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Relevant Topics of the 2020 Tax Reform

On December 9, 2019, the Decrees that modify the Income Tax Law, the Value Added Tax Law, the Excise Tax Law, the Federal Tax Code, the Federal Rights Law and the Income on Hydrocarbons Law were published in the Federal Official Gazette. Likewise, on November 25, 2019, the Federal Revenue Law for 2020 was also published in the Federal Official Gazette (all amendments hereinafter collectively referred to as "the Tax Reform").

In this document we summarize what we consider are the most relevant amendments contained in the Tax Reform, with a special focus on those that have an important impact both on cross-border transactions and on foreign investors doing business in Mexico.

Through this Tax Reform, no additional or new taxes were incorporated to the Mexican tax framework; however, relevant amendments and inclusions were carried out with a specific goal to generate an indirect increase in tax revenue; additionally, significant changes were included in order to empower the tax authorities with more legal tools to review transactions carried out by taxpayers.

The main changes include: a new general anti-avoidance rule; additional assumptions to consider partners, shareholders, general managers, general directors and sole administrators as jointly liable with the corporation for taxes due; a special regime to disclose transactions by tax advisors and in some cases by taxpayers (whenever such transactions fall under a set of schemes listed in the statute); Preferential Tax Regime (hereinafter referred to as "PTR") rules were also modified; new rules for tax transparent entities and vehicles were included; a new regime for services provided through or assisted by digital platforms was incorporated for both income tax and value added tax purposes.

Additionally, the exceptions for the creation of a permanent establishment in Mexico by foreign residents were modified; a general limitation of deduction of interest is introduced in the form of a 30% of tax EBITDA cap; as well as limitations on deduction to payments carried out directly or indirectly to related parties under specific circumstances.

Amendments to income tax and value added tax rules regarding the existing obligations derived from rendering services that are considered labor outsourcing were made, including a 6% withholding obligation for value added tax purposes in the case of payments related to services through which personnel is somehow granted. This withholding obligation replaces the labor outsourcing obligations for income tax purposes.

The income tax withholding rate on interest paid by entities of the Mexican financial system is increased from 1.04% to 1.45% of the principal that originates the interest.

We remind our readers that our comments and analysis included in this document are for information purposes and they should not be considered as professional advice. The new rules must be analyzed for each particular entity or client that may be affected by them. We also remind our readers that our comments might not be shared by tax, administrative or judicial authorities.

This Tax Reform, including relevant transitory provisions that complements it, supersedes all administrative provisions, resolutions, authorizations or permits, both general and particular, that oppose the provisions of the amended laws. We recommend a careful review of any particular authorization a taxpayer may have, in order to conclude if its validity prevails after the Tax Reform.

In the following pages we provide our comments on the main aspects of the Tax Reform, under the following:

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2020 TAX REFORM

FEDERAL REVENUE LAW

Interest withholding rate

[Art. 21 FRL]

For 2020, the applicable income tax withholding rate for interest arising from accounts held in Mexican financial institutions will increase from 1.04% (2019) to 1.45%. The procedure used to determine this annual withholding rate considers public and private reference indexes and prices published by the Central Bank, including inflation. This increase is determined considering the current interest rates and the maximum income tax rate for individuals, which is 35%.

We consider that the procedure to determine the tax rate does not match the current economic conditions of the country and will trigger unjustified excess withholdings to a large number of taxpayers, mostly to small savers.

Favorable balances offsetting

[prior Art. 25-VI FRL]

In accordance with the suspension of the offsetting rules of tax favorable balances of one federal tax against payable balances of another applicable during 2019, known as "universal offsetting", such rules were eliminated from the Federal Revenue Law (FRL) for 2020. Changes in several laws were made to provide that offsetting of favorable balances of a federal tax will only be available against payment obligations deriving from the same tax, including accessories.

INCOME TAX LAW

Considering the Preamble of the Executive Branch of the Mexican government when proposing the Tax Reform, several amendments to the tax laws with the purpose of adopting and implementing the measures contained in the final version of the Base Erosion and Profit Shifting (BEPS) report of the Organization for Economic Co-operation and Development (OECD) were included.

