1-2014
June

Mexican Tax Reform 2014

1. Background

On September 8, 2013, the executive branch of the Mexican federal government submitted to the Mexican Congress an economic reform package making sweeping changes to Mexico's tax system. The raft of proposed reforms amended myriad tax laws, notably including the Federal Tax Code and the Value Added Tax Law, created a new Income Tax Law, and repealed the Flat Business Tax Law.

The executive branch's proposal was widely debated and ultimately underwent several changes in the legislative process, some highly significant, and among them the following are worth mentioning which were ultimately **not** accepted:

(i) The inclusion of an anti-avoidance provision in the Mexican tax system, under which the tax authorities would have been authorized to re-characterize the transactions performed by taxpayers where there was no valid business reason for the transaction;

(ii) The elimination of the 100% depreciation rate applicable to investments in machinery and equipment for the generation of renewable energy; and

(iii) Charging VAT at the standard rate on private education services as well as on interest on mortgages on properties used for residential housing (which today remain untaxed).

Lastly, following a dynamic negotiation process between the country's main parliamentary groups, on October 31, 2013, the Congress approved the final version of the draft decree. Among its key points are:

(i) An additional 10% tax applicable to dividends distributed by Mexican companies to individuals foreign residents;

(ii) The repeal of the tax consolidation regime, and its resulting replacement with the tax integration regime;

(iii) The elimination of the reduced 11%, VAT rate in the border areas to apply the standard 16% rate; and

(iv) The ceiling on the deduction of up to 53% or 47%, as appropriate, of payments made by employers which qualify as exempt income for workers.

The aim of this commentary is to provide a brief but concise overview of the Mexican tax legislation applicable in and after fiscal year 2014, while also taking a look at the legal provisions contained in the new Federation Tax Code Regulations published on April 2, 2014, the administrative provisions contained in the Miscellaneous Tax Decision for 2014 published on December 30, 2013 and its First Amendment Decision published in March this year, as well as the "Decree compiling various tax relief measures and administrative facilities for fiscal year 2014" published in the Official Federal Gazette on December 26, 2013 ("the Decree").

2. The Federal Tax Code(CFF)

The changes made to the Federal Tax Code are primarily aimed at allowing taxpayers to use electronic media to perform their tax obligations and, also, as a mechanism for the tax authorities to exercise oversight.

Important provisions are also introduced in the area of joint and several liability for the members or shareholders of legal entities, the auditing of financial statements and the introduction of what are known as "conclusive agreements" (*acuerdos conclusivos)*, agreements that can be reached with the tax authorities as an alternative mechanism for resolving tax disputes.

2.1 Tax mailbox

A new feature appearing in the tax reform is the tax mailbox, which consists in an electronic communication system between the tax authorities and taxpayers, housed on the website of the Mexican tax service (SAT). In this way, the tax authorities can serve notices of any administrative acts or decisions they issue. Whereas taxpayers will use the mailbox to file motions, requests and notices, as well as to comply with requests from the tax authorities and to inquire about their tax position.

The tax mailbox become operational on June 30, 2014 for legal entities, and on January 1, 2015 for individuals. Special attention will have to be paid to any administrative provisions that the SAT issues to be able to implement and execute this electronic system.

2.2 Joint and several liability of members and shareholders

Starting this fiscal year, the members or shareholders of legal entities will be jointly and severally liable for the taxes that the entity has incurred, in addition to any preexisting tax obligations, where the entity vacates, without any prior notice, the premises where it is tax domiciled.

This liability cannot exceed the amount of the member's or shareholder's contribution to the capital stock. The amount of the liability will be calculated by multiplying the percentage interest held by the shareholder concerned in the company's capital stock, when the omitted tax arose, by the portion of the tax deficiency that has not been secured with the company's assets.

This joint and several liability will only apply to the members or shareholders who exert effective control over the company, meaning that they have, among others, the ability:

(i) to impose decisions at shareholders' meetings;

(ii) to appoint and remove a majority of the directors;

(iii) to retain ownership of 51% of the voting stock; or

(iv) to control the management or main policies of the company, regardless of whether this is done through the ownership of securities, under an agreement or otherwise.

2.3 Electronic accounting

Article 28 of the Federal Tax Code has been amended to broaden the definition of "accounting records" for tax purposes, which will include, in addition to the elements already included, working papers (files), account statements, any document relating to tax compliance, as well as any documentation required by other laws.

This broadened definition of "accounting records" is fleshed out and made more precise in article 33 of the new Federal Tax Code Regulations. In addition, starting July 1, 2014, taxpayers must file their accounting records on the SAT portal every month.

