxable activities of the taxpayers to protect the crediting of VAT related to such transactions.

It is necessary to specify that this is not the first attempt to incorporate the above-mentioned restriction; the explanatory statements indicate it as merely clarifying incorporation, which could represent a risk for operations of such nature carried out before the eventual reform. A similar approach was made in the economic package for 2020; however, it was eliminated during the discussion in the legislative process.

The probabilities of success in the filing of defense actions are considered limited, given the judicial precedent from which the incorporated article derives, as well as the international principle on which the aforementioned precedent is based. However, adequate control and registration of the VAT paid on costs, expenses, investments, and import operations related to the taxpayer's taxable activities could mitigate the risk of losing the right to its crediting.

Import VAT. Crediting requirements

Two additional requirements are imposed for the crediting of VAT paid on the importation of goods:

- That on the import customs "pedimento" the payment of the tax is recorded;
- The import customs "pedimento" must be in the name of the person who intends to make the crediting.

This issue is relevant since many taxpayers carry out import operations through third parties and sometimes the "pedimento" is issued in the name of the third party, while the resources for the payment of the tax come from the taxpayer who intends to carry out the import.

The provision does not restrict the crediting of the tax in operations in which the payment is made by a third party (advance payments or deposits to customs agents) when the customs declaration is issued in the name of the taxpayer that will make the crediting.

VAT in the pre-operating period. Notice of commencement of activities

The obligation to file a notice of commencement of activities is included in the law, which is currently provided for in form 9/IVA. This obligation was already included in the miscellaneous resolution under rule 4.1.10.

Temporary use or enjoyment of tangible property. Change in the causation assumption

The VAT concept of a leasing conducted within Mexico is changed for VAT purposes. The Reform abandons the criteria of considering that a lease took place in Mexico when the relevant good is delivered within Mexico and adopting the criteria that a lease will take place in Mexico when the use or enjoyment of the relevant goods occurs in Mexico, despite of the place of delivery of the good".

The provision is focused on combating practices of the shipping and aeronautical industries, where the delivery of the leased assets was made outside the national territory, as a planning measure to avoid triggering the tax liability. It could also be extended to other industries such as the automotive or industrial sector, where similar practices could be identified.

No proportion of use rule is included, where the use or enjoyment of the asset are both in Mexico and abroad.

SPECIAL PRODUCTS AND SERVICES TAX

Alcoholic beverages

It is established that, in addition to the physical tag that must be added to bottles of alcoholic beverages, an electronic one can be used, which will be the ones printed from the authorized ones by the SAT in labels.

The obligation for establishments for the final consumption of alcoholic beverages is to perform, in front of the customer, the scanning of the QR code of the tag that is added to the bottles or printed in the label or counter-label.

The SAT will be entitled to establish cases in which the obligation of destroying bottles will not be applicable.

TAX ON NEW VEHICLES LAW

Armored cars

It is established that special materials in vehicles, such as armor or other optional equipment, should be considered for the calculation of this tax, under the argument that these goods are not acquired by the general population

FEDERAL TAX CODE

Mexican tax residents

Article 9 of the FFC is amended to establish that the tax residence in Mexico will not be lost if the person who intends to change his/her residence does not prove the effective change, or if he/she does not file the corresponding notice of change of tax residence.

Likewise, it is established that the condition of tax residence in Mexico, for those who acquire a new tax residence in a REFIPRE, will be maintained for a period of five (5) years instead of three (3) years, as established in article 9 of the FFC currently in force.

it is established that such five (5) year term will not be applicable where Mexico (i) has entered into an extended information exchange agreement with the new country of residence and (ii) that Mexico has entered into and is in force a treaty with such country to allow mutual administrative assistance for the notification, collection and recovery of taxes.

Merger or spin-off of companies without business purpose and transfer of capital stock in spin-offs

Article 14-B of the FFC is amended to establish that in the event of a merger and/or spin-off what must be transferred is the "capital stock". The current article in force provides, in a generic manner, that what must be transferred in the event of such merger and/or spin-off is the "capital".

Also, it is established establish that, in the event that the tax authority, in the exercise of its powers of verification, notices that the merger and/or spin-off was carried out without a business reason, or that compliance with any of the requirements established in the article itself has been omitted, it is empowered to configure as a sale the transfers that occur as a result of such mergers and/or spin-offs, triggering with this all the applicable tax consequences.

Likewise, it is established that the financial statements used to carry out the merger or spin-off of companies, as well as those prepared as a result of such acts, must be audited by a certified public accountant.

Finally, in order to standardize the provisions related to mergers and/or spin-offs, the text of Article 15-A of the FFC is amended in order to specify that the transfer that must be made in a spin-off is that of the "capital stock".

Relevant transactions

Subsection d) of the first paragraph of article 31-A of the FFC, is amended in order to establish as part of the information that taxpayers are obliged to submit, the information corresponding to relevant transactions, in accordance with articles 14-B of the FFC, 24 and 161, both of the LISR.

