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Mexican Legal News

# Approval by the Congress of the Union of the Economic Package 2020

The Decree amending provisions of the Income Tax Law, the Value Added Tax Law, the Special Tax on Production and Services Law and the Federal Tax Code, was approved by the Congress of the Union ("**Decree**"), commonly referred to as the "Economic Package".

Below you will find a detailed analysis of the matters we consider relevant of the amendments approved by the Congress of the Union, which once published will enter into force, in general, starting January 1, 2020:

1. **Income Tax ("ISR") Law:**

    a) Changes to the definition of permanent establishment.

The concept of permanent establishment set forth in the ISR Law is updated through the Decree in its definition, as well as the premises for its creation, taking as a basis the results of Action 7 of the Base Erosion and Profit Shifting Project ("**BEPS**").

In particular it is attempted to prevent the evasion of the creation of permanent establishments through strategies such as persons different from the independent agents acting on behalf of a resident abroad or one business transaction being separated into several to argue their preparatory or auxiliary nature.

For these purposes, the definition of permanent establishment is expanded to include when a tax resident abroad acts in Mexico through a person different from an independent agent and such person regularly concludes contracts or regularly performs the principal role in the conclusion of contracts executed by the resident abroad and these: (i) are executed in the name or on behalf of the resident abroad; (ii) establishes the transfer of the property rights, or the granting of the temporary use or enjoyment of a good that the resident abroad possesses or over which it has the right of temporary use or enjoyment; or (iii) obligates the resident abroad to provide a service.

Another new inclusion is the presumption that an individual or entity is not an independent agent when it acts exclusively or almost exclusively for a resident abroad that is its related party.

The ISR Law already established that a permanent establishment is created when a foreigner carries out its activities in Mexico through an independent agent, when the latter acts outside the ordinary scope of its activity. Until this reform it was perfectly clear when it was considered that an independent agent acted outside the ordinary scope of its activity, since it established casuistically the situations that fell under this premise.

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Beginning in 2020, the ISR Law will generate legal uncertainty for taxpayers since it will establish that the cases described in such Law under which it is considered that an independent agent acts outside of the ordinary scope of its activities, are simply examples and, therefore, the tax authority may consider at its discretion that an independent agent acts outside of the ordinary scope of its activities (therefore creating a permanent establishment), even when it does not involve the acts indicated in such law.

Now, for the activities mentioned in article 3 of the ISR Law not to constitute a permanent established their sole purpose must be preparatory or auxiliary.

Furthermore, the Decree expressly establishes that the exceptions for not generating a permanent established will not operate when:

- The functions carried out by the resident abroad are complementary as part of a cohesive business transaction that it carried out in Mexico through a permanent establishment, or those that a related party that is a resident in Mexico or a resident abroad with a permanent establishment in the country, carries out in one or more places of business in national territory.

- When the resident abroad (or a related party) has in Mexico a place of business where complementary functions are developed that are part of a cohesive business operation, the combination of which indicates they do not have a preparatory or auxiliary nature.

b) Hybrid mechanisms.

A hybrid mechanism exists when two countries characterize differently the same legal concept, income, an entity or who is the owner of the assets. An example of this situation occurs when one country considers income to be interest and another country considers the same income as a dividend.

These hybrid concepts can cause fiscal distortions such as considering the same payment deductible in one country and non-accruable in another or that it can be deducted in two different jurisdictions.

To avoid this situation, in the Decree, a rule was included that denies the crediting of the tax paid abroad (by the Mexican tax resident) when the tax has also been credited in another country unless the income for which such tax was paid has been accrued in the other country or jurisdiction where it has been credited.

With regard to the crediting of the tax paid outside of Mexico by the foreign companies that distribute dividends or profits to tax residents in Mexico (crediting in second and third level), it also cannot be credited when the dividend or profit distributed represents a deduction or an equivalent reduction for the entity residing abroad that makes such payment or distribution.

Section XXIX of article 28 of the ISR Law was reformed for the same purpose of expanding the prohibition on deducting the payments that a Mexican taxpayer makes and that can also be deducted by a related party (the reform refers to deductible by a "member of the same group"). Beginning in 2020, the payments a Mexican taxpayer makes that it can also deduct in another country or jurisdiction where it is considered a tax resident will also not be deductible.

This prohibition on deduction also applies for the payments made by permanent establishments that fall under one of the premises described above.

It is important to recall that the limit that prevents deducting these payments does not apply when the member of the same group or the taxpayer that is considered a tax resident in another country also accrues the income generated by the taxpayer for purposes of the income tax (ISR). In other words, the double deduction is permitted if the double income is considered but, in this case, the deduction is limited by the amount of the income accrued abroad.

The Tax Administration Service ("**SAT**") will issue general rules for permitting the deduction of these expenditures when the reason the deduction cannot be made is caused by the temporality in the accrual of the income.

c) Limitation on deduction of interest.

In general terms we can say that the taxable base can be understood as the amount to which the rate established in the ISR Law is applied to obtain the amount of taxes to be paid by the taxpayer.

The taxable base is the result of subtracting from the accruable income the deductions permitted by the ISR Law. Thus, the fewer the deductions, the greater the taxable base.