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It is worth mentioning that BEPS report was drafted by the OECD to identify and provide countermeasures for aggressive international tax planning that artificially shift economic benefits to jurisdictions with low or non-existent taxation.

Permanent establishment update

[Arts. 2 and 3]

To adapt the Mexican legislation to the recommendations included in Action 7 of BEPS report and specific modifications established in the Multilateral Instrument (MLI), some amendments were included in order to update the assumptions under which a permanent establishment could be deemed to arise in Mexico.

Specifically, foreign residents who act in Mexico through agents not considered as independent, that on regular basis conclude or have a principal role in the conclusion of agreements, would be deemed to create a permanent establishment in Mexico.

An agent would be deemed as dependent whenever it acts exclusively or almost exclusively on behalf of foreign residents that are considered to be related parties.

Also, activities that historically were considered exceptions to the creation of a permanent establishment, should now only be deemed as exceptions if they have a preparatory or auxiliary nature for the business activities of the foreign resident.

A new rule will apply for cases where there is a fragmentation of activities of a business to argue that each one, separately, qualifies under the preparatory and auxiliary exception. For these cases all the activities will be deemed to be part of a cohesive business and therefore enforcing the creation of a permanent establishment in Mexico.

As the assumptions in the domestic law for the creation of a permanent establishment in Mexico were extended and they may affect the operations carried out in Mexico by foreign residents, it would be relevant to reexamine the way in which non-residents carry out their activities under these new assumptions.

Foreign tax credit
[Art. 5]

Two assumptions were included with the main purpose of limiting foreign tax credit in cases where there is a hybrid structure that could create distortions in the credit system.

Indirect foreign tax credit for Mexican residents will be denied when the dividend or profits payment is a deductible item for the entity paying such dividend.

A foreign tax credit will be disallowed in cases where a corresponding amount of tax was also creditable in another jurisdiction, to the extent that this credit was not related to an indirect credit or the income was not taxed in the country where it was credited.

Deductible and non-deductible items

Labor outsourcing income tax obligations – eliminated
[Art. 27-V-VI]

Certain formalities consisting in collecting supporting documentation from service providers in case of labor subcontracting included few years ago in the Mexican Income Tax Law (MITL) were eliminated.

It is now established as a deductibility requirement for expenses of such nature to fulfill the new withholding obligation for value added tax purposes, when applicable.

BEPS inspired Reforms

With the apparent intent to adapt what it is stated in BEPS final report, starting in 2020 the MITL will include provisions to prevent tax avoidance practices that may cause an erosion of the tax basis and that may lead to profit shifting; the most relevant changes are as follows:

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Payments to related parties or through structured agreements

[Art. 28-XXIII]

Back in 2014, it was decided to include rules that would be in line with the BEPS report; this was controversial as the final report had not been published. These changes were added to the MITL with the intent of protecting the Mexican tax system from tax avoidance.

According to the Preamble to the Bill submitted by the Executive Branch, the amendments included in 2014 were not clear enough as to deny the deduction of payments carried out by Mexican residents, when the payments are related to income that is not taxed abroad because such payments would be received by a hybrid structure.

Therefore, a new rule to disallow the deduction of payments carried out to related parties or under a structured agreement is included, when the recipient's income is subject to a PTR.

A structured agreement shall be understood as any arrangement made by the taxpayer or any related party, by means of which the amount paid to a third party that is subject to PTR rules is determined on payments that provide a tax benefit to the taxpayer or a related party, or it may be concluded that this was the reason of such arrangement.

There are some exclusions to this limitation such as when the recipient is resident in a country deemed as a PTR but that has a broad information exchange agreement with Mexico and the payment is related with a business activity, to the extent it can be proved that the entity has enough capabilities to carry out such business activity; or when the payment is indirectly taxed for the recipient under the new PTR rules or under the new rules for tax transparent entities and vehicles.

Also, this provision includes specific assumptions that may extend the non-deductibility effect to expenses paid to foreign related parties, when their income is not taxable on the jurisdiction where they reside.

