International Bar Association Annual Conference 2022

Recent Developments in International Taxation

Mexico

Pedro José Miranda Sadurní

Sanchez Devanny Eseverri, Mexico City

pjmiranda@sanchezdavany.com
Tax climate in Mexico

Mexico has continued to actively incorporate the Organisation for Economic Co-operation and Development (OECD)’s recommendations under the framework of the base erosion and profit shifting (BEPS) project with the main purpose of tackling tax avoidance and reinforcing the ability of the tax authority to prevent and pursue aggressive tax planning and fraudulent schemes, including new obligations to keep sensitive information from the controlling beneficiaries of Mexican entities and legal vehicles available for the tax authority following Financial Action Task Force (FATF) recommendations not only for money laundering or terrorist purposes but also for tax transparency.

In 2021 a labour, tax and social security reform introduced a ban on subcontracting personnel under outsourcing/insourcing schemes and regulation on subcontracting specialised services, which triggered many multinationals to reorganise their corporate structures in Mexico. As part of this reform, mandatory Employees’ Profit Sharing (Participación de los Trabajadores en las Utilidades de la Empresa or PTU) was also notably limited to the higher amount of: (1) three months of the employee’s salary; or (2) the average PTU received by such an employee in the last three years.1

The Mexican tax authority (Servicio de Administración Tributaria or SAT) has been making its tax collection strategies more sophisticated to foster self-correction to avoid tax disputes and litigation. This situation has triggered a substantial increase in tax revenue from those activities, mainly from large taxpayers and multinationals.2 There is a clear trend of auditing tax compliance enforcement for cross-border intercompany transactions (ie, interest, intangibles, royalties and services) focused on economic substance and business reasons. In 2021, the tax authority published the first reference parameters with respect to effective tax rates for the measurement of tax risks corresponding to more than 300 economic activities within more than 21 industrial sectors (mining, manufacturing, wholesale distributors, retailers and financial services), which prompted many taxpayers involved in those activities and sectors to review their transfer pricing policies accordingly.

The Federal Taxpayers’ Advocate Office (Procuraduría de la Defensa del Contribuyente or PRODECON) has also played an important role in tax dispute composition through conclusive settlement procedures whereby taxpayers and tax authorities have reached important agreements to avoid tax litigation before the Federal Court of Administrative Justice. The Federal Tax Prosecutor (Procuraduría Fiscal de la Federación) has continued with compliance enforcement chiefly related to the use of fraudulent invoices and outsourcing schemes.

The Supreme Court of Justice has experienced reduced activity on tax matters. Recently, the First Chamber ruled on the constitutionality of the deduction restriction on net interest

---

1 All employees in Mexico have the right to participate in ten per cent of the taxable profits of companies that provide their services. After 2021, this obligation is capped at the higher amount between: (1) three months of employee’s salary; or (2) the average PTU received by such an employee in the last three years.

2 For instance, in the last three years (from 2019 to 2022), tax collection from large taxpayers represented more than 86 per cent of the total collection from 2012 to 2018.
exceeding 30 per cent of tax earnings before interest, tax, depreciation and amortisation (EBITDA) introduced in the 2020 tax reform.\textsuperscript{3}

**The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the 'MLI')**

The MLI has yet to be ratified by the Mexican Senate, which is a constitutional requirement for the convention to legally enter into force in Mexico. It is worth noting that Mexico elected to combat treaty abuse with a combination of a principal purpose test (PPT) supplemented with a simplified and more objective limitation on benefits (LOB) provision; however, most of Mexico’s treaty partners did not elect to apply the simplified LOB provision and as such, the PPT would apply as the default position. Mexico did not accept mandatory binding arbitration.

**Tax conventions**

Mexico has 62 tax treaties for the avoidance of double taxation\textsuperscript{4} and 12 tax treaties under negotiation,\textsuperscript{5} and 17 broad exchange of information agreements in force\textsuperscript{6} and five under negotiation.\textsuperscript{7} Mexico is party to the OECD-sponsored Convention on Mutual Administrative Assistance in Tax Matters.

