

Tax Reform Initiative for 2020

In compliance with a Constitutional requirement, on September 8th, 2019, the Federal Executive introduced to the Mexican Congress the economic package for the year 2020.

From the commitment expressed by the Mexican President that there will not be more or higher taxes, but there will be a greater collection, it is intended to strengthen them through a combat to the tax evasion and avoidance.

The economic package for 2020 includes the initiative to the Mexican Revenue Law, the Expenditure Budget and the General Criteria of the Economic Policy.

Below, we will mention the relevant aspects of the economic package introduced before the Congress of the Union by the Federal Executive, with the understanding that during its discussion some modifications may arise:

Economic indicators

It is estimated that economic growth by 2020 will be between 1.5% and 2.5%, using 2.0% for budgetary purposes with 3% inflation; figures that turn out to be the same as the presented for the year 2019, where the only change is that an annual inflation of 3.4% was estimated in 2019.

The oil price is estimated at 49 dollars (USD) per barrel and an average rate of the 28-day Mexican Federal Treasury Certificates (CETES by its acronym in Spanish) rate of 7.4%.

Regarding the dollar exchange rate, it is estimated an annual average of MXN \$19.90 pesos.

Surcharges

The current surcharge rates will remain in cases of extension, as shown below:

Surcharges	Monthly Rate
Extension	0.98%
Bias up to 12 months	1.26%
Bias from 12 to 24 months	1.53%
Bias greater than 12 months and deferred payment	1.82%



For such purposes, it is specified that the aforementioned surcharge rates includes the inflation adjustment.

Measures oriented to combat tax evasion

It is proposed to classify as tax fraud and its similar the offence of organized crime, including the issuance and disposal of fictitious invoices, in addition, the renewal of the taxation and control areas of the Mexican Tax Authorities (MTA) based on the use of technology and artificial intelligence tools that is expected to identify more efficient and faster to the tax evaders and taxpayers that have failed on their obligations. For these purposes, the following changes are proposed in the Federal Fiscal Code (FFC).

Advanced electronic signature (e.firma)

In order to avoid several risk schemes in the creation of the e.firma, it is established that the MTA may validate the information related to the identity, address and, where appropriate, taxpayer's tax status and will be able to deny its granting.

Digital stamp certificates

It is proposed to modify the provisions related to the reason that may invalidate the digital stamp certificates when the digital tax invoices (CFDIs per its acronym in Spanish) are used to support non-existent, simulated or illegal transactions. These proposed changes may create a legal uncertainty in the fact that the Tax Authority may leave the certificates without effect when any assumption are detected, even without exercising their powers of review, that a taxpayer did not support the effective acquisition of goods or services, nor of joint and several liability corrected its fiscal situation within thirty days following the issuance of listed taxpayers.

Moreover, some assumptions are included in order to invalidate the digital stamp certificates, in the event that the Tax Authorities during its verification activities, considers that taxpayers does not meet the requirements; among others, the declared income does not match with the amount of the issued CFDIs, or when the means of contact for the use of the Tax Mailbox are not correct.

Joint and several liability

In order to avoid that companies whose invoice non-existent operations are liquidated without liability for liquidators, it is proposed to modify the article of joint and several liability in case of the liquidators or trustees, for the tax contributions that the company had to pay in liquidation or bankruptcy during its management. In addition, it is proposed to modify the joint and several liability regarding the responsibilities of the general management or of the sole administration of the legal entities, as well as of partners, shareholders or associates for the contributions caused or not withheld during their management.

Third fiscal contributor

It is proposed to add a new article in the FFC where the "third fiscal contributor" is defined, this will allow the Tax Authority to obtain information that provides clues to identify alleged issuers of CFDIs of non-existent operations. The incentive for the third contributor is participating in the lottery tax draws.

Tax contributions offsetting

In accordance with the removal of universal offsetting in the Mexican Revenue Law of 2019, this modification is proposed in the FFC, to indicate that the offsetting taxes would only apply in the case of similar taxes.