Homologation of the image rights with the tax treatment of royalties

A third paragraph is added to article 15-B of the FFC, in order to establish that, within the concept of the use or concession of a copyright on a literary, artistic or scientific work, the right to the image is included, thus granting the treatment of taxable royalties to the income obtained as a result of the exploitation of the copyright inherent in the image.

Self-correction through the application of favorable balances

Article 23 of the FFC is amended to include the possibility for taxpayers who are subject to the exercise of powers of verification, to correct their tax situation by compensating tax favorable balances that were previously declared and not denied by the tax authority.

Prior to the reform, the text of said article only contemplated the authority's power to offset, ex officio, credit balances in favor before those amounts owed by taxpayers, whether due to their own debt or due to withholding.

Likewise, the amendment includes the procedure to which the exercise of this right will be subject, as well as the provision of an enabling clause for the authority to issue general rules to regulate those matters that are not regulated in such article.

Finally, a transitory article establishes that the exercise of this right will become effective as of January 1, 2023.

Joint and several liability

Article 26 of the FFC is amended, in order to add several hypotheses through which the authority may presume the configuration of joint and several liability, derived from the acquisition of negotiations, for the taxes that would have been caused when they belonged to another person. According to the reform, the tax authority will be empowered to presume that there is an acquisition of a business, unless there is evidence to the contrary, when it detects that the entity transferring and the entity acquiring the set of goods, rights or obligations are located, among others, in some of the following cases: (i) partial or total transfer of assets or liabilities or (ii) that the partners or shareholders have effective control and there is partial or total identity of those of the workers, trademarks and patents, industrial property rights or partial or total identity of the fixed assets, facilities or infrastructure used to carry out the development of their activities.

Likewise, it is included, within the assumptions of joint and several liability, those legal representatives of entities residing abroad: (i) with whose intervention they carry out activities for which contributions must be paid, up to the amount of such contributions and (ii) who are appointed for tax purposes, up to the amount of the contributions or benefits referred to in the corresponding tax provisions.

Finally, in the framework of the sale and/or disposition of shares or securities that represent the ownership of property in Mexico, carried out between residents abroad without a permanent establishment, it is included, within the cases of joint and several liability, those taxpayers residing in Mexico that do not file the information related to the corresponding declaration of disposition of shares or securities. Pursuant to this reform, the taxpayer in Mexico that fails to file the corresponding information will be jointly and severally liable with the taxpayer transferring the shares or securities, up to the amount of the taxes that would have been incurred as a result of such act.

Federal Taxpayer Registry

Sections A), B) and C) of article 27 of the FFC are amended with the following objectives:

> **a)** Include the obligation to register before the Federal Taxpayer Registry ("RFC") for those individuals who reach the age of majority by the law, that is to say, once they reach 18 years of age. In this regard, it is specified that such registration will be made under the heading of "Registration of individuals without economic activity" and hence they will not acquire obligations to file returns or pay taxes;
>
> **b)** Establish the obligation of those companies that are listed in the stock exchange to submit to the RFC the information of the entities that have control, significant influence or power of command;
>
> **c)** Establish that the tax authority will be empowered to cancel or suspend the RFC when it detects that in the previous five (5) fiscal years the taxpayer: (i) has not carried out any activity, (ii) has not issued tax receipts and/or (iii) has no pending obligations to comply with or there is proof of the death of the individual; and
>
> **d)** Specify that the tax authority will be authorized to use any technological tool that provides georeferences and, based thereon, update the information related to the taxpayers' tax domicile.

In addition to the above, it is established that having a positive compliance opinion on social security matters will be required in the case of liquidation of entities .

Exchange of information

Article 30 of the FFC is amended in order to include a ninth paragraph establishing that the term of conservation of the information and/or documentation that financial entities and savings and loan cooperative societies are obliged to keep (referred to in article 32-B and 32-B Bis of the FFC), are obliged to keep will be of six (6) years, counted from the date on which said information and/or documentation was generated or should have been generated, or from the date on which the returns related to said information and/or documentation were filed or should have been filed, as the case may be.

Tax obligations

Article 31 of the FFC is amended to include a twelfth paragraph, in order to establish that, in those cases in which the tax provisions do not indicate the deadline for filing tax returns, the deadline for filing such returns will be the same established for making the payment of contributions, in terms of Article 6 of the FFC, that is to say: (i) no later than the 17th day of the immediately following calendar month, in the case of contributions that are calculated by periods or (ii) within five (5) days of the moment of the causation of the contribution, in the other cases.

Likewise, the penultimate and the last paragraph of the aforementioned article 31, which referred to digital document certification providers, have been repealed, and thus the mandatory use of digital seals has been incorporated.

Standard for the automatic exchange of information on financial accounts

Article 32-Bis of the FFC is amended to establish that the tax authority is empowered to enter into collaboration agreements with other agencies or entities of the Federal Public Administration and thus be able to coordinate actions for the effective implementation of information exchange.

