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Global Tax Alert

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Mexico's President submits 2021 economic proposal to Congress

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Mexico's President submitted to Congress the economic proposal for 2021 (the Proposal). Compared to the 2020 economic package, the Proposal addresses more administrative and enforcement types of tax issues with fewer cross-border tax implications and does not include tax increases or new taxes.

Before the Proposal can become law, both chambers of Mexico's Congress must debate and vote on it. They need to approve the Proposal by 31 October 2020. Once approved, the Proposal will be sent to the President for his signature and will be published in the *Official Gazette*. The Proposal will become law on the date of publication and should be effective 1 January 2021. Taxpayers and investors should be aware of these proposals as they make their way through the legislative process.

This Tax Alert focuses on the provisions that are most relevant to foreign investors.

Federal Fiscal Code

General anti-avoidance rule (GAAR)

As part of the tax reform enacted on 9 December 2019, Mexico established a general anti-avoidance rule that allows the Mexican tax authorities to recharacterize a transaction for tax purposes if it lacks a business purpose.

Although the last sentence of the GAAR states that no criminal consequences should result from the application of the GAAR, the Proposal would clarify that this provision would not impede a criminal investigation or charges.

Spin-offs

For Mexican tax purposes, a spin-off is treated as a tax-free transfer of assets if certain requirements are met. In an effort to address a perceived abuse of tax-free spin-offs, the Proposal would treat a spin-off as a taxable transfer when the spin-off increases the stockholders' equity in any of the entities involved, leading to the creation of provisions or accounting entries that did not exist prior to the spin-off. The spin-off would be treated as a taxable transfer even if all of the other requirements are met.

Joint liability

The Proposal would establish that joint liability may apply to a spin-off that is treated as taxable transfer. Joint liability also would apply when foreign related parties of Mexican resident companies have established a permanent establishment as a result of transactions conducted with the resident companies.

Additional proposed amendments to the Federal Fiscal Code

The Proposal would also include the following provisions:

- Adjustments to the refund procedures (e.g., the refund request would be withdrawn for taxpayers that the Mexican tax authorities cannot locate or whose address they cannot confirm)
- Elimination of the reduced fines in transfer-pricing matters
- Modifications to the procedure for canceling and reactivating digital seal certificates for invoicing
- The use of technological tools by the tax authorities to collect information when conducting tax audit procedures (e.g., use of cameras, video cameras, tape recorders and the use of cell phones)
- Extension of the time the tax authorities have to complete electronic tax audits in foreign trade matters
- Modifications to the conclusive agreement procedure (i.e., similar to an arbitration process)
- Modifications to the requirements for issuing electronic invoices

Income tax law

Maquiladoras

The maquiladora tax regime rules will not change except for a minor wording change to reinforce the original intent of the 2014 tax reform. The change would reinforce that maquiladoras must apply either the safe harbor methodology or secure an Advance Pricing Agreement (APA) to satisfy the transfer pricing rules.

From a customs perspective, the Proposal would expand the definition of "contraband" to include, among others, machinery and equipment temporarily imported under a maquila or IMMEX program and not returned abroad or subjected to a change of customs regime, as applicable.

Nonprofit entities

The Proposal would limit revenue that nonprofit entities and trusts authorized to receive tax-deductible donations could receive from activities unrelated to their donation-related activities. The revenue from unrelated activities would be limited to 50% of their total revenue.

Value-added tax

Digital services

The Proposal would expand the rules for nonresident digital service providers and establish additional non-compliance consequences.

As part of the tax reform enacted in 2019, Mexico requires nonresident digital service providers to register, collect and report VAT for certain sales of goods and services to Mexican residents. Additionally, a nonresident digital service provider that serves as an intermediary for the purchase of goods and services over its platform must collect VAT on goods and services paid for through the platform. Under the current rule, the VAT collected on these transactions must be withheld and remitted to the tax authorities only if the seller is a Mexican resident individual. The Proposal would expand this obligation to require VAT to be withheld and remitted on transactions in which the seller is a nonresident. The intermediary platform would then also be required to issue the invoice upon the user's request.

Currently, intermediaries involved in the sale of used goods do not have to register, collect and report VAT. The Proposal would eliminate the exclusion for intermediaries involved in the sale of used goods and require them to comply with all of the VAT obligations.

The Proposal also includes rules that would block nonresident digital service providers from the telecommunications networks in Mexico if they are determined to be non-compliant with the VAT registration and compliance rules.

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