Now, in order to limit the deductions of interest by taxpayers, and according to the recommendations of the Final Report of Action 4 of the BEPS Project, in the Decree that will enter into force in 2020 section XXXII was added to article 28 of the ISR Law, which establishes that the net interests of the fiscal year that exceed the amount that results from multiplying the adjusted tax profit by 30%, will not be deductible.

It is important to take into account that even in the cases in which a tax profit is not obtained or when a tax loss is generated, the adjusted tax profit must be determined. If its value is zero or a negative number the deduction of all the interests of the taxpayer will be denied (except for the amount not subject to this limitation).

Section XXXII itself establishes what should be understood for net interest of the fiscal year and for adjusted tax profit:

- Net interests of the fiscal year:

  The amount that results from subtracting from the total of the interest accrued during the fiscal year (for debts of the taxpayer), the total income from interest accrued during the same period.

- Adjusted tax profit:

  The amount that results from the sum of the following concepts: (i) the tax profit; (ii) the interest accrued for debts of the taxpayer; and (iii) what was deducted as fixed assets, deferred expenses, deferred charges and expenditures made in pre-operative periods. All of the above corresponding to the same fiscal year and in accordance with the ISR Law.

It is important to take into account that to calculate the above concepts, only the deductible interest and the taxable interest should be considered, and in case of income that has a foreign source, it will be taken into account in the same proportion as the ISR must be paid.

To make this calculation the following will not be taken into account: (i) the exchange rate profits or losses accruing from the fluctuation of foreign currency (unless derived from an instrument whose return is considered interest); and (ii) the consideration for acceptance of a security (unless it is related to an instrument whose return is considered interest).

The first twenty million pesos of interest that a company deducts will not be subject to this limit. In the case of companies that are related parties or that belong to the same group, the twenty million pesos will be applied only once proportionally to the accrued income generated, jointly to all the companies of the group.

The net interests of the fiscal year (not deductible according to this rule) can be deducted during the next ten fiscal years, but in the understanding that such interests will be integrated again in the calculation of the 30% limitation in each fiscal year.

Furthermore, in order to avoid distortions in the tax effect of the interest and the debts they derive from, it is specified that the amount of the debts, from which interest is derived that is considered non-deductible during the corresponding fiscal year, will be excluded from the calculation for determining the annual adjustment for inflation. Therefore the amount excluded from the debts will only be considered to calculate the annual adjustment for inflation of the fiscal year in which the non-deductible net interest is deducted.

Finally, it is important to indicate that the limitation on the deductibility of interest does not apply to: (i) the productive companies of the State; (ii) the members of the financial system (in carrying out the transactions of their corporate purpose); (iii) the returns from public debt; or (iv) the interest derived from debts contracted to finance:

- Public infrastructure works.

- Constructions located in national territory, and for the acquisition of lands where they will be built.

- Projects for the exploration, extraction, transport, storage or distribution of petroleum and solid, liquid or gas hydrocarbons, as well as other projects of the extractive industry.

- Generation, transmission or storage of electricity or water.

d) Transparent foreign entities and foreign legal figures.

There are certain foreign companies and legal figures (for example, some trusts and partnerships) that are considered transparent for tax purposes. In other words, the tax authorities do not treat the transparent company as a generator of the tax; rather they attribute the tax directly to its partners or shareholders.

The treatment of tax transparency is not exclusive to Mexico. On the contrary, we can say that regarding the OECD countries, the recognition of transparent entities and figures is the general rule.

So far, the Mexican authorities had recognized tax transparency and taxed the shareholders or partners of such entities; however, beginning in 2020 this will no longer be so. With the tax reform contained in the Decree, the Mexican government changes position and inclines toward what in the jargon is considered as giving the transparent entities an "opaque" treatment.

This change of position is very important for companies that invest through transparent entities since, by considering such entities or figures as generators of the tax, the benefits of the tax treaties to the true generators of the tax, in other words to the partners or shareholders of the transparent figures, cease to apply.

The only exception to the application of this rule is when the tax treaty itself establishes the existence of transparent entities or figures, in which case the respective tax treaty will apply in the terms signed by Mexico.

In addition, it should be taken into account that when the transparent entity or legal figure maintains in the country its primary administration or actual headquarters, then such entity or legal figure should be considered as a tax resident in Mexico.

We consider that the application of such provisions will generate many practical problems because, notwithstanding that in the country of origin these transparent entities are not taxpayers, for purposes of the Mexican tax authority they will be generators of the tax. In our opinion this rule will discourage investors that use transparent entities as their investment vehicle in Mexico.

Nevertheless, in order to minimize the impact this change of position of the Mexican Government will have, it should be kept in mind that the Decree contemplates the addition of article 205 to the ISR Law by which a tax incentive is granted to foreign legal figures to maintain their tax transparency. This is provided they comply with certain requirements and only with respect to income they obtain as interest, dividends, capital gains or for the lease of real estate. Such incentive will enter into force on January 1, 2021.

e) Income obtained by Mexicans originating from transparent foreign entities and foreign legal figures.

Until 2019, tax residents in Mexico and the permanent establishments that received income from fiscally transparent foreign entities or legal figures, considered it to be income subject to a preferential tax regime.

According to the statement of legislative intent of the tax reform bill for 2020, the income from transparent entities or figures that tax residents in Mexico receive must be accrued for the sole reason that the foreign law considers that it is attributable to the partner, shareholder, member or beneficiary.