2.4 Online digital tax receipts

Starting April 1 this year, the online digital tax receipt (CFDI, *Comprobante Fiscal Digital por Internet*) will be the only valid form of tax receipt. Accordingly, taxpayers will not be able to deduct or claim amounts that are not supported by a CFDI, which must meet the requirements set out in 29-A of the Federal Tax Code, and all the other requirements laid down by the SAT in the form of general rules.

The recently published Federation Tax Code Regulations require taxpayers to file the CFDI with the SAT or its authorized supplier, within 24 hours after the performance of the transaction or payment supported by the CFDI. They also stipulate that the CFDI must include a detailed description of the property or goods that it supports.

To issue a CFDI, it will be necessary to apply to the SAT for a digital stamp certificate, using the taxpayer's advance electronic signature (FIEL, *Firma Electrónica Avanzada*). After obtaining the digital stamp, the taxpayer must issue the CFDIs using the SAT's virtual platform or that of any other party authorized to act as an electronic invoice supplier.

Under the Miscellaneous Tax Decision, and its First Amendment Decision, any CFDIs issued by taxpayers must comply with certain additional specifications where taxpayers engage in activities in specific industries or carry out certain kinds of transactions.

2.5 Option to audit financial statements

Previously, taxpayers who met certain requirements, basically relating to high revenues, were required to file with the tax authorities an opinion on their financial statements issued by a certified public accountant.

Under the tax reform, this obligation to submit the opinion to the tax authorities is eliminated. However, although it is not mandatory, certain taxpayers will have the option to continue to file these opinions.

The new wording of the Federal Tax Code establishes that the option to file the opinion on their financial statements will only be available to taxpayers who in the preceding year:

(i) obtained cumulative revenues of more than $100 million pesos;

(ii) have assets worth more than $79 million pesos; or

(iii) had at least 300 employees in each month of the year.

This change to the Federal Tax Code is highly significant because previously, when the tax authorities wanted to review an opinion submitted by a taxpayer, they first had to request information from the public accountant who had issued the opinion, under what was known as a sequential review. The tax authorities could only approach the taxpayer directly if the documents furnished by the accountant did not clarify their doubts.

In line with the above changes and with the provisions of the new Tax Code Regulations, the sequential review has gone from being the general rule to the exception, only applicable in certain cases.

Lastly, it is important to note that taxpayers who were required to have their financial statements audited under the legislation in force in 2013 must submit an opinion for fiscal year 2013 on the terms set out in that legislation. The tax authorities may rely on the same legislation to verify these opinions.

2.6 Electronic audits

A new audit power is established whereby the tax authorities can perform electronic audits of taxpayers, jointly and severally liable parties or third parties related to them, in order to verify compliance with their tax obligations. During this entirely computerized procedure, any administrative acts and decisions, as well as any motions from taxpayers, will be notified and submitted in digital documents through the tax mailbox.

It will be essential for taxpayers to check their mailboxes regularly for any notifications they may have received, and to answer any such notifications within the time limits stipulated in the relevant legislation; otherwise, they will run the risk of being deemed notified, and even of being deprived of their right to produce evidence or of being deemed to have tacitly agreed with the observations made by the tax authorities.

Lastly, according to the terms of number 61 of the new Tax Code Regulations, third parties from whom the SAT has requested information on a taxpayer will have 15 days from the date on which the notification takes effect, to reply to the request.

2.7 Assessment by presumption

The tax reform establishes that the tax authorities may assess a taxpayer's net taxable income by presumption where the taxpayer has committed irregularities or interfered with the performance of the tax authorities' audit powers.

For these purposes, the tax authorities may presume that the taxpayer's net taxable income may be obtained by multiplying the gross revenues reported in the previous year by a coefficient of 20%, or by another specific coefficient determined according to the type of activity carried on by the taxpayer.

In addition, the tax authorities will be authorized to modify the taxable income or tax loss by a presumed value that modifies the value at which the taxpayer has acquired or disposed of assets, as well as the amount of the consideration paid or received for services provided.

2.8 Exceptions to tax secrecy

The tax authorities are required to keep confidential and, consequently, not to disclose the information supplied by taxpayers or that obtained in performing their audit powers (tax secrecy).

However, starting this year, the tax authorities will be authorized to publish, on the SAT's portal, the taxpayer's name or business name, as well as the taxpayer's number on the Federal Taxpayers Register, provided that the taxpayer:

(i) is liable for firm tax debts, meaning those against which the taxpayer did not assert a timely defense, or, if they did assert a timely defense, a competent court found in favor of the tax authorities;

(ii) is liable for certain tax debts which, although enforceable, have not been paid or secured;

(iii) is registered on the Federal Taxpayers Register but cannot be located and is in systematic breach of his tax obligations;

(iv) has been convicted for a tax offense in an enforceable judgment;

(v) has had a tax debt remitted; or

(vi) is liable for any tax debts that have been canceled due to his inability to pay or insolvency.