Taxpayers must analyze the effects that this rule may have under their current corporate structures, to determine whether payments to related parties may be affected by this rule.

Payments to non-residents

[Art. 28-XXIX and XXXI]

Additional measures were included to avoid or neutralize the existence of hybrid mechanisms. A provision introduced in 2014 based in the BEPS report draft was eliminated. This rule dealt with the disallowance of deductions for interest, royalties and technical assistance payments paid to related parties.

Starting in January 2020, payments made to related parties will not be deductible if they are also deductible by a related party or by the taxpayer in another jurisdiction, if they also qualify as a tax resident in such jurisdiction. Payments made in Mexico by foreign residents with a permanent establishment located therein will not be deductible in Mexico when they are also deducted in the country of residence of their home office; this limitation will not be applicable when the income generated by the taxpayer is also accrued by the home office.

Interest-expense deduction limit

[Arts. 28-XXXII and 45]

In response to Action 4 of the BEPS final report, a new rule is included in order to further limit the deductibility of interest payments; this is due to the fact that, under the view of the Executive Branch, taxpayers have used these expenses to erode their Mexican tax base and to shift profits.

The new rule provides a limit to the deduction of net interest payments for an amount that does not exceed 30% of the adjusted tax earnings before interest, taxes, depreciation and amortization (EBITDA) of taxpayers.

The inclusion of this new rule is not in line with the economic reality of the country, as Mexico requires foreign sourced funds to carry out productive activities in the country and this rule could be extensive to any type of funding.

Procedure

a) Net Interest exceeding Ps$ 20 million

According to the rule, net interest in excess of 30% of the adjusted tax profit will be disallowed. Net interest is defined as interest accrued from the taxpayer's debt minus all

taxable interest in the year, when such net interest exceeds a *"de minimis"* threshold of twenty million pesos. At the current exchange rate, such amount represents approximately one million US Dollars.

The twenty million pesos exception should not be considered by individual companies only, but rather considering all parties in groups and related parties.

b) Adjusted tax EBITDA

The adjusted tax EBITDA would result from adding to the tax profit of the corresponding year, interest accrued in the same year, depreciation and amortization of assets and intangibles. Even if there is no tax profit of the year, the adjusted tax profit would have to be computed.

c) Deductible interest

As it was mentioned, net interest in the excess of 30% of the adjusted tax EBITDA would be considered as non-deductible and be carried forward to the next year. Any excess to that amount must be added to the net interest of that following year in order to determine each year's limitation.

According to the new rule, a taxpayer will be allowed to carry forward any excess for up to ten years, under a set of rules provided for such purpose.

Exceptions to the rule

This new rule would not be applicable to interest arising from financing related to specific activities, such as public infrastructure; constructions in Mexico including the acquisition of land; projects related to the oil and gas industry; mining; and certain activities related with electricity and water projects.

Additionally, State-owned entities and entities of the Mexican financial system would not be subject to this limitation. These mainly include banks, broker dealers, insurance companies, financial leasing companies and certain multiple-purpose financial institutions (*SOFOMs)*.

The new limitation will coexist with thin capitalization rules. Whenever the non-deductible interest under the new rule are higher than those limited under thin capitalization rules, in which case, thin capitalization rules will not apply.

Consolidation

It is provided that for groups of entities this rule could be applicable on a consolidated basis and for these purposes the tax authorities will issue the corresponding rules.

Inflation adjustment

For purposes of the inflation adjustment, non-deductible interest under this new rule would not be included; however, when the carryforward of the interest is applied, the interest would be included for inflation adjustment purposes.

Transitory provisions

For this new rule, no transitory provisions were added. Therefore, the limitation would be applicable starting in 2020, regardless if the financing was granted before 2020.

Investments in foreign entities and vehicles

[Art. 4A]

Effective in 2021, a special regime is included for transparent foreign entities and vehicles, so that the tax authorities have a better way to identify aggressive schemes carried out through this kind of entities or vehicles.

Transparent foreign entities and vehicles, regardless if all or part of its members, partners, shareholders or beneficiaries consider the income generated through them as taxable income in their country of residence, will be taxed as entities and therefore, when applicable, will be obliged to pay income tax either on: a) their worldwide income, if they are effectively managed in Mexico, or b) their Mexican source income, if effectively managed outside of Mexico.