Regulation in the matter of controlling beneficiary

Articles 32-B Ter, 23-B Quarter and 32-B "Quinquies", all of the FFC, are amended to include the obligation of entities, trustees, settlors, trustors and/or the contracting parties or members in the case of any legal entity, to keep the information related to their controlling beneficiaries as part of their accounting and provide such information to the tax authority.

Regulation related to controlling beneficiaries

Articles 32-B, 32-B Quarter, 32-B Quinquies, 84-M, and 84-N, all of the FFC, are amended to include the obligation of obtaining, keeping and submitting to the tax authority the information and documentation related to the controlling beneficiaries that are part of the legal entity, trust or legal figure in question.

Offenses and fines related with controlling beneficiaries

In line with the above, Articles 32-B, 32-B Quarter, 32-B Quinquies, 84-M and 84- N, all of the FFC, are amended to include as offenses subject to fines those related with failing to comply with the obligation of obtaining, keeping and submitting to the tax authority the information and documentation related to the controlling beneficiaries that are part of the legal entity, trust or legal figure in question, per the following:

a) Between $1,500, 000.00 and $2,000,000.00 for each controlling beneficiary in case of failure to obtain, keep and/or file the information according to the means and formats established by the tax authority;

b) $1,000,000.00 for each controlling beneficiary in case the corresponding information is not kept up to date; and

c) Between $500,000.00 and $800,000.00 for each controlling beneficiary in the event that incomplete, inaccurate, and/or erroneous information is submitted.

Simulation of legal acts for tax purposes

Article 42-B is added to the FFC, thereby granting a new attribution to the tax authority so that it can determine, within the framework of its auditing attribution, the simulation of legal acts, solely and exclusively for tax purposes. Regarding operations with related parties, such assessment will have to be properly justified by the tax authority within an audit procedure.

It is important to keep in mind that this situation was already foreseen as a general rule on the FFC (Art. 5-A). However, this amendment entails granting this attribution to the tax authority as part of its auditing attributions.

Confidentiality document in tax audits

Article 46, Section IV, of the FFC is modified, while section VII is added to article 48 of the FFC. The foregoing with the aim of incorporating the subscription of a confidentiality agreement by the taxpayer, as a requirement to have the tax authority disclose confidential information of independent third parties regarding comparable transactions that affect the competitive position of such third parties. Within such amendment, it is established that the tax authority will issue general rules pertaining to the terms and procedure under which such confidentiality agreement must be entered into by the taxpayer.

This amendment is relevant, particularly with respect to transfer pricing audit procedures. This is because a confidentiality agreement will now be necessary for the tax authority to reveal to the taxpayer the confidential comparables of its direct competitors in which the authority based the respective assessment. The intention of this amendment is to protect the confidential nature of information from direct competitors to which only the tax authority has access.

Tax audits at the taxpayer's domicile

Article 49 of the FFC is amended to include financial institutions, trust companies, trustors or trustees and/ or the contracting parties or members in the case of any transparent vehicle, as subjects susceptible to the exercise of verification attributions, under the modality of domiciliary visits.

For purposes of the above, it is established that such domiciliary visits may be carried out at the place where the activities are carried out, as well as at the place where the legal acts that give rise to compliance with the obligations established in articles 32-B, section V, 32-B Bis, 32-B Ter, 32-B Quarter and 32-B Quinquies, all of the FFC, are celebrated, executed, have effects, are documented, are registered or are recorded.

Exceptions to the sequential review order

Article 52-A of the FFC is amended to exclude from sequential tax audits (those in which the tax authority firstly exercise a review of the audited financial statements) those taxpayers obliged to have their financial statements audited and those who voluntarily elected to audit such estatements.

Filing of the corresponding tax return for a payment in installments or deferred payments

Article 66, section II, of the FFC is amended in order to provide as a requirement for a taxpayer to pay in installments or to defer payments of taxes, that 20% of the total amount of the corresponding tax assessment has already been paid at the time of requesting the corresponding authorization. In this regard, the taxpayer must attach to the request for authorization, the tax return evidencing such payment.

Expiration in the exercise of the powers of verification

Article 67 of the FFC is amended in order to:

a) Include the request for a resolution to a transfer pricing consultation ("APA") as an event of suspension on the statute of limitations period to the powers of verification by the tax authorities. This suspension on the statute of limitations period will operate from the moment the request has been filed until the notification on the conclusion of the corresponding APA takes place.

b) Provide that, in the event the statute of limitations period is suspended for two (2) years or more, such suspension may not exceed seven (7) years, seven and a half (7.5), or eight (8) years, depending on the specific case.

Finally, it is specified that the statute of limitations period will not affect the implementation of the agreements reached as a result of comprehensive information exchange agreements that Mexico has in force or the implementation of agreements reached as a consequence of inter-institutional agreements entered into by Mexico.