According to the preamble to the tax reform, this measure is intended to keep complying taxpayers from conducting business with taxpayers considered by the SAT to pose a risk. This is to save complying taxpayers having any credits or assets they may claim in respect of those transactions rejected by the tax authorities.

2.9 Conclusive agreements

The conclusive agreement mechanism is created as an alternative method for resolving disputes in tax audits. Taxpayers may request a conclusive agreement where they do not agree with the facts or omissions that the tax authorities have identified in the tax audit, before the tax debt is determined.

To initiate the conclusive agreement process, the taxpayer must submit a written application to the Office of the Taxpayer Advocate (PRODECON*, Procuraduría de la Defensa del Contribuyente*). In his application, the taxpayer must set out the facts or omissions attributed to him and with which he does not agree, stating his opinion on those facts or omissions. The taxpayer may also file any documents he considers to be relevant.

If the authorities agree with the terms of the conclusive agreement, the agreement must be signed by the taxpayer, the auditing authority and the PRODECON. The terms accepted in these agreements will only take effect between the parties and will be final, so no defense can be asserted against it. A taxpayer who reaches a conclusive agreement will be entitled, only on this one occasion, to a remission of the whole amount of any fines determined by the tax authorities.

It is important to note that because conclusive agreements only take effect between the parties (the taxpayer and the Mexican tax authorities), there are certain risks for taxpayers who operate in a number of jurisdictions. What may happen, for example, is that foreign tax authorities might not recognize the terms agreed in those conclusive agreements (i.e. transfer pricing adjustments that involve a jurisdiction with which Mexico has signed a tax treaty), since the agreement was not reached under the mutual agreement procedure provided for in the tax treaty.

Therefore, multinational companies will need to consider the myriad scenarios that may arise when assessing whether to enter into a conclusive agreement with the Mexican tax authorities and with the involvement of the PRODECON.

2.10 Appeal for reversal

Several amendments are made to the appeal for reversal (which is the defense in the administrative jurisdiction provided in the Federal Tax Code against tax decisions), aimed at streamlining this instrument.

The time limit for filing the appeal is shortened from 45 to 30 days. In addition, the time limit in which taxpayers can announce their intention to produce further evidence to the evidence mentioned in the appeal itself will be 15 days from when the appeal is filed. Likewise, the time limit for producing this additional evidence is also shortened to 15 days from when the announcement was made.

Any taxpayers who file an appeal for reconsideration will no longer be required to post a bond for the tax deficiency until the tax authorities decide on the appeal. However, taxpayers will be required to post a bond for the tax deficiency or pay the tax debt within 10 days following notice of the decision on the appeal.

Lastly, an important point to bear in mind is that according to the tax reform we are looking at, any evidence that the taxpayer fails to produce during the audit proceeding, or during the procedure for the subsequent appeal for reconsideration, may no longer be produced at a later point in the proceeding for setting aside the decision that may be brought at the Federal Court of Tax and Administrative Justice, in accordance with the case law of the Mexican Supreme Court.

2.11 Obligations for financial institutions

The tax reform sets out specific obligations for banks and certain institutions in the financial system requiring them to provide information on accounts, deposits, services, trusts, credit facilities or loans provided to individuals or legal entities, as well as on any transaction on the terms that may be requested by the tax authorities.

3. New Income Tax Law

The new Income Tax Law was officially published on December 11, 2013 and entered into force on January 1, 2014, whereupon the former law in force since 2002 was repealed.

It must be underlined, however, that the Regulations to the former Law published on October 17, 2003, will continue to apply, unless they contradict the new Income Tax Law, just until the Regulations implementing the new law are issued.

Although the new Income Tax Law keeps the structure of the repealed law largely intact, it makes important changes that significantly alter the workings of Mexico's most important tax.

Particularly worth looking at are the provisions on the additional tax on dividends, the elimination of the tax consolidation regime and the limit on the credits taken by employers where their payments qualify as exempt income for their workers, in the case of contributions paid to the Mexican social security system by the employer although the cost is borne by the worker.

3.1 Corporate tax rate

The tax reform retains the 30% rate at which legal entities that are resident in Mexico are taxed. The transitional articles do not refer to any increase or decrease in this rate for future years.

3.2 Application of tax treaties

Article 4 of the Income Tax Law provides that to qualify for the benefits contained in an international tax treaty, the taxpayer must evidence his residence in the state concerned and comply with the provisions contained in the treaty, as well as the requirements laid down in the domestic law.