This new regime includes the definition for Mexican tax purposes of foreign entities and vehicles, as well as what should be understood as “transparent”; these definitions used to be included in the PTR section of the law.

This special regime will not be applicable to entities that are protected under a double tax treaty, where the provision of the treaty should prevail. It is worth mentioning that the treaties Mexico has in effect rarely grant transparent treatment.

This regime for foreign transparent entities and vehicles implies that such vehicles will be treated as non-transparent (opaque entities and vehicles) for Mexican tax purposes, either when income derives from a Mexican source or due to the fact that such entities or vehicles will be considered as residents of Mexico.

Derived from the Tax Reform, we recommend that taxpayers thoroughly analyze their particular corporate structures where foreign transparent entities and vehicles are included, and that may fall under the new provisions and to identify possible alternatives to restructure.

Investors in foreign pass-through entities and vehicles

[Art. 4B]

It is established that Mexican residents and foreign residents with a permanent establishment in Mexico will be obliged to pay taxes according to the MITL with respect to the income obtained from foreign transparent entities and vehicles proportionally to their participation and the income obtained through foreign vehicles, regardless of the tax treatment of the latter. This will apply when taxpayers have a direct or indirect participation in foreign transparent entities or vehicles.

Regarding income obtained from foreign transparent entities for tax purposes, taxpayers will only consider as income the amount attributable to such entity and this will be the taxable profit on the current year determined in terms of Title II (Entities) of the MITL.

For income obtained through foreign transparent vehicles, such income would be taxable according to the applicable section of the MITL and in the proportion that corresponds to the taxpayer in a given tax year.

Prior to the Tax Reform, the MITL already included similar provisions in the PTR section. Now, the rules include specific provisions regarding the currency in which the taxable income will have to be computed.

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For the case of foreign vehicles that are considered as tax residents in a country or jurisdiction abroad or in Mexico, the taxable income will correspond to the tax profit of the year and in turn would have to be considered as part of the taxable income of the corresponding year for the taxpayer. The tax profit will be determined in accordance with the section of the MITL that deals with Mexican corporations.

When a taxpayer maintains an indirect participation in a transparent vehicle that in turn has a participation in at least one foreign entity that is not considered as fiscally transparent, the income obtained through the foreign transparent entity or vehicle in which the foreign non-transparent entity has participation will be subject to PTR rules.

In the event that the income obtained through the foreign transparent entity or vehicle is subject to tax in terms of the MITL and this has been effectively paid, a tax credit will be allowed to avoid double taxation.

As part of the obligations of this new regime, taxpayers must keep a tax profit account (CUFIN per its acronym in Spanish) as provided in the PTR section, for each of the foreign transparent entities or vehicles; this is also to avoid double taxation when the income is distributed to the taxpayer.

The regime for investors in transparent vehicles will be applicable even when the foreign transparent entity or vehicle does not distribute the income.

The accounting records of the foreign transparent entity or vehicle, or the documentation that allows to verify its expenses and investments must be at the disposal of the tax authorities. If this requirement is not complied with, the deduction of expenses and investments made by such entity or vehicle will not be allowed.

The new tax regime does not provide for an exception in the case of investors that do not have effective control, in contrast with rules that govern the PTR.

Private equity funds

[Art. 205]

A tax incentive for foreign vehicles that manage private equity funds investments and that hold participation in the equity of Mexican resident entities, and that are considered as fiscally transparent in its country or jurisdiction of incorporation is included. The tax incentive consists in the recognition of the tax transparency status for purposes of the MITL, even when these foreign vehicles fall under the terms of the new regime for this type of vehicles (Article 4-A MITL).

Partners of these vehicles will be taxed in terms of the corresponding section of the MITL. This special regime only applies for income obtained from interest, dividends, capital gains or lease of real estate.

The application of said regime is subject to particular requirements that must be met by the manager or legal representative of the vehicles, by the vehicle itself as well as by the members or effective beneficiaries of the vehicle.