Updating of the legal framework of tax secrecy

Article 69, section X, of the FFC, is amended in order to include as an exception to the reservation of tax information and taxpayers' data ("tax secrecy"), those individuals or legal entities whose digital seal certificate has been canceled by the tax authority for (i) not having corrected and/or disproved the irregularities detected within the procedure of temporary restriction of the digital seal certificate, (ii) not having corrected and/or disproved the presumption of the non-existence of operations and/or (iii) not having corrected and/or disproved the presumption of undue transfer of losses, unless the corresponding irregularities are corrected, or they correct their tax situation.

Update to the procedure against Companies that Invoice Simulated Transactions and Companies that Deduct Simulated Transactions

Article 69-B of the FFC is amended in order to include as a cause for the presumption of the non-existence of transactions covered by tax invoices, the case where the tax authority detects that a taxpayer has been issuing invoices supporting transactions with third parties, during the period in which the third party's certificate of use of the digital seal certificate has been suspended or temporarily restricted, without the third party having corrected the irregularities detected by the tax authority.

Penalty for the simulation of labor relationships

Article 108 of the FFC is amended to include a paragraph j) by which the simulation of the rendering of independent professional services under the Simplified Taxation Regime now included in the amendments to the Income Tax Law is considered as a qualified tax fraud offense.

Amendments related to Advance Electronic Signature or Digital Certificates (CSD)

- <u>Restriction of Advanced Electronic Signature (FIEL) or Digital Certificates (CSD) in the case of legal entities with partners or shareholders in an irregular tax situation</u>.

The situations where the FIEL and CSD applications, required to issue tax invoices, will be denied, are extended to any of the following: (a) any of the partners or shareholders with effective control of the applicant entity falls under articles 17-H, sections X, XI or XII or 69 sections I to V of the FFC (e.g., unguaranteed tax assessments, tax crimes, or cancellation arising from failure to pay a tax assessment); or (b) the applicant is a partner or shareholder with effective control of another legal entity that falls under any of the situations described on the aforementioned articles. The foregoing will not be applicable when the irregularity has been corrected.

With the entry into force of this provision, greater control must be taken regarding the tax compliance of all the partners or shareholders who have effective control of the taxpayer, to avoid that non-compliance of such partners or shareholders affects the operation of the group. Bear in mind that there are already court precedents according to which, upon the filing of a legal remedy against the cancellation of a CSD, an injunction to suspend the effects of such cancellation should be denied, meaning that during the litigation procedure taxpayers would be unable to issue tax invoices.

In our opinion, it is questionable to have the tax situation of a third party potentially trigger legal consequences to another taxpayer.

- Additional assumptions for temporary restriction of CSD referred to in Article 17-H Bis of the FFC.

Three new situations are added, whereby the tax authority is entitled to initiate the procedure of temporary restriction of CSD and, eventually, cancel the same, as follows:

a) Taxpayers subject to the new Simplified Taxation Regime, who omit the filing of three or more monthly estimated payments of the IT in a calendar year, consecutive or not, or the filing of the annual declaration of the IT.

b) Taxpayers who resist or obstruct the exercise of auditing attributions (i.e., by not providing the required information or not allowing access to auditors, among others). For these purposes, the tax authorities must have previously notified the taxpayer of the fine for having relapsed into conduct that hinders the exercise of auditing attributions.

c) Taxpayers falling into any of the two following situations: (a) any of the partners or shareholders that have effective control of the taxpayer, fall under the scope of articles 17-H, sections X, XI, or XII or 69 sections I to V of the FFC (e.g., unguaranteed tax assessment, tax crimes, or cancellation arising from failure to pay a tax assessment); or (b) the taxpayer is a partner or shareholder with effective control of another legal entity falling in the cases provided for in the aforementioned articles.

Again, it is advisable to properly keep track of tax compliance concerning all the entities in which there is effective control so as to avoid that the non-compliance in one of them affects the operation of the entire group.

We also consider that it is questionable having the tax situation of a third party potentially trigger legal consequences to another taxpayer.

- Clarification Procedure of Irregularities upon a Temporary Restriction and Cancellation of CSD (Articles 17-H and 17-H Bis of the CFF)

The possibility of applying for a clarification procedure of irregularities to restore canceled CSDs, is eliminated for those taxpayers who have exhausted the clarification procedure of temporary restriction referred to in articles 17-H and 17-H Bis of the FFC or for taxpayers published in the definitive list referred to in article 69-B (non-existent operations) and 69-B Bis (non-existent tax losses) of the FFC. This is because the clarification procedure cannot take place until the assumptions that gave rise to the respective publications are disproved. However, it is still questionable that the right of due defense would be violated in those cases that, for example, the taxpayer is not included in the aforementioned lists and, by mistake, the CSDs are canceled.

On the other hand, regarding the temporary restriction of CSD, Article 17-H Bis of the FFC only provided for the cases in which the tax authority, before canceling a CSD, would need to follow a temporary restriction procedure that if not clarified would lead to a cancellation of CSD. The Reform now adds that, if within this process the taxpayers do not provide the required information before the deadlines indicated in the article, the request for clarification will be considered as not submitted, so the suspension granted as a consequence of the clarification request will be null and void and the use of the CSD will be restricted again. In addition, the forty-day period prior to the cancellation of a CSD to file a clarification request before such cancellation takes place will continue to run.