For these purposes, the taxpayer must file an information return on his tax position, or the auditor's opinion on the financial statements referred to in section 2.5. above.

In addition, where transactions are performed with related parties that are resident in foreign countries, the tax authorities may ask the nonresident related party to evidence by way of an affidavit signed by a legal representative that there is a position that triggers double taxation. The affidavit must identify the income that is taxable in Mexico and is also taxed in the country of residence. The foreign taxpayer must indicate the applicable legal provisions and furnish the necessary documents.

The Miscellaneous Tax Decision for 2014 provides, however, that nonresident taxpayers will not be required to evidence the existence of double taxation where:

(i) the taxpayer is resident in a country with a territorial income tax system in relation to income tax;

(ii) the foreign resident is not subject to tax in his country of residence as a result of applying the exemption method provided for in the tax treaty signed by Mexico with that country; or

(iii) the disposal of shares in question was carried out with observance of the corporate restructuring rules established in the treaty in question.

3.3 Tax paid abroad

Previously, the mechanism whereby Mexican residents could claim the taxes they had paid abroad was relatively simple. Now, the new law establishes a host of complex mechanisms and requirements to claim those taxes.

In the case of direct taxes, the new law imposes a limit on the tax paid abroad that will be claimable in Mexico, which will be calculated according to the country or territory from which the income is received. The purpose of this change is to enable the Mexican tax authorities to prevent taxpayers from claiming taxes paid abroad at higher rates than those applicable in Mexico.

For indirect taxes, a specific mechanism is established whereby taxpayers must apply to determine the proportional amount of the tax paid by foreign companies who are first-tier and second-tier subsidiaries.

3.4 Employee profit sharing payments

It is clarified that to determine the net taxable income, employee profit sharing payments will have to be deducted from the aggregate total revenues received in the year.

In addition, the Income Tax Law establishes that legal entities cannot deduct any loss carryforwards, and any amounts paid in respect of employee profit sharing payments in the same year in the calculations to determine the taxable income that will be the basis for the profit sharing payments.

What the taxpayer will be able to deduct from his taxable income, however, are any amounts paid to his workers that are not deductible for income tax purposes (amounts paid by the employer that qualify as exempt income for the workers).

3.5 Cost of shares

Article 22 of the new law also establishes a procedure for determining the cost of shares for tax purposes, no matter how long the shares have been held. For these purposes, it will be necessary to determine the verified acquisition cost of the shares by reference to the differences in the previously taxed earnings account (CUFIN, *Cuenta de Utilidad Fiscal Neta*), the tax loss carryforwards, the reimbursements made and the tax losses generated before the taxpayer held the shares but used while held by him.

In addition to this, taxpayers who in a corporate restructuring dispose of shares at a value equal to the cost for tax purposes are required to file the tax information return for the year in which the restructuring is carried out, where the law imposes the obligation to provide this information.

If the companies being restructured are not required to file the return, then they must file the auditor's opinion on the financial statements referred to in point 2.5.

3.6 Payments to workers

Starting this year, a limit is placed on the tax credit for any amounts paid by employers which are also exempt income for the workers. As a general rule, a taxpayer who has employees may only deduct 47% of the payments made, if the payments are exempt income for his workers. Employers may deduct 53% of these amounts, however, where the fringe benefits they provide to their workers are not lower than they were in the immediately preceding year.

Where the taxpayer pays out more than $2,000 pesos in salaries and wages, for the payments to be deductible, they must be made by electronic transfer, order check, credit, debit or service card, or by electronic purses authorized by the SAT. In addition, for legal entities to be able to take this credit, the amounts concerned must appear in a CFDI (online digital tax receipt). The employer will be responsible for issuing these CFDIs.

This limit on deductions has been one of the most controversial points of the reform and has even led to a number of "amparo" proceedings to protect constitutional rights being brought against it, on the ground there is no justifiable reason to transfer the tax impact of the repeal of the flat business tax (which placed a limit on the deduction of payments representing income for workers) to income tax.

3.7 Payments to be borne by third parties

Previously, it was established that contributions in the subsidized portion or which were originally intended to be charged to third parties could not be deducted, except for contributions paid to the social security system. Now, article 28, paragraph I, restricts the exception to allow only the employers' share of the contribution to be deducted. With this change, the law clarifies that contributions paid to the social security system by the employer, but to be borne by the worker, will not be deductible.

This change is due to the fact that it was common practice in Mexico for employers to include the social security contributions to be borne by the worker as a benefit established in the employment contract. However, the new rule prevents employers from deducting these contributions which they have paid, but are to be borne by the employees, when they calculate their income tax charge.