Consistent with the amendments for the transparent entities and vehicles' regime, it was established that this tax incentive will enter into force on January 1st, 2021.

PTR rules

[Art. 176, 177 y 178]

PTR provisions were modified to adapt them to the new regime for foreign transparent entities and vehicles, which were previously described. In addition, the definition of "control" over an entity is expanded.

PTR rules will now only be applicable for entities with separate legal personality from its Mexican resident owners (including permanent establishments located in Mexico). The new rules will become effective on January 1st, 2020 and will apply for both foreign transparent entities and vehicles, as well as for foreign entities with separate legal personality that reside in countries or jurisdictions with low or no taxation.

The amendments to the PTR rules are carried out in order to comply with Mexico's commitments under Actions 2 (Neutralizing the effects of hybrid mismatch arrangements)

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and 3 (Controlled Foreign Corporations) of BEPS final report. In the view of the Executive Branch, these changes will prevent taxpayers from carrying out aggressive tax planning through the use of these legal structures.

The PTR will continue to be applicable for cases where the taxpayer has effective control over a foreign entity that falls under the applicable assumptions. Nevertheless, the definition of effective control was expanded to include the following cases:

i. When the taxpayers' average daily participation in the foreign entity allows it to exercise more than 50% of the voting rights in the entity, or grants the taxpayer voting rights in the decisions of the entity or requires the taxpayer's favorable vote for the decision making; or the taxpayer has a participation of more than 50% of the total shares issued by the entity.

ii. When by means of an arrangement or document other than those mentioned in i. above, the taxpayer has the right over 50% of the assets or profits of the foreign entity in case of any capital reimbursement or liquidation, at any time during the calendar year.

iii. If the taxpayer does not reach the threshold participation mentioned in i. and ii. above, when adding both items the taxpayer has more than 50% of the referred rights.

iv. When the taxpayer and the foreign entity consolidate their financial statements according to the applicable accounting regulations.

v. When considering facts and circumstances, or any other type of arrangement or document, the taxpayer has the direct or indirect right to unilaterally determine the resolutions in the shareholders meetings or the decisions of the management of the entity, even if it acts through a separate person.

Additionally, a taxpayer will be considered to exercise control over an entity for cases of i, ii and iii above, when such taxpayer:

a. May directly or indirectly exercise the right to exercise the effective control of each foreign intermediate entity which separates the taxpayer from the corresponding foreign entity;

b. May directly or indirectly exercise the right over more than 50% of the assets or profits of any intermediate entity which separates the taxpayer from the respective foreign entity in the event of any capital redemption or liquidation, that it is related to agreements or documents other than those mentioned in the previous paragraph; or

c. Whenever the taxpayer does not reach the threshold participation mentioned in the preceding paragraphs, but when adding rights under both assumptions a. and b. above, the taxpayer may exercise more than 50% of the referred rights.

A specific exclusion provided for certain royalties that did not erode the Mexican tax base was eliminated. Also, the application of the exceptions for passive and business income was clarified so that taxpayers have the exact procedure to determine all cases when such income should not be not considered under PTR rules. Likewise, the procedure for the determination of the due tax was amended to clarify that it should be calculated according to the participation the taxpayer has in each controlled entity.

The obligation for Mexican taxpayers to disclose an investment through vehicles under these assumptions remains; this obligation will also be applicable for foreign transparent entities and vehicles, even if they are no longer included in the PTR rules.

Goods and services offered through digital platforms

[Arts. 113-A, 113-B y 113-C]

Considering BEPS report’s Action 1, as a measure to control the collection of income tax and value added tax of the participants of the collaborative economy through digital platforms, general administrative rules were introduced to facilitate the fulfillment of their tax obligations and to ensure the proper collection of taxes. The new rules covered activities related to passenger transportation services and delivery of prepared foods, when these services are contracted through digital platforms. Digital platforms that reside both in Mexico and abroad are obliged to withhold and submit such taxes.

In consequence, a new section is included to the MITL that will be applicable to individuals with business and professional activities that sell goods or render services through internet based digital platforms, applications or similar solutions.

