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Blockchain

Mexico: Trends & Developments

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Trends and Developments

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The present era is bearing witness to the unstoppable force that the trajectory of technological advance is taking. The non-linear but, rather, exponential curve of technological progress has impacted several areas, to which the finance industry has not become the exception. The rapid and disruptive rise of technology within the sector, such as blockchain, has led to a pressing need for legislatures around the world to continuously adapt to new and ever-changing circumstances.

Blockchain Generalities

Blockchain technology is basically a new method of record keeping. This digital, decentralised, public ledger has a capacity to process transactions in a more secure, faster and cheaper way by putting up together digital pieces of information that essentially store and transfer data.

In recent years, there has been one application of blockchain technology that has caught the mind of the general public: crypto-assets or cryptocurrencies, which have been used as an alternative means of payment in e-commerce markets, instead of the traditional currency, among many other uses.

There are, mainly, four kinds of crypto-assets or so-called tokens:

- payment tokens;
- utility tokens;
- security tokens; and
- asset-backed tokens.

By using a peer-to-peer system, they exist only electronically and are not backed by any central bank or government to protect their owners.

Mexican Fintech Regime

Given the relentless upward trend within the market, on 9 March 2018, the Mexican Congress enacted the Financial Technology Institutions Law ("Fintech Law") to regulate the rendering of financial services through innovating schemes, such as those used by crowdfunding and electronic money institutions, and the use of cryptocurrencies, which made Mexico one of the first countries in the world and the first in Latin America to issue formal legislation exclusively to address the financial technology industry.

The Fintech Law defines crypto-assets as "a representation of value electronically registered, used among the public as a means of payment for any kind of legal act and that shall solely be transferred by electronic means".

Because of the broad nature of such definition, the Mexican Fintech Law does not distinguish between the different characteristics and applications that each crypto-asset may have, but rather focuses on the use given to such as a means of payment – a situation that may open a deep, technical discussion on whether cryptocurrencies that do not meet all the elements provided by such definition could be legally considered by such.

This law also sets forth the obligation for financial technology institutions (FTIs), such as crowdfunding and money entities, that carry out transactions with crypto-assets to be able to provide to their users, at any time when requested, the amount of crypto-assets owned or the amount in national currency that corresponds to the payment received as a consequence of selling such assets.

Additionally, FTIs are obligated under the Fintech Law to disclose to their clients the risks involved in carrying out transactions with crypto-assets, informing, at the very least, that these tokens are not national currency and are not backed by the federal government nor by the Central Bank, as well as the fact that there is no reversal of the transactions once executed, including the volatility of the value of the crypto-asset, and the technological, cybernetic and fraudulent risks involved thereof.

In general terms, the Fintech Law allows for FTIs to carry out a broad range of activities and operations with crypto-assets, under certain parameters and to the extent that the inherent risks are informed to their clients.

The Mexican Fintech Law provides that secondary regulation must be issued by certain autonomous specialised institutions, such as the National Securities and Banking Commission, as well as Mexico's Central Bank.

As a part of that secondary regulation, on 8 March 2019, Mexico's Central Bank issued the ruling letter 4/2019 "General Rules Applicable to Credit Institutions and Financial Technology Institutions in Transactions made with Crypto-assets", by means of which the Central Bank basically establishes that the

crypto-assets that may be used by FTIs and credit institutions must have the following characteristics:

- they shall be information units, unequivocally identifiable (even fractionally), that are registered electronically and do not represent the ownership or rights to an underlying asset, or that represent such ownership or rights in a lesser value than these;
- they have the necessary issuance controls defined by determined protocols and to which third parties may subscribe; and
- they have the necessary protocols that avoid the availability of replicates of the information units or its fractions to be transmitted more than once in a single moment.

However, under ruling letter 4/2019, the Central Bank restricted any external crypto-asset transaction that the FTIs could make under the Fintech Law, by producing certain arguments dealing with financial and legal risks.

Several legal grounds exist to challenge the justification of such restrictions, since the Central Bank has exceeded its constitutional powers by setting restrictions that seem to go beyond the legislator's intention when enacting the Fintech Law. Violations on the grounds of legality, progressivity of fundamental rights, freedom of work and economic development principles that have been found in such action may be challenged eventually in courts.

It is important to bear in mind that the Fintech Law and this ruling letter is addressed solely to certain financial institutions, such as FTIs and banks, that would be the subjects that would have to comply with their content and, therefore, with the restrictions contained therein. In other words, entities that are not regulated specifically under financial legislation would not be subject to the aforesaid restrictions that bar "external" transactions and risk transfer to clients, neither to the limitations set forth by the Fintech Law.

