Crediting unwithheld VAT

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The authority has found taxpayers who acquire goods under the V5 approach, withholding no value added tax (VAT). In light of this, the authority has conducted audits that require for the application and payment of the tax withholding. This results in the taxpayer to pay tax, other government charges and penalties, but not being able to credit such tax withheld as taxpayer fail to pay at the outset, pursuant to the terms provided by law.

Aiming at facilitating certain foreign affairs transactions in Mexico, the authority allowed for taxpayers - registered under the approach of entity certification in VAT and excise tax mode, AAA item, or under the approach of authorized economic operator - to be able to permanently transfer the goods temporarily imported by entities under the IMMEX program to entities residing in Mexico which do not have an IMMEX program. This transfer would be applied through the general rules of foreign trade using the "V5" customs declarations.

Based on this context, the maquila industry has used this kind of customs declarations for transferring goods into Mexico, not requiring to export them physically and then import them again into the country. A nonresident owns the goods imported under the temporary regime by a maquila company, and it is this nonresident who transfers the product in Mexico.

As a consequence of the foregoing, and pursuant to the Value Added Tax Law (VAT Law), the entity who purchases the goods owned by the nonresident, using V5 customs declarations, shall withhold the VAT on the transaction, based on the general 16 percent rate irrespective of the tax due and paid on the permanent import.

When goods are purchased using V5 customs declarations, VAT shall be withheld on the respective transaction

Taking into account that a significant number of taxpayers have experienced the issue described above, on September 11, 2017, the Tercera Resolucion de Modificaciones a la Resolucion Miscelanea Fiscal para 2017 (Third Resolution of Amendments to the Miscellaneous Tax Regulations for 2017, or "RMF 2017", per its Spanish abbreviation), the authority issued the following regulation:

Crediting the unwithheld tax

4.1.11. For purposes of article 5, section IV of the VAT Law, taxpayers who may not have withheld VAT in accordance with article 1-A, section III of the referred law before September 21, 2017, may revise their tax situation, provided that payment of the amount due for the tax that should have been withheld, is paid including the respective inflation rate, interest and, if applicable, the penalties that may arise.

Should the taxpayer have a recoverable tax balance, it may offset said balance against the amount of tax that should have withheld including the respective update, as set forth by article 23 of the Federal Fiscal Code, provided that the taxpayer pays the interest and, if applicable, the respective penalties.

When taxpayers pay or offset the tax pursuant to this regulation, they may consider that VAT was transferred to them and, thus, credit it.

To take benefit of this regulation, the provisions of the proceedings file 10/IVA "Solicitud de acreditamiento de IVA no retenido", contained in Anexo 1-A shall be met.

As a result of the above, and based on the referred file, for applying the referred regulation, the taxpayer shall give notice in the following cases:

- Taxpayers who are subject to the authority's exercise of verification powers:
  - For in-office audits, before issuing the official letter of observations
  - For domicile inspections, before issuing the final record
- Taxpayers who are not subject to the authority's exercise of verification powers; at any moment

The following benefits may be obtained from the above:

1. Though lately paid, VAT may be credited
2. Should recoverable tax balances result, these may be offset, though it is not clear whether it refers to recoverable tax balances already reported or to be generated
3. It is important to consider that the VAT was transferred in the tax receipt; thus, it is possible to take deduction on the cost of such disbursements

Taxpayers who do not withhold VAT in accordance with article 1-A, may revise their tax situation

Furthermore, the regulation described above has caused some matters of concern, as detailed below:

1 Should recoverable tax balances be offset, is it possible to reduce the amount of interest considering as a reference the date when the recoverable tax balance was reported in the tax return, according to the Rules of the Federal Fiscal Code?

2 May the benefit provided by the aforesaid regulation be applicable to unwithheld VAT after September 22, 2017?

Wording of the second paragraph of the regulation transcribed, seems not to be intended to reduce the interest but to offset the recoverable tax balances and, if applicable, to pay interest should the offset have not been applied.

Consequently, it may be intended that the taxpayer - under the presumption that it may have not withheld tax before September 22, 2017 - has elements to apply the benefits provided by the regulations over subsequent periods. Thus, it is important to mention that sometimes the authority has accepted such application over subsequent periods. However, it is recommended to examine it with the authority on a case-by-case basis.

Following the tax amendments published for 2019 and the universal offsetting eliminated by the Revenue Law, on January 30, 2019, the authority published in the Sixth Resolution of Amendments to the Miscellaneous Tax Regulations for 2018, an amendment to the referred regulation 4.1.11, which wording remains the same for 2019 - derogating the second paragraph and modifying the third one, which eliminates the possibility to offset recoverable VAT balances against this tax withholdings.

In addition to the foregoing, a systematic analysis was issued on March 11, 2019, by the Taxpayer's Advocacy Agency (PRODECON, per its Spanish acronym) whereby certain technical arguments are set forth to avoid the aforementioned withholding, by requiring to modify the foreign trade regulations regarding the certification and authorized economic operator. Such withholding seems to be confirmed, highlighting that, as of the date, no conclusion has been reached by the Tax Administration Service (SAT, per its Spanish acronym) on this resolution.

Finally, as mentioned in this bulletin, it is important and recommendable that the entities who have been involved in transactions using V5 customs declarations, to evaluate and review the appropriate compliance with VAT withholdings or, if applicable, to document the reason why the withholding was not made.

Should an omission be found as a result of the audit, it would be important to examine the following scenarios:

Carry out an auto-correction in accordance with regulation 4.1.11 not recurring to the tax authority

Carry out an auto-correction in accordance with regulation 4.1.11 recurring to the tax authority in order to confirm certain application criteria in regard to the regulation and, if applicable, to avoid penalties including invitations or forgiveness thereof under a number of existing approaches

Prepare a defense file so that, in case of an audit, this can be used for facing the matter with the court or with the Taxpayer's Advocacy Agency

Under any such scenarios, it is worth documenting and grounding the procedures for entities to evidence their deductions and maintain the possibility to recover the recoverable VAT balances generated from paying the aforementioned tax withholdings.

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Note: the views and opinions herein expressed are those of the author and do not necessarily represent KPMG in Mexico's views and opinions.

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