This section provides for specific rules regarding the fulfillment of the withholding obligations, as well as other formal obligations including, among other, the enrolment to the Federal Taxpayers' Registry of the non-resident, entities or vehicles, that allow the use of such digital platforms; the issuance of electronic invoices that comply with all the applicable Mexican regulations; and to disclose specific information from their users.

In addition, non-resident entities that collect a fee for the use of their digital platforms will be subject to value added tax at the general 16% rate over such fees as they are collected.

Lease of property and royalties

[Arts. 158 y 167]

Considering that the payments for granting the lease of property for business, industrial or scientific activities are deemed as royalties in terms of the Federal Tax Code (FTC) and the double tax treaties entered into by Mexico, the tax treatment related to these payments will now be included in one provision of the MITL.

Additionally, a new assumption that was previously ruled through an administrative rule is included in order to reduce the income tax withholding rate to 1% for income obtained from the lease of aircrafts with the license or permit by the Federal Government to be commercially exploited and used directly by the lessee in the transportation of goods or passengers.

Shelter maquila program

[Arts. 183 y 183-Bis]

The limitation of a consecutive four-year period established in the MITL as of 2019 in order for a non-resident not to create a permanent establishment in Mexico was repealed, to the extent the non-resident principal directly or indirectly provides raw materials, machinery and equipment for maquila activities through enterprises with a shelter maquila license granted by the Ministry of Economy under an IMMEX program.

In order to access to this benefit, several obligations and requirements previously established in the applicable administrative rules are incorporated into the MITL, which must be fulfilled by non-residents, through entities with a shelter maquila program; in addition, new obligations applicable to those entities are included.

Within the obligations that were already covered under administrative rules, which are now incorporated into the MITL, it is expected that entities with a shelter maquila program will be jointly liable in the determination and filing of taxes on behalf of the non-resident, without the need to inform such situation to the authorities.

The amendments also clarify that non-residents under this regime can sell the products produced in Mexico through the maquila entity, to the extent that an export format is obtained in such transaction.

Private Real estate FIBRA (REITS)

[Art. 187]

The option to set up private real estate FIBRA is eliminated. Considering the Preamble to the Tax Reform, the rationale is that such regime does not contribute to the promotion of the real estate industry and has been used for aggressive tax planning schemes.

VALUE ADDED TAX LAW

Tax withholding on certain services

[Art. 1-A y 5 Fr. II]

A new obligation for entities and individuals with business activities to withhold a 6% rate from the consideration derived from services of labor outsourcing received is included.

For this purpose, a definition of labor outsourcing is included but such definition does not consider the labor legislation. A new definition is included to cover contractual arrangements where a party renders services to another party and in the process provides personnel available to the contractor of the services. Thus, it will be relevant to review each contract related with labor outsourcing from a tax and labor perspective.

Failure to carry out the withholding would imply the disallowance of the associated expense for income tax purposes.

This withholding obligation substitutes the existing obligation of obtaining support documentation of the transactions that qualified as labor outsourcing.

Digital economy

A tax regulatory framework applicable to certain digital services provided by residents in Mexico and foreign residents with or without a permanent establishment in Mexico, in favor of recipients that are located in Mexico was included.

For these purposes, a "link" criterion to allow Mexican tax authorities to fiscally control foreign residents without a permanent establishment in Mexico that provide digital services in Mexico was incorporated. Additionally, these foreign residents will have to comply with several formal obligations that consist in charging, disclosing, withholding and payment of taxes.

Likewise, it is established that residents in Mexico and foreign residents with a permanent establishment in Mexico are subject to the same obligations established for foreign residents without a permanent establishment in Mexico, in order to standardize the treatment granted to this industry.

It is established that in no case the fulfillment of these obligations by the foreign resident digital service providers will constitute a permanent establishment in Mexico.

This tax regime will enter into force in June, 2020.

FEDERAL TAX CODE

General anti-avoidance rule

[Art. 5-A]

A general anti-avoidance rule that grants the tax authorities, during the course of a tax audit, the right to assess the tax effects that correspond to those that would have been derived by obtaining a "reasonably expected economic benefit", to legal acts that lack of a business reason and generate a direct or indirect tax benefit to the taxpayer was incorporated.