This limit has also been a controversial point of the reform by not permitting the deduction of a necessary and mandatory expense after it has been set out in the employment contract, thereby affecting the employer's taxpaying capacity.

3.8 Payments to related parties (Based on: Base Erosion and Profit Shifting - "BEPS" - Action Plan)

Under the new legislation, amounts paid by taxpayers to their related parties resident in Mexico or abroad will not be deductible where these amounts are also deductible by the related party in question. This restriction on the deduction will not apply where the related party that deducts the payment made by the taxpayer also retains the income generated either in the same fiscal year or the following year.

3.9 Payments to foreign residents in respect of interest, royalties and technical assistance (BEPS initiative)

New cases are added in which amounts paid in respect of interest, royalties and technical assistance will not be deductible where they are paid to foreign entities that control, or are controlled by, the taxpayer.

The law determines that these expenses will not be deductible where the foreign entity receiving the payment is considered a pass-through entity for tax purposes.

However, amounts paid for these items will be deductible to the extent and in the proportion that:

(i) the members or shareholders of the foreign entity receiving the payment are required to pay the equivalent in their jurisdiction of the income tax on the profits received from these entities; and

(ii) the amount paid is in line with arm's length prices for comparable transactions between independent parties (transfer pricing).

3.10 Losses

A transitional provision establishes that legal entities resident in Mexico that have incurred losses in prior years must use these tax loss carryforwards in accordance with the terms of the new law.

3.11 Tax integration regime

The tax reform eliminates the tax consolidation regime which allowed companies to defer payment of the consolidated income tax, and to deduct the losses generated by a company, in the same year, from the income generated by other companies in the same business group.

Groups that were taxed under the consolidation regime until December 31, 2013 will need to elect, according to their particular circumstances, one of the following alternatives:

- Business groups that elected to be taxed under the consolidation regime from 2010 onward may continue to be taxed under this regime, only for the years remaining to complete the mandatory five-year period, reckoned from the year in which they began to file consolidated returns. Once this period has ended, they will need to elect either of the following options.

- Groups that have been taxed under this regime for more than 5 years will need to deconsolidate and, consequently, calculate and pay the tax deferred to September 31, 2013. They must do so by implementing one of the following options:

  (i) apply the deconsolidation rules contained in the repealed income tax legislation, and pay in five years;

  (ii) elect the optional procedure contained in paragraph XV of transitional article nine of the Income Tax Law; and make staggered payments over five years, or

  (iii) calculate the deferred tax from fiscal years 2008 to 2013, which will be paid in installments under a 10-year plan.

- Migrate to the new tax integration regime, which replaces the repealed consolidation regime. The integration regime allows a partial deferral of the tax payment for three years only; however, it sets out fewer relief measures than were previously granted under the tax consolidation regime.

To qualify for the integration regime, the integrating company (the parent company) must meet the following requirements:

(i) it must be resident in Mexico;

(ii) it must own, directly or indirectly, at least 80% of the voting stock of the integrated companies (subsidiaries); and

(iii) a portion of 80% of its voting stock must not be owned by another company(ies), unless these companies are resident in a country with which Mexico has signed a broad exchange of tax information treaty.

Groups that used to file consolidated returns and wish to migrate to the integration regime should have notified the tax authorities before February 15, 2014. Groups that until the 2013 year-end did not file consolidated tax returns have until August 15 of this year in which to request authorization from the tax authorities to be taxed under the tax integration regime.

3.12 Previously taxed earnings account (CUFIN) and capital contribution account (CUCA)

A new mechanism is implemented for calculating the net taxable income for each year, which must be used by taxpayers who are required to retain proportional amounts of taxes paid abroad. Like that discussed in point 3.3 above, this is a highly technical mechanism and requires a careful study of each taxpayer's tax position.

Generally speaking, the new method provides that it will be necessary to deduct from the income for tax purposes for the year, the amount calculated under a method based on the income tax paid abroad that was not claimable by the Mexican resident legal entity.

A transitional provision establishes the procedure for determining the balance of net taxable income for the fiscal years from 2001 to 2013, for which the balance of the previously taxed earnings account as of 2014 is actually obtained.

Moreover, the transitional provisions of the Income Tax Law establish that any taxpayers who have commenced operations before this year can treat as the initial balance of the capital contribution account (CUCA - *Cuenta de Capital de Aportación*) the sum that would have been determined on December 31, 2013, by reference to the terms of the repealed law.

3.13 Individuals

Starting in 2014, Mexican resident individuals who, in respect of business activities or the provision of services, obtain income above 750 thousand pesos per year will be taxed at a rate of 32%.