In contrast, the preferential tax regime is a mechanism for early accrual that is applied when the income from abroad that Mexicans receive is taxed abroad, but at a rate equal to or less than 75% of the rate that would be paid in Mexico for the same income.

In view of the above, article 4-B was added to the ISR Law which specifically regulates the income that Mexicans receive from transparent foreign entities and legal figures and where the obligation is established to accrue all of such income in the proportion that corresponds to them from the moment the transparent entities and figures receive them. This tax treatment will be applicable even when the fiscally transparent foreign entity or foreign legal figure does not distribute or deliver the income regulated by this article.

It should be indicated that the accounting records or the documentation to prove the fiscally transparent foreign entity's or foreign legal figure's expenses and investments must be available for the tax authorities; otherwise, Mexican taxpayers will not be permitted to deduct the expenses and investments made by them.

f) Preferential tax regimes.

The characteristic of this regime is the early accrual that Mexican taxpayers must make of the income received by an entity residing abroad that is controlled by a resident in Mexico. Consistent with the above, this regime is no longer applicable to the income received by the transparent entities and figures.

For the income received by an entity residing abroad to be subject to the preferential tax regime it is necessary that it is not taxed abroad or taxed at a rate less than 75% of the ISR that would be generated and paid in Mexico. In addition, this regime is not applicable when the taxpayer does not exercise effective control over the foreign entity in question.

One of the substantial changes to this regime that the Decree contemplates is in relation to the definition of effective control. In this regard, what these amendments seek is to broaden the definition of effective control so that more income falls within this regime.

The following situations fall under the expansion of the definition of effective control:

- The average daily participation of the taxpayer in the foreign entity allows it to have more than 50% of the total voting rights in the entity, confers the veto right in the entity or its favorable vote is required to adopt such decision, or such participation corresponds to more than 50% of the total value of the shares issued by it; or that it has the right, directly or indirectly, to exercise the effective control of each of the intermediate foreign entities that separate it from the foreign entity in question.

- Any agreement by which the Mexican taxpayer has the right to more than 50% over the assets or profits of the foreign entity in case of a reduction of capital or liquidation or that it has the right, directly or indirectly, over more than 50% of the assets or profits of the intermediate entities that separate it from the foreign entity in question in case of any type of reduction of capital or liquidation.

- A combination of the above points the sum of which means that the taxpayer has more than 50% of the mentioned rights.

- That they consolidate their financial statements based on the accounting standards that are applicable to them.

- That it has the right, directly or indirectly, to unilaterally determine the resolutions of the shareholder/partner meetings or the administrative decisions of the foreign entity, including through someone else.

It is presumed, unless proven otherwise, that the taxpayer has effective control of the foreign entities that generate the income subject to preferential tax regimes.

In addition, in contrast to the ISR Law in force until 2019, with the reform of article 176 of the ISR Law the exception was eliminated that consisted of not considering royalties as income subject to a preferential tax regime.

For the determination of whether or not income is subject to the preferential tax regime the option is established of comparing the statutory rate of the ISR of the country of its tax residence with the general rate applicable to entities or the maximum contemplated for individuals, as applicable. This comparison will not be applicable when the foreign entity is subject to different statutory rates in its country or jurisdiction of residence.

For purposes of the referred comparison, it will not be considered income subject to preferential tax regimes when such profits are taxed with a rate equal to or greater than 75% of the rates mentioned previously, provided all their income is taxable (except dividends received between entities residing in the same country and that the deductions are or have been really disbursed). Such comparison will only be applicable if: (i) the foreign entity is not subject to any tax credit or benefit in its country of residence that reduces its taxable base or tax to pay that would not be granted in Mexico; and (ii) when such country or jurisdiction has a broad information exchange agreement signed with Mexico.

g) Payments to preferential tax regimes.

The prohibition is maintained of deducting the payments made to related parties when the income of their counterparty is subject to preferential tax regimes, and the exception is eliminated that permitted making their deduction when the price or the amount of the consideration was equal to what would have been agreed to by unrelated parties in comparable transactions.

The concept is included of "structured agreement" and the deduction is prohibited of the payments that are made to related parties, or through those agreements, when the income from its counterpart is subject to preferential tax regimes.

A structured agreement is understood as one in which the taxpayer or one of its related parties participates and that:

- The consideration is in function of payments made to preferential tax regimes that favor the taxpayer or one of its related parties; or

- When based on the facts or circumstances it can be concluded that the agreement was carried out for this purpose.

In the statement of legislative intent of the bill it is established that the concept of "structured agreement" is introduced *"to prevent aggressive tax planning that tries to avoid the requirement of payments between related parties, through which the payment is made to a third party, which in turn makes a payment to the related party of the taxpayer"*.

Rules are also established so that, through payments to third parties, the application of the corresponding deduction is prevented.

It should not be forgotten that these payments can be deducted when the payment that is considered income subject to a preferential tax regime is the result of the exercise of the business activity of its recipient, provided the following requirements, among others, are met:

- That the recipient has the personnel and the assets necessary for carrying out such business activity.

- The recipient of the payment has its actual headquarters and is incorporated in a country with which Mexico has a broad information exchange agreement.

- The payment is not considered income subject to a preferential tax regime because of a hybrid mechanism.