According to the Preamble to the Tax Reform, this rule is needed since the authorities have reasons to know that taxpayers commonly carry out transactions with the main purposes to be in a better position regarding the payment of taxes. This has implied that Mexico has one of lowest tax collection rates in Latin America and the Caribbean, according to OECD reports.

Also, the Preamble points out that this kind of rule is commonly used by other jurisdictions in order to grant the tax authorities with enough grounds to be entitled to deny specific transactions that are carried out in order to reduce the tax collection.

The tax authorities may only apply this rule when obtaining a favorable resolution from a collegiate board; such board will be comprised by officers of the Tax Administration Service (SAT) and the Ministry of Finance (SHCP), during the applicable stages of a tax audit.

According to this rule, tax authorities would be entitled to assume, unless is proven otherwise, that the there is no enough business reasons for certain legal act or acts when the expected economic benefit is lower than the tax benefit; additionally, they will also be entitled to assume that the economic benefit was achievable if the transaction is carried out in a different way that implies less corporate acts and the tax effect is different.

An economic benefit would be deemed to arise when the transactions carried out by the taxpayer have as main purpose to create an income, reduce expenses, create value to goods owned by such taxpayer, have a better position in the market, among other cases.

In order to value the benefit, current information related to the transaction at hand could be used, including the projected economic benefit.

A tax benefit would be deemed to arise when there is a reduction, withdraw or deferral of a tax; including those that are obtained through deductions, exemptions, no recognition of a gain or taxable income, adjustments or lack of taxable income, credits or re-characterization of a payment or activity, among other cases.

Listed Transactions Report

[Art. 82-A - 82-D, 197-202 and 7th Transitory Disposition-II]

A new Title is incorporated into the FTC through which several obligations for tax advisors and taxpayers in relation to disclose tax planning schemes are established.

Any plan, project, proposal, advice, instruction or recommendation proposed expressly in order to materialize a series of legal acts will be considered as a scheme; assistance in a procedure before the tax authorities or the defense of a taxpayer in tax disputes, would not be deemed as a scheme.

These schemes are considered reportable when they generate or can generate, directly or indirectly, a tax benefit in Mexico and have any of the characteristics provided in the FTC which are detailed below.

For these purposes, the value derived from any reduction, elimination or temporal deferral of a tax duty is considered a tax benefit; including those that are obtained through deductions, exemptions, no recognition of a gain or taxable income, adjustments or lack of taxable income, credits or re-characterization of a payment or activity, among other cases.

The Ministry of Finance through administrative rules will issue the guidelines of the minimum amounts in which the provisions of this new Title of disclosure of tax planning schemes will not be applicable.

The temporary provisions of the FTC establish that the deadline to comply with the obligations arising from this new Section of the code will start on January 1st, 2021.

There are two type of reportable schemes: those considered as general and those that are created for a specific taxpayer.

Tax planning schemes that have to be reported are those designed, commercialized, organized, implemented or managed as of 2020 or before that year when such scheme will have an effect in 2020 or any subsequent year. In this last assumption the taxpayers will be obliged to disclose their tax planning scheme.

A tax advisor is understood as any individual or entity that, in the course of their ordinary activity, is responsible or involved in the design, commercialization, organization, implementation or management of a tax planning scheme or someone who provides a reportable scheme, but a third party is responsible for its implementation.

The tax planning schemes will have to be disclosed regardless of the tax residence of the taxpayer to the extent a tax benefit is obtained in the country.

The tax advisor will have to obtain the identification number of the tax planning scheme and issue a certificate to the taxpayer, as well as to inform the rest of the tax advisors involved.

Tax advisors must file before the tax authorities an informative return in February of each year with the name and Federal Tax Registry of the taxpayers to whom they have provided tax advice regarding reportable schemes.

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It is established that the disclosure of reportable schemes by tax advisors will not constitute a breach to professional secrecy. Finally, it is established that the SAT will issue the administrative rules for the application of these rules.