General anti-abuse rule

Probably the modification proposed in the FFC that can generate more legal uncertainty is related to the addition of an article that empowers the Authority to re-characterize or consider non-existent legal acts when they lack "business reason" and generate tax benefit. For these purposes, it is proposed to conjecture that there is no business reason when the quantifiable economic benefit, present or future, is less than the tax benefit. In addition, it is proposed that the Authority presumes, unless proven otherwise, that a series of legal acts lack business reasons when the economic benefit pursued could be achieved through the performance of a smaller number of legal acts and the fiscal effect of these would have been more burdensome. It is also established that it will be considered as a tax benefit any tax reduction, removal or temporary deferral of a contribution, including deductions, exemptions, no restraints, non-recognition of an income or gain, among others.

Disclosure of reportable schemes

It is proposed to include a new chapter into the FFC "on the disclosure of reportable schemes" that pretends to obligate to the tax advisors who are responsible or are involved in the commercial design, organization or implementation of a reportable scheme. For these purposes, it is proposed that the tax advisors submit an informative return in February on an annual basis. In this sense, if the tax advisor fails to submit the return, taxpayer would be obligated to disclosure it.

A Reportable scheme is defined for anyone who generates directly or indirectly a tax benefit in Mexico, for example, among others, when the information exchange is avoided; when the application of wage provisions for individuals is avoided; when there are legal acts that allow tax losses to be transmitted to people other than those who generated them; when foreign residents are involved to whom an agreement is applied to avoid double taxation; when avoiding the consideration of an expense as non-deductible item; when involved operations that transmit intangible assets; in case that a company restructure is carried out; when there are interpretations or application of tax provisions that produce effects similar to those provided in the non-binding criteria or regulatory criteria of the Authority; when using foreign entities for whose beneficiaries are not designated; when avoiding triggering a permanent establishment (PE); when a hybrid mechanism is involved; when the identification of the effective beneficiary is avoided; when tax residence changes are made.

Digital economy

In order to simplify the payment of the Corporate Income Tax (CIT) for individuals, in case of income obtained through the intermediation platforms that also process the payments made by the acquisition of goods and services, it is proposed that the tax is paid through a withholding made by technological platforms, whether they are legal entities resident in Mexico or foreign resident with or without PE in the country.

In addition, it is proposed that the withholding will be carried out over the total income, not including value added tax (VAT), considering it as an advanced payment. The aforementioned platforms must pay the withholding through the corresponding tax returns which will be submitted no later than the 17th of the following month for which the withholding was made regarding each individual that provides services or disposes of goods through the technological platforms, computer applications and any similar.

Through transitional provisions it is mentioned that this new section will be in force from April 2020.

VAT on digital services

As part of the measures to increase efficiency in VAT collection, it is proposed to modify the treatment applicable to some digital services provided by foreign residents without establishment in Mexico when they are provided to recipient of such services that are located within national territory



through the addition and modification of various provisions of the VAT Law (VATL). In this sense, it is included as part of the concepts, that it will be considered as provision of services any digital services provided by foreign residents without establishment in Mexico, as well as, that the services provided within national territory when the recipient of the services is located in Mexico, with the purpose of establishing a linkage criteria that allows establishing a methodology to taxed foreign residents with or without PE providing such services.

VAT on intermediation services

In addition, the concept of digital intermediation services between third parties is added in the VATL, whether they are suppliers or clients of these, including the advertising services provided to them. As part of the intermediaries obligations, they shall provide information to the MTA about the operations carried out through them; and when they also process the payments, they charge on behalf of the seller or service provider, in addition to the price, the corresponding VAT, and carry out a 50% withholding of said tax, which must be paid no later than the 17th of the following month.

Administrative facility

It is included as an administrative facility, in case of individuals who have obtained income up to MXN \$300,000 through intermediation platforms, and who do not receive income from other concepts (with the exception of income from wages and salaries and interests), may benefit from a simplified tax scheme which consists in considering the withholdings made as a definitive payment; however, when the collection of the activities has been carried out by the intermediation platform and others have been made directly by the taxpayer, the individual must submit a monthly tax return for the payments made directly, applying an additional rate of 8%.

Additionally, it is established that digital intermediation services between third parties provided by residents in Mexico are subject to the same obligations as foreign residents in terms of withholdings and supporting information. It is proposed that these provisions – those that comprise the applicable treatment; the correlatives applicable to residents in Mexico that provide digital intermediation services between third parties; those applicable to individuals and corporations that operate through these intermediaries – become effective as of April 2020.