The applicable rate for those receiving more than 1 million pesos in the fiscal year will be 34%, whereas individuals whose income from these activities exceeds 3 million pesos will be taxed at 35%.

3.13.1 Securities sold on the Mexican stock exchange

Before the discussed tax reform, any gains obtained by individuals on the sale of shares listed on the Mexican stock exchange were exempt from income tax. From this year onwards, these gains will be taxed at 10%.

The tax reform also establishes an alternative mechanism for determining the cost of shares sold on the stock exchange. To calculate the gain on shares up to December 31, 2013, the taxpayer may elect to base this calculation on the original cost of the share, or the average value of the last 22 listed prices.

3.13.2 Restriction on personal allowances

A limit is placed on the allowances that individuals may claim, starting in 2014. Personal allowances will be capped at 10% of the taxpayer's income or at the amount equal to 4 annual minimum wages (approximately $98,243.00 pesos), whichever is lower.

3.13.3 Tax inclusion regime

The tax reform eliminates the intermediate regime and small taxpayer regime, and replaces it with the tax inclusion regime, which seeks to serve as a bridge for individuals who were taxed under the intermediate regime or as small taxpayers to migrate to the general regime.

The inclusion regime is only open to individuals who engage in business activities, dispose of assets or provide non-professional services, and receive annual revenues below $2 million pesos.

Taxpayers who apply the tax inclusion regime will receive the following benefits:

(i) Easier option for calculating and paying their taxes in the form of a two-monthly return, including any taxes they have withheld;

(ii) Release from the obligation to file information returns, on the understanding that the relevant information will be supplied on the two-monthly returns, and among others,

(iii) Simplified bookkeeping and issuing of tax receipts.

This regime is transitional and will only be available to taxpayers for a maximum period of ten years, after which, they must be taxed under the regime for individuals with business activities.

Taxpayers applying the inclusion regime will qualify for a 100% reduction in the income tax payable in the first year, and this discount will be lowered by 10% each year thereafter, until from the eleventh year those taxpayers will pay the whole of their tax debt.

The Decree establishes a tax relief measure for individuals who perform transactions with the general public and who elect to be taxed under the tax inclusion regime, consisting of a tax asset equal to 100% of the value added tax resulting from the activities of selling goods, providing independent services and granting the temporary use or enjoyment of goods.

It also establishes for these individuals a tax relief measure consisting of a tax asset equal to 100% of any excise tax that may arise on their products and services.

Both relief measures are conditional on their making no tax charge whatsoever in respect of these items to the purchaser and on their providing information on revenues, expenses and transactions with suppliers.

3.14 Tax regime for dividends

Before the entry into force of this reform, any dividends that originated from the CUFIN (previously taxed earnings account) were not taxed, as they had already been taxed at corporate level. Where dividends did not originate from the CUFIN, the law established a method for paying the relevant tax.

To come into effect on January 1, 2014, the reform establishes an additional 10% tax payable by resident individuals or nonresidents who receive dividends distributed by Mexican resident legal entities, regardless of whether or not they originate from the CUFIN, as described below.

The tax will be paid by way of a withholding by the company distributing the dividends. In addition, individuals who receive dividends from nonresident legal entities must also pay the 10% tax on those amounts, regardless of the amounts withheld from them by the foreign company in question.

The foregoing tax will apply only to income generated in or after 2014. For these purposes, legal entities must, besides keeping their CUFIN with the earnings generated through 2013, create a new CUFIN in which they will place amounts relating to the earnings they generate in or after 2014.

The tax authorities may presume that all of the earnings have been obtained from this year if a company does not keep two separate accounts, or does not identify the earnings relating to each fiscal year in its CUFIN.

It is important to underline that taxpayers may apply a tax treaty that establishes lower rates or even exempts dividends from tax.

Likewise, in accordance with the provisions of article 4 of the Income Tax Law analyzed above, special attention should be paid to cases where there is juridical double taxation in the recipient country of the dividends, since this situation could jeopardize the application of the tax treaty in question under Mexican domestic law.

3.15 Tax regime for maquiladora companies

In accordance with the tax reform, *maquiladora* companies will not qualify as a permanent establishment in the country where certain requirements are met, including, inter alia, complying with transfer pricing rules.

The Income Tax Law only allows the safe harbor method under which the *maquiladora* companies must report as taxable income the larger of the following: 6.9% of the value of the assets used in the *maquila* process, or 6.5% of total operating costs and expenses.