**Mexican domestic tax law**

There were many changes from the 2021 to 2022 fiscal years. The most relevant are as follows:

**Outsourcing prohibition and specialised and intercompany shared services regulations**

As anticipated on 23 April 2021, several provisions of the Federal Labor Law, Social Security Law, Law of the National Workers' Housing Fund Institute, Federal Tax Code, Income Tax Law and Value Added Tax Law, among others, were amended to prohibit the subcontracting of personnel. Subcontracting of specialised services or the execution of specialised work, if they are not part of the corporate purpose or the main economic activity of the beneficiary,\textsuperscript{3}

---

\textsuperscript{3} Based on Action 4 of the BEPS programme, the 2020 tax reform introduces a restriction on the deductibility of net interest that exceeds the 30 per cent of adjusted income (EBITDA). This limitation is regardless of whether the interest derives from Mexican residents or non-related parties, and all interest shall be considered for this calculation. It will not apply to entities that are part of the Mexican financial system, or financing infrastructure projects. Coordination rules with thin capitalisation restrictions (3:1 equity ratio) are also contemplated to apply the higher deductibility restriction.

\textsuperscript{4} Argentina, Australia, Austria, Bahrain, Barbados, Belgium, Brazil, Canada, Colombia, Costa Rica (in force as of 1 January 2020), Chile, China, the Czech Republic, Denmark, Ecuador, Estonia, Finland, France, Germany, Georgia, Greece, Guatemala, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Korea, Kuwait, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Panama, the Philippines, Peru, Poland, Portugal, Qatar, Romania, Russia, Saudi Arabia, Singapore, the Slovak Republic, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States, Ukraine, Uruguay, the United Arab Emirates and Venezuela (to be published in the official gazette).

\textsuperscript{5} Egypt, Iran, Ireland, Lebanon, Malaysia, Morocco, Nicaragua, Oman, Pakistan, Slovenia, Thailand and Vietnam.

\textsuperscript{6} Aruba, Bahamas, Belize, Bermuda, Canada, Costa Rica, the Cayman Islands, the Cook Islands, Guernsey, Gibraltar, the Isle of Man, Jersey, the Netherlands Antilles, the United States, Liechtenstein, St Lucia and Samoa.

\textsuperscript{7} The British Virgin Islands, the Marshall Islands, Monaco, Turks and Caicos and Vanuatu.
is allowed subject to several compliance regulations, including that the service provider must obtain its registration from the Ministry of Labor.

Pursuant to the amendment, payments made as consideration for the forbidden subcontracting of personnel cannot be deducted for income tax purposes and corresponding VAT cannot be credited. The beneficiary will be held jointly and severally liable pertaining to withholding tax obligations corresponding to those employees used by the provider to execute the specialised services or specialised works. Those who render specialised services could also be prosecuted for tax fraud if the authority interprets that the rendering of such specialised services is in fact a simulated scheme.

Mexican financial system (withholding on interest payments and thin capitalisation rule)

As part of certain abusive tax planning related to the interposition of certain financial entities in Mexico (Sociedad Financiera de Objeto Múltiple or SOFOM) to finance intercompany loans for Mexican subsidiaries in order to apply for a reduced 4.9 per cent domestic withholding rate on interest and avoid thin capitalisation rules (3:1 debt-to-equity ratio), the Mexican tax authority regulated the application of the provision that establishes which entities are considered as part of the Mexican financial system for tax purposes. As part of the reform, non-regulated SOFOMES established to achieve their corporate purpose that carry out activities mainly with domestic or foreign-related parties cannot claim either (i) the exemption of thin capitalisation rules; or (ii) the reduced 4.9 per cent domestic withholding rate on interest paid to foreign-related parties. The tax authority is already reviewing SOFOMES operations.8

Business reasons

Several provisions of the Mexican income tax law were amended to introduce business reason restrictions in many transactions. In this regard, interest from loans where there was a failure to probe business reasons cannot be deducted, but the tax authority may construe their nature as dividend distributions. Tax-free corporate reorganisation (including mergers and spins-off) must also be supported and justified with business reasons, otherwise, the tax authority will deem these transactions to trigger a taxable transfer of assets and hence, determine taxable gain considering the market value of the transmitted assets.

