

Mexico's 2022 budget includes numerous tax changes

November 1, 2021

In brief

The Mexican Congress on October 26 approved several changes to different tax laws as part of the proposed 2022 budget. These changes include amendments to the Mexican Income Tax Law (MITL), the Value-Added Tax Law (VATL), and the Mexican Federal Tax Code (MFTC). These amendments are still pending publication in the Federal Official Gazette; most of them are expected to enter into force on January 1, 2022.

Key changes include:

- Business reasons will be required to access various tax benefits, such as a transfer of shares at cost basis or the deferral of the capital gains tax derived from business restructurings, as well as for tax-neutral mergers and spin-offs.
- Maquiladoras will not be permitted to comply with transfer pricing obligations through Advance Pricing Agreements (APAs), and the only applicable mechanism to determine the profit margin will be the safe-harbor rules.
- The reinstatement of the tax report ('dictamen fiscal') obligation carried out by a CPA registered with the Mexican Tax Authority.
- Activities related to hydrocarbons will be subject to greater controls and penalties for noncompliance with the relevant tax obligations.
- Taxpayers that carry out acts or activities considered outside of the VATL's scope will not be able to credit the tax paid to suppliers or on the importation of goods when linked to those out-of-scope activities.
- If a taxpayer enters into a Mutual Agreement Procedure (MAP) under a tax treaty, the tax authority interest will have to be guaranteed.

The takeaway: Given the broad nature of the changes introduced, multinationals with operations in Mexico should analyze the impact of these new provisions as well as the relevant business requirements and tax formalities to observe when determining the Mexican tax treatment.

In detail

General rules to Mexican residents

Determination of foreign exchange rate for tax purposes

The foreign exchange rate gain or loss may not be less than or exceed, respectively, that which would result from applying the foreign exchange rate published by the Mexican Central Bank, on the day on which the gain or loss is realized or incurred.

Technical assistance, technology transfer, or royalties

Payments in connection with technical assistance, technology transfer, or royalties paid to Mexican residents will only be deductible for specialized services or the execution of specialized works, which are not part of the corporate business purpose or the preponderant economic activity of the beneficiary of the services, in accordance with the recently enacted subcontracting/outsourcing reform.

Business restructurings

Domestic restructurings

Mexican tax authorities will only authorize the transfer of shares at cost basis for business restructurings where the parties are tax residents in Mexico and belong to the same group. There are additional requirements needed before the registered CPA can issue the tax report.

Whenever the Mexican tax authorities detect during a tax audit that the business restructuring lacks a business reason, or that it does not comply with any of the relevant requirements, the authorization will be void and the tax corresponding to the transfer of shares must be paid.

Additionally, taxpayers shall include in their authorization requests all “relevant transactions” that are related to the restructure subject to the authorization, and that took place during the five years prior to the request.

Finally, when taxpayers perform a “relevant transaction” within five years after the implementation of the business restructuring, they must file an informative tax return.

“Relevant transactions” include:

- Any transfer of property, enjoyment, or use of the shares or voting rights of the issuing, acquiring, or transferring entity.
- A grant of a right over the assets or profits of the issuing, acquiring, or transferring entity upon a capital redemption or liquidation.
- An increase or decrease in the book value of the shares of the issuing, acquiring, or transferring entity by more than 30% to that determined on the date in which the authorization is requested.
- An increase or decrease in the equity of the issuing, acquiring, or transferring entity.
- A shareholder increases or decreases its percentage of participation in the capital of the issuing, acquiring, or transferring entity and, as a result, the percentage of participation of another shareholder increases or decreases.

- The tax residency of the shareholders of the issuing, acquiring, or transferring entity changes.
- A transfer of one or various business lines of the issuing entity, or of the acquiring or transferring entity.

Cross-border restructurings

In connection with tax-deferral authorizations for cross-border intra-group restructures, the deferred tax will become due whenever the Mexican issuer and the acquirer cease to consolidate their financial statements for accounting purposes.

Moreover, the tax deferral authorization shall be rendered void when the tax authorities, during a tax audit, ascertain that the restructure or the relevant transactions (see section above covering domestic restructurings) related thereto performed either five years prior to, or five years after, the restructure lack a valid business reason, or when the tax authorities detect that the exchange of shares results in income subject to a preferential tax regime.

When a relevant transaction is performed during a five-year period after the restructure, the acquiring entity or its legal representative shall inform the tax authorities.

Finally, the tax report prepared in connection with the restructure shall include the business lines and the economic activity of both the issuing and the acquiring entity, as well as certifying that those entities consolidate their financial statements.

Mergers and spin-offs

If during an audit review the Mexican tax authorities determine that there is a lack of business reasons behind the merger or spin-off or that the taxpayer has not complied with any of the MFTC's requirements, a transfer of assets will be deemed to take place (voiding the tax neutral effects).

For purposes of the foregoing, the accruable income should be the gain derived from the merger or spin-off.

In connection with the above, the tax authorities may take into account the "relevant transactions" related to the merger carried out within the five years before or after the merger or spin-off.

The following will be considered a "relevant transaction":

- Any transfer of property, enjoyment or use of the shares or voting rights of the merged or spun-off entity or entities.
- A grant of a right over the assets or profits of the merged or spun-off entity or entities upon a capital redemption or liquidation.
- An increase or decrease in the book value of the shares of the merged or spun-off entity or entities by more than 30%.
- An increase or decrease in the equity of the merged or spun-off entity or entities.
- A shareholder increases or decreases its percentage of participation in the capital of the merged or spun-off entity or entities and, as a result, the percentage of participation of another shareholder increases or decreases.
- The tax residency of the shareholders of the merged or spun-off entity or entities changes.
- A transfer of one or various business lines of the merged or spun-off entity or entities

In addition, if any of the above-mentioned relevant transactions take place within five years after the execution of the merger, then the surviving entity must report such transaction.