To be considered a *maquiladora* company for income tax purposes, the company must meet the requirements set out in article 181, including most notably the following:

(i) All of its revenues must originate exclusively from its *maquila* operations;

(ii) The goods must be supplied by the nonresident under a *maquila* contract protected by a *Maquila* Program authorized by the Ministry of Economy ("IMMEX");

(iii) The goods must be temporarily imported into the country for processing or repair, and subsequently returned to the foreign country; and

(iv) The *maquila* process must be carried out with machinery at least 30% owned by the nonresident and such machinery must not have been owned by the *maquiladora* company or any of its Mexican-resident related parties.

The new legislation also restricts the maximum term of *maquiladora* "shelter" companies to 4 years.

The tax reform also repeals the presidential decree of October 2003 which provided significant income tax relief to *maquiladora* companies.

3.16 Tax incentives for the real estate industry

3.16.1 Trusts engaged in property acquisition and construction

The new law retains the preferential tax treatment applicable to trusts that engage in acquiring or building properties for lease (usually referred to as "FIBRAS" in Mexico after their initials in Spanish, which are the Mexican equivalent of "REITs").

Additional requirements are established, however, for FIBRAS wishing to apply the tax incentives offered by the Income Tax Law.

Starting this year, FIBRAS must, besides the requirements imposed by the repealed law, meet the following conditions:

(i) In any lease agreements that are concluded, the portion of the consideration agreed to in variable amounts or subject to percentages, if any, must not exceed 5% of the total rental income received by the FIBRA, unless they involve consideration calculated on the basis of a fixed percentage of lease sales; and

(ii) They must be registered on the FIBRAS Register, complying at all times with the administrative rules issued by the SAT for the purpose.

3.16.2 Real estate investment companies

The tax reform eliminates the tax incentives that the repealed law provided for companies engaged in acquiring or building properties for lease (usually referred to as "SIBRAS" in Mexico, after their initials in Spanish).

In a transitional decision, it was provided that taxpayers who have contributed land or buildings to a SIBRA will recognize the gain on the disposal of those assets where the taxpayer in question disposes of his shares in the SIBRA or where the SIBRA disposes of the assets contributed by the taxpayer in question.

If the above scenarios have not arisen as of the 2016 fiscal year-end, taxpayers must recognize the total amount of the gain on the disposal of assets contributed which has not already been recognized.

3.16.3 Taxpayers engaged in building and selling real estate developments

The tax reform establishes an additional rule for taxpayers who elect to apply the tax incentives established for those whose activity consists in building and selling real estate developments.

These taxpayers may deduct the total cost of the land they acquire in the year in which the properties are acquired. The penultimate paragraph of numeral 191 of the new law provides, however, that after the end of the three year period immediately following the year in which the land in question was acquired and deducted, these taxpayers must treat the revalued acquisition cost of these properties as taxable income.

3.17 Tax incentives for aircraft leases

The Decree reaffirms that Mexican residents who use aircraft and have a concession or permit from the federal government to operate them commercially, for the purposes of transporting passengers or goods, and where the lease agreement on the aircraft establishes that the amount of the income tax that arises pursuant to article 158, paragraph six of the Income Tax Law is covered by the Mexican resident, they will receive a tax incentive equal to 80% of the income tax that arises in this connection.

3.18 Elimination of investment incentives

The mining industry used to receive a significant tax incentive under which they were allowed to deduct all the expenses incurred in pre-operating periods when exploring for new deposits, in the year in which they were incurred.

The new legislation eliminates this option, however, so now they will have to deduct these expenses under the rules applicable to investments, in particular to pre-operating expenses, which determine that they are deductible at 10% per year.

Also eliminated under the new legislation is the option to deduct, in a single fiscal year, 100% of the expenses incurred in respect of investments in certain fixed assets, such as cash registers for tax receipts and electronic equipment for tax registration purposes.

Support continues to be given, however, to investments in adaptations to facilities that are aimed at helping people with different abilities to access and use them and, accordingly, the immediate deduction incentive remains in place.

Lastly, the amount that can be deducted for investments in automobiles is reduced to MXN $130,000 per unit, without including value added tax. Likewise, the amount that can be deducted for automobile rental is adjusted from MXN $65 to $200 per day per unit.

4. Value added tax

4.1 Elimination of reduced rate

Supplies of goods and services in the border area were previously taxed at a reduced 11% rate. As from January 1 of the current year, the VAT rate applicable to transactions performed in the border area is brought into line with the standard 16% rate.

4.2 Inclusion regime

Any VAT that has been withheld by taxpayers subject to the tax inclusion regime will be paid over on the two-monthly return, mentioned in section 3.13.3. above.