Finally, it is added that in those cases in which the tax authority has issued a resolution in which it decides the definitive tax situation of the taxpayers derived from another procedure and that has given rise to a cause of restriction or cancellation of CSD (i.e., as it would be a resolution in which they publish in the definitive list of 69-B or 69-B Bis of the FFC to a taxpayer or a tax is assessed), such taxpayers may only carry out the clarification procedure provided that they first self-correct their tax situation.

The amended provisions do not provide guidance in connection with what happens when the decision is challenged through a legal remedy. In this case, we consider that a clarification should have been made stating that the reform should only be applicable in the case of final resolutions that cannot be subsequently claimed.

Modifications within the return procedures

The conditions under which the 40 days term that the tax authority has to rule on the tax refunds, within an ordinary procedure (without the exercise of powers of verification) is suspended, has been modified so that this term is suspended from the first request of information and until the taxpayer complies in full with the information and documentation requested, even up to the second request of information.

Additionally, a period of 20 days counted as of the notification of preliminary findings within a formal audit procedure on a tax refund is now included so that the taxpayer can submit documents, books or records to modify the facts or omissions that are known during the review for which it could give rise to a refusal of the tax refund. Having concluded the foregoing period, the authority must issue the corresponding resolution within the following wo working days. If the refund is authorized, it will be made within the ten days following those in which the resolution is notified.

It is advisable to attend in due course and in as much detail as possible the preliminary findings issued within a formal audit procedure on a tax refund . This is because in the case of refund procedures there is no opportunity to reach an agreement with the tax authority through a Settlement procedure before PRODECON, and then if the differences are not clarified, taxpayers will ultimately be forced to eventually challenge thorugh the available legal remedies a resolution denying the refund, thereby significantly extending the recovery time of the refund.

Characteristic of Digital Tax Receipts (CFDI)

Taxpayers who transport goods that are not subject to alienation must issue the CDFI that protects this operation. Likewise, taxpayers who issue CFDIs must have the corresponding obligations registered with the tax authority and comply with the general rules that the same authority will publish through its official website.

Finally, it is specified that CFDIs documenting expenses that do not have a justification and/or documentary support to evidence the returns, discounts, or bonuses before the tax authority, may not be reduced from the CFDIs documenting accrual of income of the taxpayer. The foregoing could be reviewed by the tax authority through the exercise of the relevant auditing attributions granted to the authority.

Fines and Penalties

- Penalties and fines related to the cancellation of CFDI

A new case considered as infractions related to the cancellation of CFDIs is added, when said tax receipts of income are issued by mistake or without just cause or are canceled outside the period established by the applicable laws.

- Fines related to labels, seals, and containers of alcoholic beverages, as well as for manufacturers and importers and cigars or manufactured tobacco

New cases and infractions are added for producers of alcoholic beverages, as well as for manufacturers and importers of cigars and manufactured tobaccos, such as failing to comply with health regulations, incorrectly using labels or seals, producing more electronic folios than those authorized, as well as making an incorrect use of the security codes granted by the tax authority.

- Infractions committed by public officials or employees

Finally, if public servants or officials do not issue or resolve the matters under their charge within the deadlines indicated by the procedural rules for a fiscal matter, this conduct will be considered as an infraction.

The above is a result of the constant delays by the tax authorities which result in issuing resolutions the requests submitted by the taxpayers after the relevant deadline has already elapsed.

Clarification of the export of goods that are not subject to alienation, or made free of charge.

The first paragraph of Article 29 is amended to specify that taxpayers who export goods that are not subject to alienation or made free of charge must issue the corresponding digital tax receipt, in order to provide legal certainty to the persons who carry out this type of transaction.

Publication of complements

A new validity requirement is introduced for the digital tax invoices. Starting 2022, the invoices must include, if applicable, the complements published by the Tax Administration Service on its web page, as well as to specify the publication information in such web page.

Issuance delimitation on expenditure digital tax receipts

There are cases in which taxpayers issue income vouchers that, when having a flaw in its emission, should be cancelled; however, taxpayers do not issue its cancellation and instead they issue expenditure vouchers without justification to reduce their income.

Therefore, Article 29, Section VI, third paragraph of the Federal Tax Code was modified to establish that in the case that expenditure vouchers are issued without having documentary support that demonstrate refunds, discounts or bonuses, these cannot be reduced from income, which may be verified by the tax authorities through their faculties.

Update of activities and obligations stated by taxpayers in case of discrepancy

Section V of Article 29-A of the Federal Tax Code is modified to include the power of the authority to update taxpayers' economic activities to its corresponding tax regime, whenever there is a discrepancy between the services, goods, merchandise or usage descriptions stated in digital tax receipts and the economic activity registered by taxpayers.

The foregoing, since the tax authority has spotted that some vouchers indicate operations that are not related to the economic activities that taxpayers have in the Federal Tax Registry.