However, it is indicated that the payment will not be deductible when it is attributed to a permanent establishment or a branch of a member of the group or by virtue of a structured agreement and such payment is not taxed in the country or jurisdiction of tax residence of its recipient, nor where such permanent establishment or branch is located.

In addition, the SAT will issue rules that must be complied with to be able to deduct these payments proportionally when they are taxed indirectly due to the application of the regulation corresponding to the income received from transparent tax entities or from the regulation referring to the controlled foreign entities subject to preferential tax regimes (or similar provisions contained in the foreign tax legislation).

h) Digital Economy.

1. The ISR Law

In the Decree, a Section III was added to Chapter II of Title IV of such Law, called "Income from the sale of goods or providing of services through internet".

Since it is found in Title IV of the ISR Law, the incorporation of this section is directed toward individuals with business activities that sell or provide services through internet.

With the above it is intended that the ISR derived from such transactions (sale of goods or providing of services) carried out by individuals through technological platforms, be withheld by the entities residing in Mexico or residents abroad, with or without permanent establishment in the country, as well as by the foreign entities or legal figures that provide, directly or indirectly, the use of these platforms. The withholding will be made on the total of the income actually received by the individuals (without including VAT) and it will have the nature of a provisional payment.

The withholding rates contemplated vary depending on the type of service or if the sale of goods is involved, as well as considering the amount of the consideration, which is to say:

I. In the case of providing land transportation of passengers and delivery of goods, as follows: Up to $5,500 - 2%, up to $15,000 – 3%, up to $21,000 – 4% and more than $21,000 – 8%.

II. In the case of providing lodging services, as follows: up to $5,000 - 2%, up to $15,000 – 3%, up to $35,000 – 5% and more than $35,000 – 10%.

III. In the case of sale of goods and provision of services, as follows: up to $1,500 -.4%, up to $5,000 –.5%, up to $10,000 –.9%, up to $25,000 – 1.1%, up to $100,000 – 2% and more than $100,000 – 5.4%.

In this respect, the Decree establishes an option for those individuals whose income does not exceed three hundred thousand pesos annually to consider the payment as definitive, provided they do not receive income other than salaries and interest.

If the individuals receive part of the consideration for providing services or sale of goods directly from the users or purchasers, they may choose to pay the tax for such income according to the new rates established, and in this case the payment of the tax will be considered definitive.

In relation to the above, residents abroad without an establishment in Mexico, as well as foreign legal entities or figures that provide, directly or indirectly, the use of the cited technological platforms, software applications and similar will have the following obligations: (i) register in the Federal Taxpayers Registry ("**RFC**") as a withholder; (ii) provide Digital Tax Receipts by Internet ("**CFDI**") to the individuals for which the withholding has been made; (iii) provide to SAT information on its clients that sell goods, provide services or grant the temporary use or enjoyment of goods; (iv) pay the withholding of ISR to the tax authorities; and (v) preserve as part of their accounting records the documentation that shows the withholding and payment made.

If the individuals do not provide their RFC to the technological platforms, the entities residing in Mexico or residents abroad, with or without a permanent establishment in the country, as well as the foreign legal entities or figures that directly or indirectly provide the use of these platforms, must withhold 20% on the amount of the income that is subject to the payment of ISR (instead of applying the rates specified in previous paragraphs).

The income referred to above is expressly excluded from the Tax Incorporation Regime.

It is established that these obligations enter into force as of June 1, 2020, and that the SAT will issue the generally applied rules no later than January 31, 2020.

2. Value Added Tax ("**VAT**") Law

Although this section of our analysis only covers ISR matters contained in the Decree, given the importance of the matter of the digital economy we consider it relevant not to separate the intimately related aspects of the VAT.

In this regard, in the VAT Law the treatment is established applicable to certain digital services provided by residents abroad (without a permanent establishment in Mexico) to recipients of them that are in national territory so that it is the service provider that transfers and charges the VAT.

In this respect, it is considered that the service is provided in Mexico when the recipient of the service is in the country.

Thereby, a new Chapter III BIS is established in such Law that contemplates the regulatory framework applicable to providing such digital services by residents abroad without a permanent establishment in Mexico.

The Decree specifies that the treatment will not be applicable to all digital services, but rather exclusively to those that are generally for final consumption in homes or used by persons for their individual consumption. It is clarified that the burden of the corresponding tax will fall on the final consumer.

In order to define whether the recipient of the service is in Mexico, certain premises are included such as that the recipient: (i) has manifested to the service provider a domicile in the country; (ii) provides a telephone number (whose country code corresponds to Mexico); (iii) makes the payment through an intermediary located in Mexico; and (iv) that the IP address that the electronic devices of the recipient use corresponds to the range of addresses assigned to Mexico. The occurrence of any of the above indicated premises implies that the recipient is in national territory.

In relation to the above, certain obligations are included for the digital service providers residing abroad or without a permanent establishment. They consist of: (i) registering in the RFC; (ii) collecting the VAT expressly and separately; (iii) providing quarterly to the SAT the number of operations carried out with recipients located in national territory (classified by type of service and its price); (iv) calculating and paying the VAT monthly; (v) providing to their clients in Mexico a payment receipt with separation of the VAT; (vi) designating before the tax authorities a legal representative and a domicile for purposes of notification and oversight of compliance with obligations; and (vii) processing their advanced electronic signature.