VAT withholding for labor subcontracting

It is proposed that organizations that hire personnel companies that are located in the case of labor subcontracting, withhold and pay the corresponding VAT due to said hiring. This pretends to avoid the opportunities for tax evasion in this type of activities. Moreover, the deduction of such expenses for CIT purposes, It is imposed as an additional requirement to have withheld the corresponding VAT.

Changes in international taxation

Several amendments to the Mexican Income Tax Law (MITL) are proposed in order to harmonize several provisions in accordance with the recommendations of the OECD regarding the BEPS action plan project.

Concept of PE

It is proposed that when a resident abroad acts in Mexico through a person different to an independent agent, and said person habitually concludes contracts or, performs the main role that leads to the conclusion of contracts, the foreign resident will trigger a PE in Mexico.

It will be presumed that an individual or legal entity is not an independent agent when acts exclusively or almost exclusively on behalf of residents abroad, when both are related parties. There is no reference to economic or stock control as the proposal made in the BEPS project.



Regarding the activities excepted from triggering a PE, it is added as a general requirement that the activities should be considered as ancillary.

It is considered that a PE will be trigger, in case of business operations in which fragmentation schemes are used, if jointly these activities do not have a preparatory or auxiliary nature.

Residents abroad with operations with shelter companies

In response to various requests from the industry, which groups the shelter companies in the country, it is proposed that residents abroad who carry out manufacturing operations with this type of companies, pay the corresponding CIT from the beginning of its operations instead of having the first 4 years exempted, as currently happens. This modification pretends to give legal certainty to foreign investors that they will be able to meet their tax obligations in Mexico in a consistent manner and not as currently established, in which during the first years they have no fiscal obligation and subsequently have 4 years to comply with these through the company, under the modality of shelter, considering the option to continue in the country or register as a company separately from the shelter operation.

Hybrid mechanisms

By an unclear wording, it is established that the fiscal transparency will not be recognized in Mexico of those entities that are not subject to taxes, but only their partners or shareholders.

On the other hand, the "credit" of the tax paid indirectly in distribution of dividends or profits is denied, when said dividend or profit were deducted by the payer or in the event that the tax is credited in some other country, except when the income in comment is accumulated.

Non-deductible payments made to foreign residents

Significant changes are proposed regarding the payments made abroad, since they cannot be deductible those payments made to foreign related parties or through a structure settlement when the income is subject to preferential tax regimes, disregarding the possibility to deduct if this payment was made at market value.

Income through transparent entities

In case of obtaining income through fiscally transparent entities, this shall pay the corresponding tax in Mexico, regardless of whether it is a business activity, or if the tax rate paid abroad is 75% lower than the Mexican rate.

Preferential tax regimes application

Additional assumptions are included for determining cases where there is control by the Mexican resident over the foreign entity, which are, among others: voting participation, decision making and effective right over assets or profits.

In case of income for the business activities, it is established that it should be subject to a preferential tax regime when more than the 50% of the foreign entity income is Mexican sourced, or represents a deduction in Mexico.

Also, it will be considered as passive income those stemming from intangibles developed abroad, even when do not represent a deduction in Mexico.

Lease of movable property

With the aim of provide further clarification and avoid any possible inconsistency, it is mention that income sourced in Mexico obtained by a foreign resident for granting the use or enjoy of movable



properties aimed to commercial, industrial and scientific activities, will be taxed in terms of the "royalties" provision.

New limitations for the interests' deduction

Considering the final report of the Action 4 – BEPS, and for avoiding that multinational groups indebted to its subsidiaries, and considering that this report establishes limitations for the interests' deduction is more effective than the thin capitalization rules, it is proposed that the net interest deduction (accrued interests in favor and accrued interests charged) cannot be greater than 30% of the taxable income adjusted. In case that the interests cannot be deducted in that fiscal year, these can be deducted in a 3 year period, as long as comply with specific requirements.

This disposition will be applicable to the deductible interests from the fiscal year 2020, whether if the debts originating these interests derived from prior fiscal years.

As part of the exceptions for this deduction, there are the debts contracted for financing public infrastructure works, construction of real estate and national productive enterprises.

Reducing the profit-sharing (PTU) from the income tax advanced payments

It is proposed to include in the MITL the tax incentive established in the Mexican Revenue Law of 2019 and previous years, the proportional amount of the PTU paid in the fiscal year to reduce the taxable income for purposes of the income tax advanced payments from May up to December of the corresponding fiscal year.