Additional data on digital tax receipts

The elements of the digital tax invoice are modified to include the name or business name, the tax domicile's postal code for the person to whom the voucher is issued, as well as the code of the tax purpose that the recipient will give to it.

This is due to the fact that there is an increased number of taxpayer requests that do not recognize commercial transactions or labor relationships that are covered by such receipts, which is why the aforementioned requirements are included in order to have a better control for the identification of this type of situation.

Delimitation in the cancellation of income digital tax receipt

Article 29-A of the Federal Tax Code is modified to include that digital tax receipts may only be cancelled in the fiscal year in which they were issued and when the person in whose favor they were issued accepts their cancellation, unless the tax provisions provide a shorter term.

The foregoing, since the authorities have detected that during the exercise of verification powers taxpayers cancel digital tax receipts, which causes legal uncertainty regarding such cancellations. Therefore, it is proposed that in order for taxpayers to be able to cancel them, they must prove and justify that such receipts had a flaw in their issuance, being able to prove before the tax authority the origin of such cancellation.

This amendment is related to article 82, section XLII of the Code, which establishes a fine of 5 to 10% of the amount of each tax receipt as a penalty for the cancellation of tax receipts after the established term.

Establishment of the obligation for certain taxpayers to have their financial statements audited by a registered public accountant

Article 32-A of the Federal Tax Code is modified to include the obligation for certain taxpayers to have their financial statements audited by a registered public accountant, under the terms of Article 52 of the Federal Tax Code. Such obligation will be applicable to corporations that are taxed under Title II of the Income Tax Law, which in the last fiscal year declared to have recorded in their regular tax returns income equal to or greater than an amount of $876,171,996.50, as well as those that at the close of the immediately preceding fiscal year have stocks placed among the general investing public in a stock exchange.

The foregoing is derived from the non-compliance of some taxpayers with respect to the obligation to provide information regarding their tax situation, for which reason, as a control measure, it is necessary to establish the obligation for them to report their financial statements, since the information is presented incompletely or with errors, for such reason and, as a control measure, it is necessary to establish that, in order to comply with their tax obligation they must use a professional, such as a registered public accountant, to report their financial statements.

Taxpayers who are not required to have their financial statements audited may do so, at their own election.

On the other hand, the submission date of the report is modified to May 15, as this is a reasonable term for compliance with this obligation, since the information that will be audited is the information obtained at the close of the immediately preceding fiscal year.

Compliance opinion on tax obligations

In order to obtain a positive compliance opinion of tax obligations, compliance with the procedures established by the federal tax authorities in social security matters is now mandatory.

Tools and programs for voluntary compliance

For better compliance with the powers of the tax authorities, paragraphs c) and j), Section I, of Article 33 are modified.

With this, the development of electronic tools, forms or return formats for their easy filing are introduced, which will be disseminated on time, as well as the information of dates and means of filing all returns.

Programs to promote tax certainty and prevent tax controversies through voluntary compliance are also introduced.

Filing declarations, notices and information reports

Article 41, first paragraph of the Federal Tax Code is modified to state that authorities may require the filing of information reports on volumetric controls referred to in Article 28, Section I, paragraph B of the Code, when such reports are not filed on time. Accordingly, it is proposed to amend section I of said Article to refer to "information" instead of document (also when they have not been submitted in accordance with the applicable provisions).

Obligations and penalties of the registered public accountant

Section III of Article 52 of the Federal Tax Code is amendad, to establish as an obligation of the registered public accountant to inform the tax authority when, as a result of the preparation of its report, the accountant becomes aware that the taxpayer has not complied with the tax and/or customs provisions or has carried out any conduct that may constitute the commission of a tax offense.

Likewise, Section III of Article 91-A is amended, in order to make the public accountant responsible when failing to comply with the obligation set forth in Section III, third paragraph of the Code, referring to informing the tax authority when, derived from the preparation of its report, the accountant becomes aware that the taxpayer has failed to comply with the tax and customs provisions or that has carried out any conduct that may constitute the commission of a tax offense.

Appraisals

Section VI is added to Article 42, to indicate that the tax authorities may perform the appraisals referred to in this section, and may also perform appraisals with respect to all kinds of goods or rights referred to in Article 32 of the Income Tax Law and all kinds of services. The appraisals made by the authority shall be made also in accordance with the provisions in this Code for appraisals.

The foregoing is for the purpose of verifying compliance with tax and customs provisions and, if applicable, to determine omitted contributions or tax credits, as well as to verify the commission of tax offenses and to provide information to other authorities.

Verification powers over the financial institutions, fiduciaries, trustors or trustees

Article 42 is amended to include Sections XII and XIII that establish that the tax authorities may conduct home visits and desk reviews of financial institutions, fiduciaries, trustors or trustees, in the case of trusts, or the contracting parties or members of any other legal entity, to verify compliance with the above-mentioned provisions, as well as the obligations derived from Articles 32-B, Section V, 32-B Bis, 32-B Ter, 32-B Quater and 32-B Quinquies of the Code.