Furthermore, it is indicated that the VAT can be credited by the recipients of the services located in Mexico, in accordance with the applicable provisions of the Law.

Additionally, the platforms through which digital intermediation services are provided between third parties that offer goods or services and those requesting them are incorporated in this treatment.

In relation to the intermediation service providers it is intended to incorporate certain obligations, such as: (i) publish on their internet page expressly and separately the applicable VAT; and (ii) when they charge the price and the tax on behalf of an individual seller or service provider for the use or enjoyment of goods they must: (a) withhold 50% of the tax collected (if the individuals do not provide their RFC the withholding will be 100%); (b) pay the withholding monthly; (c) issue to the person from whom it is withheld a CFDI (according to general rules that will be issued); (d) be registered in the RFC as a withholder; and (e) provide certain information on the operations carried out with their customers (when they have acted as intermediaries).

Similarly, it is established that those individuals that have obtained income of up to three hundred thousand pesos in the immediately prior fiscal year, for the activities carried out through the intermediation platforms, and do not receive income for other concepts (except wages, salaries and interest) may join this scheme and consider the withholding made as definitive.

If there are amounts charged by the platform and others directly by the taxpayer, the withholding will be considered definitive when the taxpayer files a monthly return for the charges it made directly applying a rate of 8%.

It is expressly indicated that compliance with the above obligations by the resident abroad will not give rise to it being considered that it constitutes a permanent establishment in Mexico.

Finally, it is established that these obligations will enter into force as of June 1, 2020 and that the SAT will issue the generally applicable rules no later than January 31, 2020.

2. **VAT Law:**

   a) Companies that render and receive labor subcontracting services.

The obligation is eliminated for taxpayers that contract providers of labor subcontracting services to collect certain documentation from them (e.g. CFDI, returns, among others) in order to deduct, for purposes of the ISR Law, the payments made and to credit the VAT transferred.

On the other hand, the obligation is established of the taxpayers contracting labor subcontracting services to withhold and pay the VAT transferred for such transactions considering a rate of 6%.

For such purposes, it was specified that the types of services that will give rise to the withholding of the VAT will be those through which personnel are made available to the contracting party or a party related to it that perform their functions in the facilities thereof, or outside of them, whether or not they are under the direction, supervision, coordination or dependency of the contracting party.

   b) Moment of causation in free services.

The current Article 17 of the VAT Law establishes that regarding services provided free of charge, for which the tax must be paid, it is considered that such provision is made at the moment such service is provided.

This situation is currently generating conflicts because, regardless of the moment in which such provision is made, the VAT Law establishes the causation of the tax based on a cash flow scheme; in other words, VAT is not caused until the moment at which the provision of services is charged.

To avoid this situation, article 17 of the VAT Law was reformed to specify that, in the case of services (subject to VAT) that are rendered free of charge, the tax will be caused at the moment in which they are provided.

3. **Special Tax on Production and Services ("IEPS") Law:**

   a) Cut tobacco and flavored beverages.

For IEPS an annual indexing mechanism was established for the fees applicable to the sale or import of cut tobacco and flavored beverages. The Ministry of Finance and Public Credit will publish the indexing factor in the Official Federal Gazette during the month of December of each year, as well as the indexed fee (which will be expressed up to the ten thousandth).

Additionally, in the Sixth Transitory Article of the IEPS Law it is established that the fee in force in 2020 for cut tobacco will be indexed based on the inflation corresponding to the period from December 2010 to December 2019, and that the fee applicable in 2020 for flavored beverages will be indexed based on the inflation corresponding to the period from December 2017 to December 2019.

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b) Beer fee scheme.

Currently, the IEPS Law establishes a scheme applicable to manufacturers, producers and bottlers of beer according to which for the sale or import of beer the tax paid is the greater between applying an ad valorem rate (according to the alcohol content of the beer) and a specific fee of $3.00 per liter sold or imported, less the amount of $1.26 per liter when reusable containers are used.

According to information of the National Institute of Statistics and Geography on the prices of beer over the last 8 years, it was observed that the average price per liter of beer went from $28.37 in January 2011 to $39.06 in June 2019, and therefore the IEPS that would be payable would never be equal to or less than $3.00 or $1.26, in the case of reusable containers.

Based on the above, the minimum fee scheme currently applicable is obsolete, and therefore the Decree contemplates its elimination, as well as the other related provisions.

c) Set-off of IEPS refunds.

The current drafting of articles 5 and 5-D, of the IEPS Law has generated different interpretations of the possibility of setting off refunds of IEPS corresponding to a specific category against amounts to pay of IEPS corresponding to another category. This is from the indication that when in the monthly payment return there is a refund due, it can be set-off against the IEPS owed in the following monthly payments until it is exhausted.

In order to clarify this, the Decree establishes that each of the taxes applicable to the categories of goods and services contemplated in the IEPS Law will be considered different taxes and therefore its set-off will not be possible among the different categories.

4. **Federal Tax Code ("CFF"):**

a) Joint obligation.

The regulation of joint liability in the case of liquidators and bankruptcy trustees, as well as of partners or shareholders of entities, is changed.

- Liquidators and bankruptcy trustees.