The financial statements utilized to carry out the merger or spin-off, as well as the financial statements resulting from the merger or spin-off should be audited by an independent and authorized CPA. This CPA will prepare a tax report (known as dictamen fiscal in Spanish) that should be filed with the tax authorities.

Losses on spin-offs

In the case of spin-offs, the tax losses pending to be offset against tax profits must be divided between the spun-off entities that have the same business activity.

Concept of spin-off

The new budget clarifies that in the case of a spin-off, the share capital is transferred, which is in accordance with the provisions of the General Law of Commercial Companies.

Changes in partners or shareholders for amortization of losses in mergers

The budget introduces several new provisions whereby it shall be considered that there is a change of or shareholders to authorize the amortization of losses of the surviving entity against the profits obtained from the same business units.

Financing transactions

Back-to-back financing

Financing operations that derive interest from legal entities or permanent establishments in Mexico will attract the same treatment as back-to-back loans (interest recharacterization to nondeductible dividends), whenever such operations lack business reasons.

Thin capitalization

For purposes of the thin capitalization rules, net operating losses pending to be offset that have not been considered in the determination of the tax result should be included in the calculation of the tax equity for the year based on the tax balances. This option may not apply when the result of that operation exceeds 20% of the total accounting equity of the fiscal year in question, with certain exemptions.

Certain clarifications are included for hydrocarbon exploration and extraction activities.

Also, the exception applicable to non-regulated SOFOMs (Mexican non-bank financial institutions) no longer will apply when performing activities with related parties.

Reduced withholding tax rates

The reduced withholding tax rate on interest payments made to nonresidents with a source of income in Mexico (4.9%) shall not be available when the beneficial owners receive directly or indirectly, individually or jointly with related parties, more than 5% of the interest payments regardless of the origin of the loans, meaning if they derive from one or multiple loan instruments and are:

1. shareholders of more than 10% of the voting stock of the debtor, directly or indirectly, individually or jointly with related parties, or

2. legal entities in which more than 20% of their shares are property of the debtor, directly or indirectly, individually or jointly with related parties.

Due to the above change, SOFOMs (even those that are regulated) that received financing from related parties may not continue to apply the 4.9% withholding tax rate.

Non-Mexican residents

Fair market value of Mexican-source income

Non-Mexican residents that obtain Mexican-source income shall determine their income, gains, and, when applicable, deductions that derive from transactions executed with related parties, taking into account the consideration or profit margin that should have been obtained with independent parties (arm's-length principles).

Income from the acquisition of immovable property

For Mexican-source income derived from the acquisition of immovable property obtained by a non-Mexican resident, if the Mexican tax authorities determine a 10% difference between the property's agreed sale price and appraisal value, the party liable to pay the tax would be the seller if it is either a resident in Mexico or a nonresident with a permanent establishment in Mexico.

Capital gains tax

For Mexican-source income derived from the disposal of Mexican shares between related parties, the new budget introduces an obligation to include documentation in the relevant tax report (to apply for the 35% rate on the net gain) in order to demonstrate that the sale price of the transferred shares is the fair market value. Additional rules will be issued to address publicly traded shares.

Legal representative

Legal representatives who are appointed in Mexico by non-Mexican residents will voluntarily assume joint and several liability, which will not exceed the taxes to be paid by the non-Mexican residents, but they must have sufficient assets to respond as a jointly liable person.

Maquiladora regime

For maquiladora companies and those that have a shelter program, the new changes eliminate the possibility to request a particular resolution or APA with the Mexican tax authorities to comply with their transfer pricing obligations and avoid triggering a permanent establishment in Mexico. The so-called 'safe harbor' rules will be the only available method to comply with this requirement.

Value Added Tax (VAT)

Acts or activities outside the scope of the VATL

Acts or activities that are outside the scope of the VATL are defined as those that the taxpayer does not carry out in national territory, as well as those not specifically listed in the VATL, for which the taxpayer obtains income or compensation, and makes expenses, investments, or imports and VAT is paid. Under the new provisions, the VAT paid by the taxpayer that is linked to activities that are outside the scope of the VATL would not be recovered.

Federal Tax Code

Concept of royalties

The right to the image will be incorporated within the concept of the use or granting of use of a copyright in a literary, artistic, or scientific work.

Joint and several liability

For purposes of defining joint and several liability in the acquisition of an ongoing concern, the budget lists cases that may arise from such a situation.

Those entities or individuals who are appointed as legal representatives in Mexico in compliance with the tax provisions also are jointly and severally liable with taxpayers, up to the amount of the taxes and in terms of the relevant provisions.

Tax report

Mexican entities will be obligated to audit their financial statements and produce a tax report prepared by an authorized CPA in Mexico when in the previous fiscal year they:

1. declared accruable income for an amount equal to or greater than MXN\$1,650,490,600, or
2. listed shares among the greater investor public in the authorized stock exchanges.

Controlling beneficiaries of legal entities, trusts, and tax figures

Seeking to ensure that the tax authorities comply with international standards requiring minimum levels of transparency in connection with controlling beneficiaries of legal entities, trusts, and other legal figures for tax purposes, the budget introduced changes that include the obligation of such vehicles to obtain and maintain, as part of their accounting records, and to disclose with the Mexican tax authorities, the relevant information related to their controlling beneficiaries in a reliable, complete, and up-to-date manner. For such purposes, the definition of controlling beneficiary is included in the FTC.

Let's talk

For a deeper discussion of how the 2022 Mexican tax budget tax changes might affect your business, please contact:

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