Legal Nature of Crypto-Assets under Domestic Law

The Mexican Monetary Law defines the Mexican peso as the unit of the domestic system and sets forth which are the currencies that are allowed to circulate within the country, which, as one may expect, does not include cryptocurrency.

Furthermore, crypto-assets should not be considered as foreign currency, since the Fintech Law expressly states that the latter shall not be considered as a legal currency within Mexican territory, nor foreign currency in any way.

The Mexican Federal Civil Code (FCC) provides that "goods" will be deemed as everything susceptible to be appropriated. Furthermore, rights or obligations will be considered as goods themselves.

Since crypto-assets are part of a decentralised public ledger (blockchain) that represents the right of a person, crypto-assets should be deemed intangible "movable goods" in accordance with the FCC. These crypto-assets as movable goods will have the characteristic of being intangible "movable goods", given that crypto-assets only exist electronically; thus, not tangible.

It is important to mention that the legal treatment of specific crypto-assets will depend on the nature of the token under analysis. Whether a (i) payment, (ii) utility, (iii) security, (iv) asset-backed tokens, or a (v) hybrid token, users of FTIs should bear in mind that the applicable treatment may change.

For example, security tokens may fall within the scope of the hypothesis included in the Securities Market Law and additional regulations could be applicable, such as when carrying out an initial coin offering.

In this line of thought, crypto-assets users should have a case-by-case approach to the tokens that are being used in the transactions carried out, so as to correctly determine the applicable restrictions, limitations and regulations set forth by the legal framework.

In trying to address this matter, the Mexican Council of Financial Information Rules issued the rule NIF C-22, which sets forth the criteria to be followed for valuation, presentation and disclosure of crypto-assets. Under NIF C-22, a crypto-asset is considered as a right portrayed as an intangible asset that is recovered when using it as a means of payment or when sold, that can be recognised as an asset and must be subject to reasonable valuation.

General Tax Treatment of Crypto-Assets

The enactment of the Fintech Law did not come with a holistic, harmonic approach regarding the necessary connections that it should have with other federal legislation. An example of this issue would be the fact that the tax legislation was not amended to reflect the same principles when the Fintech Law came into force; hence, no specific tax treatment exists for crypto-assets in any of the applicable tax legal frameworks.

Income tax

In general terms, the Mexican Income Tax Law (MITL) taxes any increase in income for both individuals and legal entities. As previously mentioned, this legislation should be adapted to include specific tax treatments applicable to the different sorts of crypto-assets that are available, in order to correctly reflect the various consequences that could exist for taxpayers.

Despite the fact that the MITL in force is not clear on the tax treatment applicable to crypto-assets, from a general perspective, one may conclude that once the nature of the crypto-assets has been defined as intangible movable goods, in general terms, the income obtained by a transaction dealing with said assets may be considered as income deriving from the sale of goods. In this respect, a person that gives a crypto-asset to another as consideration may be deemed as payment in kind or an alienation or sale of movable property.

The MITL provides that the profit arising from a payment in kind that transfers the property of goods is considered taxable income.

Legal entities that sell cryptocurrencies should determine the corresponding profit considering the market value on the date of alienation as taxable income and would also be allowed to take the applicable deductions, such as the cost basis. The corporate tax rate in Mexico is set at 30% and would be applicable to the profit determined.

However, the law is not clear on whether a legal entity should deem its crypto-assets as merchandise, in which case the cost of goods sold would have to be determined, or as an investment, to which depreciation rates would apply.

In any case, it is important to bear in mind that certain formalities would have to be followed by legal entities, such as issuing/receiving digital invoices for each transaction, in order to be able to have the corresponding documentation to support the deduction taken.

On the other hand, individuals would be subject to the relevant chapter in the MITL pertaining to sale of goods. As a general rule, the amount of taxable income obtained by the seller will be the consideration obtained when selling goods; if there is no consideration, then market value must be taken into account. Similar deductions are available as well for individuals, such as cost basis.

There is a special rule for bartering or exchanges of goods, in which the relevant chapter in the MITL considers that two alienations are taking place for tax purposes.

The comments included in this section stem from a general analysis performed on crypto-assets; however, these are various in nature, with distinct characteristics that may cause the applicable tax treatment to vary. Specific crypto-assets such as those dealing with interest, investments and hybrid crypto-assets are not analysed herein.