Article 26, section III, of the CFF establishes that liquidators and bankruptcy trustees are jointly responsible with taxpayers for the taxes to be paid of the company in liquidation or bankruptcy, as well as those caused during their management.

Until 2019, this joint liability was eliminated when the company in liquidation complied with its obligations to file the notices and provide the corresponding reports. Beginning in 2020, this exclusion will no longer apply, and therefore they will continue to be jointly liable, regardless of whether the company files the notices and reports established in the tax provisions.

- Directors, managers or administrators.

While the Federal Executive's bill proposed eliminating the exclusion from joint liability of the directors, managers or administrators of entities, under the Decree such exclusion will survive, and it will be limited to the same premises that will be applicable to the partners or shareholders of the entities (which are indicated below).

- Partners or shareholders.

The premises for joint liability of partners or shareholders for the taxes caused by the entity they are partners of are increased. The premises are the following:

I. That the entity is not located in the tax domicile registered before the RFC.

II. That the entity fails to pay to the tax authorities, within the period that the laws establish, the amounts it has withheld or collected as taxes.

III. When the entity is on the definitive list of taxpayers that invoice simulated transactions.

IV. In the case of taxpayers that have deducted simulated transactions (for more than $7'804,230.00) and have not corrected their tax situation within the period of 30 days indicated in the CFF.

V. When it is on the definitive list of taxpayers that have not disproved the improper transfer of the tax losses (as a consequence of restructuring, spin-off or merger of companies, or change of shareholders for which the taxpayer that has a right to the subtract this loss ceases to form part of the group to which it belonged).

It is important to take into account that the joint liability of partners or shareholders continues to have the following limitations: (i) with respect to the taxes that were caused by the company when the partner or shareholder had such status in the entity; (ii) only in the part of the tax interest that is not covered by the assets of the entity; and (iii) the liability cannot exceed the participation the partner or shareholder had in the corporate capital of the company during the period or date in question.

b) Obligation to report tax schemes that generate or could generate tax benefits.

- Reportable schemes:

The obligation is established to inform the SAT of reportable schemes.

A scheme is considered any plan, project, proposal, advice, instruction or recommendation stated, expressly or tacitly, for the purpose of materializing a series of legal acts.

The definition of reportable scheme is extremely broad, including any scheme that generates or could generate, directly or indirectly, the obtaining of a tax benefit in Mexico and that has any of the 14 characteristics, which are mentioned below:

(i) Prevent foreign tax authorities from exchanging tax or financial information with Mexican tax authorities; (ii) prevent the application of the regulation on transparent entities or preferential tax regimes; (iii) permit transferring losses to persons different from those that generated them; (iv) consists of a series of payments or operations in which all or part of the amount of the first payment that forms part of such series is returned to the person that made it or one of its partners, shareholders or related parties; (v) involves a resident abroad that applies a tax treaty with respect to income that is not taxed (or is taxed with reduced rates) in the country or jurisdiction of tax residence of the taxpayer; (vi) involves certain operations between related parties; (vii) avoids creating a permanent establishment in Mexico; (viii) involves the transfer of an asset totally or partially depreciated and this permits its depreciation by another related party; (ix) involves a hybrid mechanism; (x) prevents the identification of the effective beneficiary of income or assets; (xi) in certain cases that involve tax losses whose period for subtracting them from the tax profit is about to expire and operations are carried out to obtain tax profits from which such losses are subtracted; (xii) those that prevent applying the rate of 10% on dividends (applicable to national individuals and foreign persons); (xiii) in which a good is leased and the temporary use or enjoyment of this same good is granted to the lessor or to a related party of the lessor; (xiv) involves operations whose accounting and tax records show differences greater than 20% (unless they arise from differences in the calculation of depreciations).

For its part, tax benefit means the monetary value derived from any reduction, elimination or temporary deferment of a tax (including those reached through deductions, exemptions, non-subjections, non-recognition of a profit or accruable income, the crediting of taxes, the recharacterization of a payment or activity, a change of tax regime, among others).

Two kinds of tax planning are distinguished: generalized (they seek to commercialize massively to all types of taxpayers or a specific group of them) and personalized (to be adapted to the particular circumstances of a specific taxpayer) and both are considered reportable schemes.

- Obligated to report:

  - Tax adviser

The first one obligated to inform SAT of the reportable scheme is the tax adviser, who is understood as any individual or entity that, in the ordinary course of its activity engages in tax advice activities and is responsible for or involved in the design, commercialization, organization, implementation or administration of all of a reportable scheme or who makes available all of a reportable scheme for its implementation by a third party.

In addition, the tax advisers are obligated to file annually (in February) an informative return that contains a list with the names or company names of the taxpayers, as well as their RFC numbers, to which they provided tax advice with respect to the reportable schemes.

In fact, when it involves a scheme that is not reportable, but that generates tax benefits in Mexico, the tax adviser must issue a certificate to the taxpayer in this regard, in the terms the SAT establishes in the general provisions. The tax adviser has the same obligation (to issue the certificate) when it is legally prevented from carrying out such disclosure.

It is clarified that the disclosure of reportable schemes does not constitute a violation of the professional secret obligation.