Also, taxpayers are obliged to reveal the reportable schemes in the following assumptions:

I. When the tax advisor neither provides the identification number of the reportable scheme issued by the tax authorities, nor provides a certificate justifying that such scheme is not reportable.

II. When the tax planning scheme has been designed, organized, implemented and managed by the taxpayer. In these cases, if the taxpayer is an entity, the individuals that are the tax advisors and either hold shares or a participation in the taxpayer, or that are employees of such taxpayer, would be relieved from the obligations to report.

III. When the taxpayer obtains tax benefits in Mexico of a tax planning scheme that has been designed, commercialized, organized, implemented or managed by a person not considered as a tax advisor.

IV. When the tax advisor is a non-resident without a permanent establishment in Mexico in terms of the MITL or even when if he does, the activities attributable to such permanent establishment are not those realized by a tax advisor.

V. When the tax advisor has a legal impediment to reveal the tax planning scheme exists.

VI. When the tax advisor and the taxpayer reach an agreement upon which the latter is the obliged to reveal the reportable scheme.

Taxpayers obliged to disclose tax planning schemes will be those that qualify as Mexican residents or non-residents with a permanent establishment in the country and that their tax returns reflect tax benefits derived from such reportable schemes. Additionally, they will be obliged to disclose such schemes when they carry out transactions with related parties abroad, if such schemes generate tax benefits in Mexico.

A tax planning scheme is considered as anything that produces or may produce, directly or indirectly, a tax benefit in Mexico. For these purposes, fourteen broad assumptions were

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included in the FTC that oblige advisors and taxpayers to disclose tax planning schemes, which generally include the following:

I. Preventing that foreign tax authorities exchange tax or financial information with the Mexican tax authorities.

II. Avoiding the application of PTR rules.

III. Allowing the transfer of tax losses.

IV. Returning all or part of the payment, to the person who made it or to any of its partners, shareholders or related parties.

V. Involving a foreign resident who applies a double tax treaty signed by Mexico, regarding income that is not taxed or taxed at a lower rate in the taxpayer's country or jurisdiction of tax residence.

VI. Involving certain transactions with a related party (specific transfer of intangibles, corporate restructures, non-remunerated transactions, unique assets, unilateral protection regimes).

VII. Avoiding the constitution of a permanent establishment in Mexico.

VIII. Involving the transmission of a totally depreciated asset.

IX. Using of hybrid mechanisms.

X. Avoiding the identification of beneficial ownership.

XI. Any transactions that imply the use of tax losses that are going to expire soon.

XII. Avoiding the 10% income tax rate over dividends.

XIII. Subleasing of assets to the landlord or a related party.

XIV. Involving transactions in which accounting and tax records contain differences greater than 20%, excluding depreciations.

Also, another mechanism that seeks to avoid the application of the prior sections is included as a reportable scheme.

The entry into force of this listed transactions report regime is in 2021, but with respect to schemes that have tax benefits as of 2020. It is also specified that in the case of schemes implemented prior to the year 2020, but that have an effect as of said year, taxpayers will be obliged to submit the report.

Severe penalties are included for the omission of the rules regarding the listed transactions report either by advisors or taxpayers.

Joint Tax Liability

[Art. 26]

New assumptions are included in which partners, shareholders, associates, general managers, general directors and sole managers can be considered as jointly liable with the corporation for due taxes, during their participation or administration, respectively.

The main new assumptions among others are: i) when the taxpayer is not found in the registered tax address; ii) when an omission to pay withheld or collected taxes takes place; iii) when the entity is included in the list published by the tax authorities as a consequence of failing under the hypothesis of having issued invoices in connection with non-existing operations (with an amount of more than $3.6M US Cy); and, iv) the improper transfer of tax losses.

Liquidators and receivers should be considered as unlimited jointly liable regarding any tax due on the process of liquidation or bankruptcy.

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The present document contains information of general nature, and thus it does not address any particular case or facts. The information contained herein is accurate as of the date of issuance; however, we make no representation as to the fact that such information be accurate in the future. Accordingly, we recommend that specific advice addressing your particular circumstances be requested.

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