4.3 Taxable activities

As from the entry into force of the tax reform, VAT will be charged at the standard rate on supplies of:

(i) goods subject to the strategic bonded warehouse regime;

(ii) pet food;

(iii) chewing gum.

Likewise, in and after 2014, the following services will be subject to VAT:

(i) public transportation of persons, unless provided in urban, suburban or metropolitan areas; and

(ii) tourism hotel services for foreigners to participate in congresses, conventions and fairs.

4.4 Temporary imports of goods

The new legislation eliminates the tax applicable to supplies of goods between foreigners and *maquiladora* companies authorized to operate as *maquilas* on the terms of the IMMEX program.

Also eliminated is the exemption that previously applied to supplies of goods subject to the strategic bonded warehouse regime. Accordingly, starting this year, these transactions will be taxed at the standard rate, and taxpayers will be able to apply the exemption until the month following that of the payment in question.

4.5 Transitional regime

By way of a transitional provision, the new legislation establishes that supplies of goods or services made during 2013 will be taxed in accordance with the new legislation, where the consideration for such supplies is paid after January 10, 2014.

4.6 VAT certificate

In accordance with article 28-A of the reformed Value Added Tax Law, to avoid the financial effect of paying VAT on the arrival of goods that are destined for temporary import customs regimes for manufacturing, processing or repair under *maquila* or export programs; bonded warehouses to be used in vehicle assembly and manufacturing processes, or manufacturing, transfer or repair processes in a private bonded warehouse and public bonded warehouse, a certificate mechanism is created.

Obtaining this certificate from the Mexican Tax Service (SAT) will enable companies to take a tax asset equal to 100% of the VAT that is payable on the temporary import, which can be taken against the VAT expense on these activities.

4.7 Treatment applicable to international carriage by air

As a result of the recent reform, the treatment applicable to the international carriage of goods by air is brought into line with the carriage of passengers.

This means that in the international carriage of goods, 25% of the consideration can be treated as a supply of services in the national territory, and the remaining 75% as an export of services, and that the 0% rates can be applied to this activity, while allowing all of the input VAT to be deducted if it meets the requirements laid down in the law.

4.8 Tax incentives

The Decree establishes a tax incentive for hotel enterprises, as well as for enterprises renting conference and exhibition centers to foreigners, consisting of a tax asset equal to 100% of the VAT payable on the supply of services or on the rental service, which can be taken against the VAT expense on those activities.

Likewise, in the case of juices, nectars, concentrates or drinkable dairy products containing fruit, vegetables or pulses, in packages containing under 10 liters, a tax incentive is provided consisting in an asset equal to 100% of the VAT that should be paid on the import or sale of these products, which can be taken against the VAT that should be paid on those activities.

Both incentives are conditional on the VAT on the above-mentioned activities not previously being charged to the purchasers or borrowers.

5. Production and Services Excise Tax Law

Starting this year, the excise tax on products and services (IEPS, *Impuesto Especial Sobre Producción y Servicios*) will apply to beverages flavored with added sugars and to non-basic foods that are high in calorie density.

The new law establishes a tax of MXN $1 per liter, which will apply to whoever sells or imports beverages flavored with added sugars. For the purposes of the discussed new law, "flavored beverages" means non-alcoholic beverages prepared by dissolving any type of sugar in water and which may include additional ingredients such as natural, artificial or synthetic flavoring, added or otherwise, from juice, pulp or nectar from fruits, vegetables or pulses, from their concentrates or extracts and other food additives, and which may or may not be carbonated.

Beverages that have a registration dossier for health products such as medicines, oral serums and milk in all its formats will not be subject to the IEPS excise tax.

In addition, the sale of non-basic foods, with a calorie density of 275 kilocalories or more per 100 grams, will be subject to an 8% tax on the sale price

5.1 Tax incentives

The Decree states that, given that Mexico is a party to numerous international conventions that exempt the sale and import of jet fuel from tax, and with the aim of promoting free market conditions, a tax incentive is granted to importers and sellers of jet fuel equal to the tax charge represented by the IEPS excise tax that is levied on the import or sale of this fuel, so that this tax cost is not passed on to the domestic and international airlines.

In addition, given that, as a result of the reform, the sale of chewing gums is subject to VAT and to the IEPS excise tax because they are considered to have a high calorie content, the Decree establishes that these products will only be subject to VAT and not to the IEPS excise tax.

6. Conclusions

The entry into force of the tax reform has made significant changes to the legislative framework applicable to direct and indirect taxation in Mexico. It is very important, therefore, for domestic and foreign investors to be aware of these changes and to implement the tax strategy that is best suited to their specific needs and, consequently, to adopt a tax efficient structure for their operations in Mexico.

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