- Taxpayer

The taxpayer is obligated to report the tax schemes when: (i) the tax adviser does not report the tax planning; (ii) it has been the taxpayer itself that has designed, organized, implemented and administered the reportable scheme; (iii) the taxpayer obtains benefits from a scheme designed by a person who is not considered a tax adviser; (iv) the tax adviser is a foreigner; or (v) when there is a legal impediment for the adviser to disclose the scheme.

- Reports:

The information that the report should contain is very broad and includes, among other things, detailed information on the reportable scheme, the tax adviser, the taxpayer, the entities or legal figures that form part of the tax planning and the tax benefit obtained or expected.

To ensure reporting of all the reportable tax planning it is established that SAT will grant an identification number for each of the schemes reported that have been disclosed. This identification number must be delivered by the tax adviser to the taxpayer to release the latter from the obligation of reporting the operation. Furthermore, the taxpayer must include this number in its annual returns corresponding to the fiscal years in which it implements the reported tax scheme.

Similarly, when several tax advisers are involved in the reportable scheme, one of them has to inform SAT of the tax planning and, once the registration number of the scheme is obtained from SAT, it should be provided to the other tax advisers together with a certificate showing that the reportable scheme has been disclosed to the authorities.

The information filed in the report (when it involves information strictly essential for the functioning of the scheme) may not be used as evidence in an investigation of possible tax crimes, except in the case of crimes related to the acquisition, issuance or sale of CFDI that cover non-existent or false operations or simulated legal acts.

- Sanction:

In case the taxpayers fail to comply with the obligation to reveal a reportable scheme or revealing it incompletely or with errors, the tax benefit provided for in the reportable scheme will not be applied and an economic sanction equivalent to an amount between the 50% and 75% of the amount of tax benefit of the reportable scheme obtained or expected to be obtained in all fiscal years in which the application of the scheme is or would be involved.

Notwithstanding that the obligation to reveal the reportable schemes initiates as of January 1, 2021, it is established that the reportable schemes that must be disclosed are those designed, commercialized, organized, implemented or administered beginning in the year 2020, or prior to such year when any of their tax effects are reflected in the fiscal years starting with 2020. In this last case the taxpayers will be the ones obligated to disclose.

c) Universal Set-Off.

The reform that entered into force in the year 2019 included, in the Revenue Law, the prohibition on the universal set-off of taxes. Since this provision is in the Revenue Law, it would only be in force during the year 2019.

With the reform of 2020, this prohibition on making a universal set-off was incorporated into the CFF with which it became a permanent provision.

The set-off is a concept in civil law that is established as a form of extinguishing obligations. In this regard, the Federal Civil Code[1] establishes that the set-off operates when two persons are reciprocal debtors and creditors and the consequences are that, by operation of law, the two debts are extinguished up to the lesser amount.

Thus when the federal tax authority and the taxpayer are reciprocal debtors and creditors (of liquid and payable amounts) it should, by justice and simple logic, apply the set-off of the debts regardless of their origin.

It seems that that only objective that is sought by prohibiting the universal set-off is so that the federal tax authority is financed with the money of taxpayers without having to pay interest. This situation is made even worse if we take into account the difficulty taxpayers already face in getting the tax authority to return the taxes it overcharged them.

d) Electronic signature.

As a measure to stop the operation of invoicing companies of non-existent operations, the fifth paragraph of article 17-D of the CFF was amended.
In this way SAT was given powers to validate the information and documentation that petitioners for the

[1] Articles 2185 and 2186 of the Federal Civil Code.

generation of the electronic signature file to it to prove their identity, domicile and tax situation, being able to request even more information.

The SAT, through general rules, may establish the documents and the procedure for validating the information provided by the taxpayer.

It is important to indicate that if the petitioner fails to file the information requested by SAT, the granting of the electronic signature will be denied.

e) Cancelation of digital seal certificates ("**CSD**").

The causes for which the tax authorities can temporarily restrict the use of the CSD of the taxpayers are specified and considerably expanded, when:

(i) They fail to file the annual return or two or more provisional or definitive returns; (ii) they cannot locate the taxpayer or it disappears during the administrative execution procedure; (iii) in the exercise of its powers the taxpayer cannot be located, disappears, vacates the domicile without filing notice, does not know its domicile or issued CFDI used to cover non-existent, simulated or illicit operations; (iv) the issuer of CFDI is on the definitive list of taxpayers that did not disprove the presumption of non-existence of operations covered in them; (v) the taxpayer was not able to prove the effective acquisition of the goods or the reception of the services covered in the CFDI issued by any of the taxpayers indicated in the above subsection, nor that it corrected its tax situation; (vi) the tax domicile indicated does not comply with the premises to be considered as such; (vii) the income declared and taxes withheld manifested in the returns do not match the information the authority has access to; (viii) the means of contact, for the use of the tax mailbox, are not correct or authentic for causes attributable to the taxpayer; (ix) they detect infringements committed by the holder of the CSD, related to the RFC, payment of taxes, filing of returns and issuance of CFDI, among others; (x) involving taxpayers that did not disprove the presumption of transferring undue tax losses and that therefore are published on the corresponding definitive list.

In relation to this matter, a clarification procedure is incorporated to remedy the irregularities detected or disprove the causes that led to the restriction so the taxpayers for whom the use of their CSD has been restricted can continue using them to issue CFDI.