Interests withholding from financial institutions

During 2020 it is proposed that financial institutions determine the tax to be withheld to individuals, considering a 1.45% rate over the amount subject to the interest payments.

This rate represents an increasing of 29.42% regarding the withholding tax rate applicable in 2019 (1.04%), as well as represents an increasing of 315% regarding the withholding tax rate applicable in 2018 (0.46%), both over the same taxable basis (amount subject to the interest payments).

Income tax payment for lease income

In matters of CIT and VAT, in case of immovable property leasing trial, when the lessee is forced to the payment of due rents, it is proposed to the Judge to not authorized these payments to the lessor if this cannot support the issuance of the corresponding CFDIs. Nevertheless, according to the MITL and VATL, the lessor obligation is to issue the CFDIs regarding the "collected" rents, and not regarding the accrued rents.

Facilities for independent sellers

With the aim of facilitate the tax obligations of the commercial sector engaged in the retail outside of a commercial place, mainly those carried out through catalogues, it is proposed a mandatory withholding scheme to the independent sellers. For these purposes, the legal entities selling the products should determine the corresponding withholding by applying the tax rate for the individuals, considering as income the difference between the selling suggested price and the purchase price.

The withholding made will be considered as an advanced payment, except when the income obtained in the immediately prior fiscal year has not exceed MXN \$300,000, which in this case, the withholding made will be considered as a definitive payment.

Tax incentives to common (ejidos)

It is pretend to grant a preferential tax regime for reducing the tax burden to the legal entities of the agrarian law, founded by landlords and tenants, whose income only represents the commercialization

and industrialization of products derived from agricultural, livestock, forestry and fishing activities, as long as the income obtained in the immediately prior fiscal year has not exceed MXN \$5,000,000.

Tax incentives

The Mexican Revenue Law for 2020 remain the tax incentives that have been granted on an annual basis; however, some tax incentives were added in the MITL and removed of the Mexican Revenue Law. Some of the remaining tax incentives in the Mexican Revenue Law are the following:

The tax incentive that provides the offsetting against the CIT, the excise tax paid on the diesel acquisition for final consumption, as:

- Diesel acquisition for machinery, used in general terms, in business activities and marine vehicles.
- Diesel acquisition to be used for carrying out agricultural or livestock activities; alternatively it is provided a limited refund scheme for these taxpayers.
- Diesel acquisition to be used for automotive purposes in vehicles to be only used for public transportation and private passenger or cargo purposes; this tax incentive will not be applicable to taxpayers that render theirs services mainly to related parties.

It is allowed to credit the 50% of the payments made in the national toll highways network for taxpayers only engaged in the public transportation and private passenger or cargo services.

It is allowed to the acquirer of fossil fuel (when it is not intended to combustion) to credit the corresponding excise tax against the annual CIT.

Tax incentives on MITL

MITL 2019 tax incentives are maintained in general, the following amendments are proposed:

- a) It is included on the MITL an incentive that usually was considered into the Mexican Revenue Law, which allows to deduct an additional 25% to the effectively paid salary of people with motor, hearing or speaking disabilities, as well as blind people. The fiscal incentive implies a substitution for being greater than the established by 2019 fiscal year in MITL that may deduct the CIT withheld and filled derived from the salary of the people mentioned before.
- b) The possibility of individuals to create or establish real estate infrastructure trusts (FIBRAS) is eliminated. Benefits are retained only for FIBRAS whose participation certificates are placed among the large investor public. Through a transitional provision, a period of two years is granted to pay the CIT caused by the gain obtained in the disposal of the assets made to the trust.
- c) It is proposed to eliminate the obligation to present information on the application of tax incentives for research and development of technology and installations for high performance sports.

It is included in the provisions of the MITL, the tax incentive established on the Mexican Revenue Law, which allows to apply the tax incentive on monthly estimated payments when those are related with the national film production and distribution and the installations for high performance sports.