Maquiladoras safe harbour compliance

The possibility that maquiladora companies would obtain a ruling (advance pricing agreement or APA) whereby the tax authority confirmed that they met with transfer pricing obligations, and avoiding the principal constituted a permanent establishment in Mexico, was eliminated. Now all maquiladora companies must perform the calculation in accordance with the provision related to the safe harbour rule for determining their taxable profit based on the

8 A recent court case ruled on by the Federal Court of Administrative Justice upheld the tax authority’s position to refuse the reduced 4.9 per cent withholding rate on interest paid by a SOFOM to a foreign-related party (court case No IX-P-SS-55 ruled by the First Section of the Superior Chamber).
maximum value that results from applying 6.9 per cent to the total value of the assets and 6.5 per cent to the total amount of costs and expenses.

Joint and several tax liability

The 2022 reform introduced several new assumptions where the authority may presume the configuration of joint and several liability, derived from the acquisition of negotiations, for the taxes that would have been caused when they belonged to another person. According to the reform, the tax authority is empowered to presume that there is an acquisition of a business, unless there is evidence to the contrary, when it detects that the entity transferring and the entity acquiring the set of goods, rights or obligations are located, among others, in some of the following cases: (1) partial or total transfer of assets or liabilities; or (2) the partners or shareholders have effective control and there is partial or total identity of workers, trademarks and patents, industrial property rights, or partial or total identity of the fixed assets, facilities or infrastructure used to carry out the development of their activities.

Likewise, included within the assumptions of joint and several liability are those legal representatives of entities residing abroad: (1) with whose intervention they carry out activities for which contributions must be paid, up to the amount of such contributions; and (2) who are appointed for tax purposes, up to the amount of the contributions or benefits, who are referred to in the corresponding tax provisions.

Finally, in the framework of the sale and/or disposition of shares or securities that represent the ownership of property in Mexico carried out between residents abroad without a permanent establishment, included within the cases of joint and several liability are those taxpayers residing in Mexico that do not file information related to the corresponding declaration of disposition of shares or securities. Pursuant to this reform, the taxpayer in Mexico that fails to file the corresponding information is jointly and severally liable with the taxpayer transferring the shares or securities, up to the amount of the taxes that would have been incurred as a result of such an act.

Simulation for tax purpose

The 2022 tax reform introduced a new attribution to the tax authority so that it can determine, within the framework of its auditing attribution, the simulation of legal acts solely and exclusively for tax purposes in connection with those operations with related parties. It is worth noting that this amendment applies on an independent basis to the general anti-avoidance rule (GAAR) introduced in the 2020 tax reform.

Controlling beneficiary rules

As of 1 January 2022, all Mexican entities, trusts or other legal vehicles formed in Mexico, are required to identify who their controlling beneficiaries are, and keep the supporting documentation updated. The documentation and information should be disclosed to the tax authorities only when it is formally required by them.
For the purposes of this new obligation, a controlling beneficiary should mean any individual or group of individuals, that: (1) directly or indirectly obtains a benefit derived from its participation in a Mexican entity or receives the use and enjoyment of a relevant good or service, even if its participation is minimal; or (2) directly, indirectly and even on a contingent basis, exercises control over the Mexican entity.

If no individual is identified, members of the board of directors or an equivalent body shall be considered as the controlling beneficiaries, as may be the case for public companies or funds publicly traded in a recognised stock exchange market or pension funds, for example.