The procedure is carried out through the tax mailbox and contemplates the exhibition of evidence by the taxpayer, as well as the power of the authority to request additional information and documentation and even carry out a procedure. It is specified that the authority will determine the general rules applicable to the indicated procedure.

One important and positive point of the new procedure is the obligation of the tax authorities to reestablish the use of the corresponding CSD no later than the day following the date on which the request for clarification is filed by the taxpayer, and until the authority issues the corresponding ruling. The period to rule on the clarification will be 10 days (without counting requirements, extensions requested or proceedings that must be carried out).

In strict relation with the temporary restriction on the use of the CSD, it is established that they will not be cancelled until the clarification procedure specified above is exhausted.

f) Changes related to the RFC.

The content of article 27 of the CFF which establishes the principal provisions in relation to the RFC is changed substantially.

In general terms, the article is completely restructured to be divided into four parts, which are: (i) subjects and their specific obligations; (ii) general catalog of obligations; (iii) powers of the tax authority; and (iv) special cases.

The substantial section contemplating the powers of the tax authority to verify compliance with the obligations of the taxpayers with respect to the RFC stands out. Especially notable is the power of the authority to verify, without triggering is powers of investigation, the existence and location of the tax domicile through technological and georeferencing means, panoramic views or satellites.

Similarly, with the reform the exception that the legal representatives, partners or shareholders of non-profit entities do not have to request their registration in the RFC is eliminated, and the obligation is incorporated for entities to file a notice in the RFC each time their partners or shareholders change. This latter requirement is in order to combat the proliferation of companies that invoice or deduct non-existent operations.

g) Third-party tax collaborator.

In order for the tax authorities to be able to more easily identify presumed issuers and purchasers of CFDI (that cover non-existing operations), the concept of the third party tax collaborator is incorporated into the CFF, adding article 69-B Ter for that purpose. The identity of the third-party tax collaborator will be considered reserved according to the terms of the CFF.

According to the cited articles, a third-party tax collaborator is considered any person that has not participated in the issuance, purchase or sale of CFDI (that cover non-existent operations), but that has information related to taxpayers that do engage in that conduct, which is not in the possession of the tax authority, that it voluntarily provides.

In this regard, the information obtained by the authorities can be used in the processing of the proceeding established in article 69-B of the same law, relative to the presumption of non-existence of the operations covered in the CFDI, and to support the rulings of such proceeding.

h) Anti-abuse rule.

A provision is incorporated into the CFF by which the legal acts that do not have a business reason and that generate a direct or indirect tax benefit, will have the tax effects that correspond to those that would have been carried out to obtain the economic benefit reasonably expected by the taxpayer.

For such purposes tax benefits are considered: any reduction, elimination or temporary deferment of a tax (including those reached through deductions, exemptions, non-subjections, non-recognition of a profit or accruable income, adjustments or absence of adjustments of the taxable base of the tax, the crediting of taxes, the recharacterization of a payment or activity, a change of tax regime, among others).

The economic benefit expected exists, according to this anti-abuse rule, when the operations of the taxpayer seek to generate income, reduce costs, increase the value of the goods it owns and improve its positioning in the market, among others.

The authorities, through the exercise of their powers of investigation, can presume that the legal acts do not have a business reason based on the known facts and circumstances, when the quantifiable economic benefit reasonably expected, is lesser in relation to the economic benefit. Additionally, unless proved otherwise, it will be presumed that a series of legal acts lack a business reason when the economic benefit reasonably expect by the taxpayer may have been reached with the performance of less acts and the tax effect of these would have been more burdensome.

To quantify the economic benefit reasonably expected the authority will consider the information related to the transaction, including the projected economic benefit, if the information is reasonable and duly supported. It is expressly stated that the tax benefit will not be considered as part of the economic benefit reasonably expected.

It is specified that the tax authority, in order to be able to not recognize the legal acts for tax purposes, first must inform the taxpayer of this situation (in the last partial act, official notice of observations or provisional ruling, depending on whether it is a domicile visit, desk review, or electronic review), and let expire the periods the taxpayer has to file information, so the latter can try to disprove such presumption.

Similarly, the obligation is established for the tax authority to submit the case (prior to the issuance of the documents referred to in the above paragraph) to a collegiate body made up of officers of the Ministry of Finance and Public Credit and the SAT in order to obtain a favorable opinion for the application of the presumption. The provisions that clarify the issues pertaining the referred collegiate body will be issued through general rules.

According to the wording of the article, the tax effects generated by means of the same in no case will generate criminal consequences.

5. **Others:**

Withholding rate for interest paid by the Mexican financial system.

The annual withholding rate that currently applies on interest paid by the Mexican financial system is 1.04% and, according to the Federal Revenue Law for Fiscal Year 2020, such rate will increase to 1.45% which should be calculated taking as a base the capital that gives rise to the payment of the interest.

There is no doubt that this is a change that will discourage taxpayers from saving in the Mexican financial system.

*This document is valid on the date it was issued and its objective is merely informative and not interpretative in relation to the information it contains. It is not an opinion reason why it should not be considered as a professional advice applicable to particular cases under any circumstance. In case professional advice is required, in relation to the topics included in this document, please contact us directly.*

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Sincerely,

***Von Wobeser & Sierra, S.C.***

Mexico City, November 5, 2019.