Maximum period for the substantiation of the conclusive agreement procedure

Article 69-C of the Federal Tax Code is amended to include a maximum term of twelve months for the substantiation of the conclusive agreement carried out before the taxpayer ombudsman’s office, in order to avoid unnecessary delays that impact the determination of surcharges and updates of tax credits in case a consensus is not reached.

Fine reductions

An additional requirement is added in for fine reductions to proceed. The new requirement provides that the taxpayer that requests the reduction should not file or had filed a mutual agreement procedure established in a Double Tax Avoidance Agreement to which the Mexican State is a party.

Case in which it is necessary to guarantee the tax interest

A proceeding assumption to guarantee the tax interest is added. The request by a taxpayer of a mutual agreement procedure established in a Double Tax Avoidance Agreement to which Mexico is a party, without having previously filed an internal administrative appeal.

Administrative Enforcement Procedure suspension

Elimination of the exception to guarantee the tax interest and thus suspend the administrative enforcement procedure, the filing of a mutual agreement procedure established in a Double Tax Avoidance Agreement to which Mexico is a party.

Tax invoices for transactions with the general public

The second paragraph of Article 14 of the CFF is amended by eliminating all reference to simplified receipts since, nowadays, transactions carried out with the public in general must be registered in a digital tax receipt by internet (CFDI) using the generic Federal Taxpayers Registry.

The foregoing is provided that they contain the requirements established by general rules issued by the Tax Administration Service.

Fines related to provisions of the Income Tax Law

In connection with the amendments to the Income Tax Law, a second paragraph is added to subparagraph II of Article 77 of the CFF, in order to increase the fines applicable to taxpayers who do not comply with the provisions of the Income Tax Law with respect to certain obligations of the taxpayer.

This amendment updates and aligns the current legislation with the aggravating conduct to the noncompliance applicable within the Income Tax Law, thus discouraging noncompliance with tax obligations, in accordance with the amendment to article 75, subparagraph V of the CFF.

Violations related to authorized certification providers

In order to include the conduct that is considered violations that certification providers may commit when sending CFDIs, Article 82-G is added to the CFF. Such conduct is related to the non-compliance with the validations of the requirements set forth in Article 29-A of the CFF, as well as non-compliance with the technical documentation indicated in the general rules issued by the Tax Administration Service.

Now, such amendment is in consideration of the high volume of digital files that cover certified CFDIs received monthly by the aforementioned suppliers, with respect to which, upon entering the SAT’s storage databases, inconsistencies are identified, which leads the SAT to allocate resources to purge the electronic invoices with inconsistencies and reject them in order to be considered valid invoices.

Lastly, article 82-H is added to the CFF, which establishes the penalties in the event that the conduct set forth in the aforementioned article is committed.

NOL's (Net Operation Losses) offset in the optional regime for corporate groups

There are added to article 76 of the FFC, sanctions related to integrating or integrated entities that apply the optional regime for groups of companies and that report tax losses greater than those actually suffered. Such fine will be increased to an amount from 60% to 80% of the difference that is the result of the reported loss and the actual loss, regardless of whether the company had totally or partially reduced its tax profit.

Infractions committed by financial institutions

Articles 82-E and 82-F are added to establish several infractions and fines to financial institutions that do not collect information from residents abroad for whom they carry out financial transactions, as well as those institutions that fail to comply with their obligations under the Common Reporting Standard ("CRS").

Anti-corruption legislation

Subsection j) is added to the seventh paragraph of Article 108 of FFC, establishing that any practice aimed at the application of a tax benefit that is carried out in violation of the anti-corruption legislation in force, such as payments made to obtain a tax benefit, will be considered tax fraud.

Accounting for volumetric controls of hydrocarbons and petroleum products

To simplify compliance with the obligation of volumetric controls, article 28 section I, section B of the FFC is amended, which eliminates the granting of authorizations as suppliers of equipment and programs to carry volumetric controls, for the provision of services and verification of the correct operation and functioning of equipment and computer programs, which issue the opinions that determine the type of hydrocarbons or petroleum products in question, by the SAT.

Parameters of the obligation to conduct volumetric controls

As part of the modifications included in article 28, section I, section B of the FFC, the parameters to be considered regarding the obligation to conduct volumetric controls are included, which consist of the following:

- The obligation to generate and keep reports respecting volumes on a daily and monthly basis of the operations conducted by the taxpayer.
- Volume records must be obtained from measurement systems.
- Specify the measurement points.
- The obligation to associate volume records with CFDIs and/or pedimento (customs return).

Taxpayers obliged to comply with this provision are those who manufacture, produce, process, transport, store, including storage for their own use, distribute or dispose of hydrocarbons and petroleum products, such as:

- Legal entities that extract hydrocarbons under the protection of an assignment title or a contract for the exploration and extraction of hydrocarbons.
- Those that treat or refine oil or process natural gas and its condensates.
- Taxpayers who conduct the compression, decompression, liquefaction or regasification of natural gas.
- Individuals or legal entities that transport hydrocarbons or petroleum products.
- The storage of petroleum products for own use, as long as, on average, they consume a volume greater than or equal to 75,714 liters per month of petroleum products during the year in question; or, that they store natural gas for their own use in fixed facilities to receive it for self-consumption.
- Individuals or legal persons that distribute natural or petroleum gas.
- Individuals or legal entities that sell natural gas or oil.

