

# *Latin American Tax Newsalert*

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MEXICO

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## *Compliance with the new Mexican Miscellaneous Foreign Trade Rules regarding VAT*

On October 10, 2011 modifications to the Miscellaneous Foreign Trade Rules (rule 3.8.4) were published in Mexico's Official Gazette, and included a change in the application of Value Added Tax ("VAT") to maquila structures. The sale of a virtually exported good to a Mexican resident will now be considered an internal sale subject to VAT withholding, to be remitted by the resident purchaser of the good. Please see our previous Newsalert of July 19, 2011 for further details.

This represents an important change in the VAT treatment of virtually exported/imported goods in Mexico, which was originally effective October 1, 2011.

### *Background – virtual exports*

Semi-finished or finished goods produced by a maquiladora must be exported in order to comply with the IMMEX provisions. These provisions also allow legal protection from a taxable permanent establishment ("PE") for the maquiladora's foreign principal. The exported finished goods can then be sold outside of the Mexican territory or re-imported on a definitive basis to be sold in Mexico.



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Previously, in order to sell goods to Mexican clients (and comply with this rule), many businesses physically exported finished goods from Mexico and immediately re-imported them. This practice resulted in costs (and delays) for both businesses and Mexican Customs. To resolve this issue, Mexico introduced virtual exportation and importation. The customs declaration depicts a virtual export, followed by a virtual import. However, the goods in question are delivered to another (IMMEX registered) Mexican entity, as they remain physically in Mexico throughout the transaction.

In addition to allowing continued PE protection for principals involved in virtual exportation and importation, the transaction was exempt from VAT since it was not considered to take place within Mexico. However, the recent change in the Miscellaneous Foreign Trade Rules has ended the VAT benefit, as the transaction is now subject to the standard VAT rate since the virtually exported goods are physically in Mexico. Therefore, the Mexican resident purchaser must not only pay the import VAT (just as a physical import carries VAT when processed by Customs), but must also retain and remit the VAT related to the sale-purchase transaction.

### *Commentary*

- While the VAT may be creditable, the timing between the import and purchase of the goods and their subsequent sale causes a cash flow disadvantage for the purchaser. Therefore, impacted entities should plan (if possible) their purchases and sales in a manner that allows for maximum VAT credits to coincide with VAT charges in order to reduce the monthly amount payable to the Mexican tax authorities.
- The authorities may want to provide clear guidance for refunds so as to allow a timely return of the cash previously remitted.
- Affected parties should also consider the cost-benefit difference with the maquiladora's definitive exportation of the finished goods, so that the purchaser may import the goods which are physically outside Mexico, and thus only be subject to import VAT.
- Note that, administratively, the new rule requires the foreign seller to separately state VAT on invoices, and follow the invoicing rules applicable to nonresidents that do not have a PE. Otherwise, the VAT will not be easily creditable and, in addition, the purchase might not meet Mexican deductibility requirements for income tax purposes.
- Mexican purchasers should ensure they are complying with the new rule by withholding the VAT on the purchase from the foreign resident, reporting that VAT in their returns and remitting it to the tax authorities. Non-compliance would not only result in interest and penalties, but also, as mentioned above, threaten the income tax deductibility of the purchases. Thus we recommend that businesses implement the necessary system and administration controls in order to meet their compliance obligations.

Taxpayers should ensure they have the necessary planning and controls in place to comply with the new rule (effective December 1, 2011, with the first remittance of VAT due on or before January 17, 2011 – unless further postponed by the Mexican authorities), in order to manage the impact on their cash position.

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