Mexico focuses on Maquiladora conversions

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In brief

Earlier this week, the Executive Branch of the Mexican government presented its Tax Reform Package to the Mexican Congress. While the Tax Reform package contains a number of very significant legislative proposals, the Mexican tax authorities have separately announced that they will begin addressing certain issues identified in the OECD's Base Erosion and Profit Shifting (BEPS) report. This is part of a previously-defined action plan in accordance with which the tax authorities intend to apply anti-avoidance measures with respect to certain business restructurings, particularly those involving supply or value chain conversions that utilize the existing maquiladora regime.

The tax authorities' action plan targets multinationals that have restructured their Mexican manufacturing and distribution operations by migrating intangible property (IP) and related profits away from Mexico. In line with the above, the authorities have noted that over 700 BEPS targets have already been identified for audit, and that 270 of these targets have converted from full-risk operating companies to limited-risk structures involving maquiladoras with high levels of domestic production and sales in the domestic market. The tax authorities have stated that their goal is to capture the appropriate amounts of profits on their domestic sales.

In detail

The tax authorities' action plan will focus on groups with manufacturing and distribution operations in Mexico that have a high proportion of sales of locally-produced goods in the Mexican market. This initiative is not focused on maquiladoras that export the majority of their production. The relevant highlights include:

The government will focus heavily on substance. Specifically, in cases in which there are no actual substantive changes to structures, including the establishment of appropriate functions and risks, the government intends to require recognition/imposition of tax as if the restructuring had not occurred. In addition, there is a risk that the tax authorities could assert that a permanent establishment of the foreign principal is deemed to exist.

The tax authorities are establishing a specialist unit (similar to the units designated for international tax, transfer pricing, auditing, legal, etc.) to focus on BEPS. Maquiladoras would receive the initial focus.

The tax authorities may be willing to negotiate with taxpayers who approach the authorities for reasonable settlements before the Tax Administrative Services initiates a formal audit. The authorities may be open to address those situations less aggressively.

The takeaway

Multinationals that are, or that have previously, engaged in a supply chain restructuring in

Mexico utilizing the maquiladora regime should consider reevaluating their supporting documentation and other evidence of substance relating to their structures with the goal of evaluating and identifying potential risks vis-à-vis the new BEPS focus of the Mexican tax authorities.

Let's talk

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