VAT

Regarding the VAT, the following amendments are proposed:

- a) *Credit of VAT paid to suppliers when acts or activities are carried out that are not subject to the VATL.* The Federal Executive proposes this change in Law derived from a precedent of the Second Chamber of the Mexican Supreme Court, which resolved by contradiction of thesis that it is correct to include in the mechanics for the determination of the creditable VAT factor (when taxable and exempt activities are carried out) to activities not subject to VAT. Notwithstanding the foregoing, it is illogical that many of the activities not subject to such tax, are those carried out outside the country, as well as the expenses associated with

such income that were not subject to the VATL. In addition, it would be the first time that a law includes the mechanics to determine the tax on acts or activities not content in said Law and, therefore, will be outside its scope of competence.

- b) *Offset of favorable taxes.* The change in the proposal for offset purposes is to standardize the criteria established in the Mexican Revenue Law of 2019 in order to remove the universal offset and only allow to credit the favorable VAT against the payable VAT or claim the amount in refund.
- c) *Exemption for acts or activities carried out by welfare or charitable institutions, civil societies and associations created without profit.* It is proposed to modify the VATL so that acts or activities carried out by authorized donors are considered exempt (disposal of goods, provision of services and granting of temporary use or enjoyment of goods) and, therefore, could not generate favorable VAT balances. In the explanatory statement it is argued that this change is to protect the altruistic and social assistance interests of these institutions.
- d) *Taxation moment on free services.* Notwithstanding that the VATL establishes that this tax is triggered at the moment that the consideration is effectively collected, it is proposed to modify this law to establish that in the free services the tax is triggered at the moment in which said services are provided, which breaks with the established logic about this taxation.
- e) *Tax return on casual imports of intangible goods and services.* It is proposed to modify the VATL to specify that in accidental or casual acts the tax must be stated within the following 15 days in which the respective consideration was paid. The VATL Regulations establishes the possibility of crediting the tax derived from the importation in the same monthly tax return to which the imports correspond. Therefore, it is not clear that the Authority intends that VAT be paid first and then credited, or, if it can be made in the same tax return, regardless of whether it is not the monthly one, a situation that must surely be clarified by a miscellaneous resolution.
- f) *Withholding certificates.* It is proposed to incorporate into the VATL the option established in the Mexican Revenue Law of not issuing proof of withholding such tax. It should be clarified that this situation is reflected in the CFDIs issued by individuals who provide professional services or grant the temporary use or enjoyment of goods.

Excise tax (IEPS per its acronym in Spanish)

Regarding the IEPS, the following modifications are proposed:

- a) *Fees on non-industrial handling tobacco.* It is proposed to increase the tax quota for each sold or imported cigar from \$ 0.35 to \$ 0.4980. The argument is that this increase corresponds to inflation from 2011 to 2019, in this regard it is proposed that the tax quota will be updated on an annual basis.
- b) *Fees on flavored beverage.* The proposal is to increase the current tax quota from \$ 1.17 per liter to \$ 1.2705; this is due to an increase in inflation, in this regard it is proposed that the tax quota will be updated on an annual basis.
- c) *Definition of energy drinks.* Prior the reform the IEPS Law considered energy drinks to non-alcoholic beverages, added with the caffeine mixture in amounts greater than 20 milligrams per hundred milliliters of product and taurine or glucoronolactone or thiamine or any other substance that produces similar stimulating effects. In this regard, the new reform change the definition by eliminating the reference of the caffeine limit per hundred milligrams.
- d) *Definition of octane in gasoline, automotive fuels, fossil fuels and treatment of oil blends.* In the matter of fuels, the proposed reform change the definition of gasoline and diesel, opening the possibility of including the new reformulated gasoline in two types: the less than 91 octane and the greater or equal to 91 octane, to be congruent with the Official Mexican Standard (NOM); With respect to blended gasoline, the definition of automotive fuels, non-fossil fuels and ethanol will also modified.

- e) *Removal of the fee scheme on beers.* In order to simplify the calculation of this tax, the application of \$ 3.00 per liter is proposed, which can be reduced if reused containers are used.
- f) *Offset of favorable balances of IEPS.* In accordance with the intention of the Federal Executive, the references to offset of favorable balances of this tax are removed.
- g) *Register of importers of alcohol and incrystallizable honey that do not produce alcoholic beverages.* The MTA replaces the registration of the Register of Importers of Alcohol, Denatured Alcohol and incrystallizable Honeys, for the registration in the Register of Importers of the Customs Law. Therefore, the references of the Law are modified only to mention the Register of Importers.