Finesrelated to volumetric controls

Articles 81, section XXV, 82, section XXV and 111 Bis, sections I, II, III, V and VI of the FFC are amended to establish fines and criminal sanctions for those taxpayers who do not comply with the requirements in connection with volumetric controls.

Presumptive determination for the hydrocarbons sector

The power of the tax authority to conduct the presumptive determination of income is established in case the taxpayers of the hydrocarbon sector present inconsistencies in their records, for which the following are included:

- No volumetric control reports are sent to the tax authority.
- The taxpayer does not have the proper measurement of volumetric controls and/or that their measurements are not reliable.
- There is a difference between the existing measures and those calculated.
- It is detected that the taxpayer receives more than what is invoiced at the purchase level or what is imported.
- It delivers more liters than the invoices as sale or invoices more than what the taxpayer is aimed to sell.
- It received more than it sold.

In addition to the above, the methodology and the ratio to be determined that the authority will apply as part of this presumption are established.

Applicable ratio

Article 58, section I of FFC is amended to establish the ratios applicable to the activities and products in the hydrocarbons and petroleum products sector, by which the tax authorities will determine the taxable income of the taxpayers referred to in the ITL.

- Liquefied gas

In the specific case of liquefied petroleum gas, the information reported by distributors to the Energy Regulatory Commission ("CRE", per its acronym in Spanish) and those published by Petróleos Mexicanos ("PEMEX", per its acronym in Spanish) will be taken into account; an estimate of the gross profit (without considering operating or distribution costs) for the referred activity will be determined; therefore, for the presumptive determination, a ratio of 38% is established on the gross income declared or presumptively determined (net earnings).

- Gasoline

Respect to gasoline, it is proposed to estimate a gross sale price (without considering operating or distribution costs) based on the spot price reported by the Energy Information Agency of the United States of America. In addition, it is intended to consult data from the CRE with respect to retail prices to determine an average price; considering this price difference (spot price and CRE prices) to determine a gross profit (without considering operating or distribution costs) for the referred activity. Based on this estimate and considering the presumptive determination, a 15% ratio is proposed for the sale of gasoline and diesel at service stations on the gross income declared or determined by the tax authorities.

Measures to combat smuggling due to omission of excise tax applicable to taxpayers on hydrocarbons and petroleum products industry

Article 102, third paragraph of the FFC is amended to establish an exception with respect to the non-formulation of the declaration of detriment to the tax authorities.

At this point and in the case of the omission in the payment of the excise tax applicable to the goods referred to in article 2, section I, paragraph D) of the excise tax lax (Fossil Fuels and Non-Fossil Fuels) that are introduced into the national territory, the declaration referred to in article 92, section II of the FTC (declaration of detriment) will be made, even when the amount of this omission does not exceed $195,210.00 or 10% of the taxes caused, whichever is greater, and even if the amount of the omission does not exceed 55% of the taxes to be paid when the omission is due to inaccurate tariff classification due to a difference of criteria in the interpretation of the tariffs contained in the laws of the general import or export taxes, provided that the description, nature and other characteristics necessary for the classification of the merchandise have been correctly declared to the authority.

Presumption of smuggling

Regarding the presumption of smuggling, article 103, section XX of the FFC is amended to determine that, in the case of fossil and non-fossil fuels, the exception established in this section will not be applicable. In this sense, smuggling will be presumed when the assumption referred to in article 2, section I, subsection D) is given and with it the payment of the excise tax of such merchandise is omitted, due to the non-observance of the customs agent or agency of their responsibilities and obligations regulated in the Customs Law.

Likewise, subsections XXII and XXIII are added to the referred provision, to presume smuggling when goods or merchandise are transferred by any means of transportation in national territory, without the CFDI of income type or transfer type, as applicable, to which the complement of the bill of lading is incorporated.

In addition to the above, a crime is presumed when the transfer is of hydrocarbons, petroleum products or petrochemicals, which do not have such documentation, as well as the CFDI complements of such goods.

Sanctions for the crime of smuggling of hydrocarbons and oil products

Article 104 of the FFC is amended to implement a last paragraph, which establishes as a penalty the definitive cancellation of the importers' registry of specific sectors established in the Customs Law.

Liability of customs agents and agencies

The second paragraph of sections XII and XIII of article 105 of the FFC are repealed, with the purpose that the subjects who intervene in the operations and are contributing with the SAT, develop the exercise of their functions with due integrity, avoiding any type of improper practice.

To increase the care in the performance of the duties of customs agents, it has been determined that they will be sanctioned when they participate in the importation of this type of merchandise.

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Tax

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