Value added tax

As with the case of the MITL, the Value Added Tax Law (VATL) should be subject to considerable amendments in order for such legislation to be able to correctly identify and give the applicable tax treatment to the various types of crypto-assets that exist.

However, as intangible movable goods, the selling of crypto-assets should be taxable for value added tax purposes in Mexico at the general 16% rate when the seller and buyer reside in national territory. If one or both of the parties in the crypto transaction are not residents in Mexico, the transaction should not be taxable as a selling under the VATL.

Whenever a Mexican resident imports an intangible good, a reverse-charge mechanism may apply for VAT purposes, when meeting specific requirements – a situation that should be borne in mind when dealing with these transactions. Conversely, exports may be taxed at a 0% VAT rate if the intangible good is being exported by a Mexican resident, subject to certain rules.

The current rule brings forth several issues from a practical perspective, given that the complexity of the system makes it difficult to exactly identify the residence of the seller and buyer, and, therefore, to correctly shift the value added tax from one taxpayer to the other.

Furthermore, if an exchange of crypto-assets took place, value added tax should be shifted for each of the goods exchanged, since two alienations are legally considered to be happening simultaneously for tax purposes.

It is also worth mentioning that the VATL treats the alienation of certain goods, such as second-hand goods and currency, as exempt from the payment of such tax; nevertheless, difficulties arise when determining whether a crypto-asset is a "second-hand" good, thus affecting the applicability of such a treatment. Regarding the applicability of the currency exempt treatment, as previously mentioned, the Fintech Law expressly states that crypto-assets shall not be considered as a legal currency within Mexican territory, nor as foreign currency in any way.

Final Comments

Regardless of the fact that Mexico has been one of the first jurisdictions to enact legislations to address the challenges that financial technology and, specifically, crypto-assets have brought, the system is still breaking new ground and, naturally, there are certain grey areas that need to be clarified by secondary laws and case law. Several questions still subsist on the final form the legal framework will morph into and on the interpretation of such rules.

In particular, it is necessary that the authorities define the applicable treatment of crypto-assets for tax purposes, given that the currently available legislation is not adapted to the innovative elements that the disruptive forces of crypto-assets bring – a situation that could evolve into a constant, unfair tax treatment of the income derived from these transactions and could even imply double taxation from a value added tax perspective.

However, as with any new landscape, the scope of application of the law is broad enough to find areas of opportunity for companies without risking the core nature of financial technology transactions, which will allow Mexico to continue with the process of breaking down barriers built by trust issues and incentivise economic exchange.

Chevez Ruiz Zamarripa has stood out for the provision of specialised services in tax matters since its foundation, basing its quality on constant updating and innovation, which naturally, and hand-in-hand with the demands of the market, drives the need to provide comprehensive work to clients, with the aim of providing multidisciplinary solutions. In this process, Chevez Ruiz Zamarripa has integrated new practice areas to the structural scaffolding of the firm, to take one more step towards the consolidation of its goal: to give an integral service with the highest level of technical specialisation. As a part of its multidisciplinary service, the professional team is powered with specialists in fintech regulation who also have vast experience in corporate, financial, tax and litigation matters. This knowledge allows it to offer clients the comprehensive advisory services that are now crucial in this sector.

Authors

Valentin Ibarra is a partner who joined CRZ in 2004. His professional practice is mainly concentrated on advisory and litigation in the tax and legal administrative areas in a wide range of sectors and transactions, representing domestic and international clients. He litigates complex matters before federal and state administrative and tax courts, and carries out constitutional actions at the level of the Supreme Court of Justice of Mexico. He is highly experienced in alternative dispute resolution proceedings and has handled complex tax cases before the tax authorities and the Mexican Tax Ombudsman. Valentin also leads the firm's Fintech Law practice and teaches fintech law at the Universidad Panamericana and Universidad Iberoamericana in Mexico City. Additionally, he has lectured on tax and fintech law in the private and public sectors, including the Ministry of Finance.

Jorge Galland is a tax lawyer with years of experience in litigation and tax advisory. He has drafted and revised lawsuits, memoranda and opinion letters regarding various tax matters, specifically on cross-border transactions. Jorge is experienced in leading work groups and research teams, and has participated directly in constitutional litigations of tax reforms at the Mexican Supreme Court of Justice and mediation procedures between taxpayers and the Mexican tax authorities before the Mexican taxpayer's Ombudsman (PRODECON). He has been heavily involved with the application of double tax treaties, and the implementation of the BEPS Project (including the MLI), and has considerable experience in advising digital platforms on new tax regulatory frameworks.

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