

# THE POWER OF BEING UNDERSTOOD

# INTERNATIONAL TAX UPDATE

## Overview of Mexico's 2022 Tax Reform

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# Overview of Mexico's 2022 Tax Reform



## Your presenter

Edgar Lopezlena  
RSM US, LLP (Chicago)  
Senior Director, International Tax Services  
National Leader, Mexico Country Practice  
National Leader, Mexican Tax Practice  
[edgar.lopezlena@rsmus.com](mailto:edgar.lopezlena@rsmus.com)  
847.413.6378

- Board Member, USMCOC (Mid-America Chapter)
- 20+ years experience advising U.S. enterprises doing business in Mexico
- Areas of expertise include:
  - Maquiladora taxation
  - Initial set-up and structuring of operations in Mexico
  - Value-Added Tax in international transactions
  - M&A advisory and restructuring
  - Profit repatriation techniques
  - Treaty application and optimization

# Overview of Mexico's 2022 Tax Reform

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# Overview of Mexico's 2022 Tax Reform

## Summary

- The 2022 Tax Reform was approved by Congress in November 2021
- It was finally enacted through publication in Mexico's Federal Official Register ("*Diario Oficial de la Federación*") on November 12, 2021
- Most of the provisions of the Tax Reform are applicable for tax years beginning on or after **January 1, 2022**
- A considerable number of the provisions are focused at **combatting understatement of taxes and tax evasion** through:
  - Increase disclosure and reporting requirements
  - Strengthening of the "Business Purpose" doctrine
  - Adherence to the OECD's new Pillar 1 and 2 recommendations

# Overview of Mexico's 2022 Tax Reform

## Transfer pricing for Maquiladoras

- Repeal of the option to apply for an Advanced Pricing Agreement (“APA”) with the Mexican taxing authorities
- Starting FY 2021, Maquiladoras can only use the “Safe Harbor” option to determine the prices they charge to their U.S. Principal for assembly services
- No grand father rule – Maquiladoras that have an APA in force can, in most instances, continue using it for the duration of the agreement (usually five years), but must revert to the Safe Harbor option thereafter
- New Maquiladoras can only use the Safe Harbor option
- The repeal applies to both shelter operations as well as self-owned maquiladora operations

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## Transfer pricing for Maquiladoras

- On the upside, the transfer pricing compliance becomes cheaper and more expeditious

Safe Harbor	Advanced Pricing Agreement
Formulaic, mechanical process	Requires developing a transfer pricing methodology and discussions with SAT officials (Fast Track methodologies help in certain industries)
Same method can be used year after year (although rules of operation are amended from time to time)	Requires annual updates and a full re-assessment every four years
Tax preparer fees	Tax preparer fees, plus transfer pricing fees, plus government fees of approximately US\$ 13K for initial application, and US\$ 3 K for annual review

- NOTE: APAs can still be pursued for non-Maquiladora operations

## Transfer pricing for Maquiladoras

- In the wake of the repeal of the APA option, some owners of Maquiladoras may see their Mexican income tax liability increased
- *Is it time to migrate from Maquiladora to other manufacturing arrangements?*
  - *Fully-fledged manufacturing?*
  - *Contract manufacturing?*



# Overview of Mexico's 2022 Tax Reform

## Transfer pricing - other

- The income tax law now clearly specifies that **enterprise and individual** taxpayers are required to produce transfer pricing documentation (i.e. – “Transfer Pricing Study”) to support the prices they use in transactions with related parties **foreign or domestic**
- In addition to the prices used in intercompany transactions, **the profit margins** that the taxpayer obtains as a result of those transactions is subject to scrutiny

# Overview of Mexico's 2022 Tax Reform

## Transfer pricing - other

- The transfer pricing documentation must now include information on functions performed, risks borne, and assets used by each party, **per each individual transaction**
- In most instances, comparability analyses must include only the fiscal year under review
  - Before 2022, the comparability analysis comprised the average for the current year, plus the prior two years
  - The use of more than one year is permitted in certain cases when the business cycle or product cycle exceeds the calendar year under review

# Overview of Mexico's 2022 Tax Reform

## Transfer pricing - other

- The six traditional transfer pricing methods remain
- But, adjustments to transfer prices have to be based only on one of the following methods:
  - The interquartile method
  - Method approved by the SAT and the IRS through a Mutual Agreement Procedure (Article 26 of the U.S. – Mexico Treaty)
  - Method approved by the SAT in an Advanced Pricing Agreement (“APA”)
- **With the increased complexity in transfer pricing compliance, taxpayers may want to explore the possibility of applying for an APA**
  - Reduce the exposure to transfer pricing adjustments

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## Transfer pricing – other (new statutory due dates)

Requirement	Due date
Information returns for transactions with related parties (Annex 9)	May 15 of the following calendar year (currently, Annex 9 is filed with the income tax return, with a due date of March 31)
Master file	Dec. 31 of the following calendar year (unchanged from the current due date)
Local country report	May 15 of the following calendar year (changed from the current Dec. 31 due date)
Country-by-country report	Dec. 31 of the following calendar year (unchanged from the current due date)

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## Transfer pricing – other (new statutory due dates)

### *Temporary provisions for 2021*

For the tax year ending Dec. 31, 2021, the following due dates are optional for reporting related to transfer pricing:

Requirement	Original date	Optional due date
Information returns for transactions with related parties (Annex 9) – For taxpayers that opt for the statutory audit for 2021	March 31, 2022 (with the 2021 income tax return)	July 15, 2022
Local country report – For taxpayers that opt for the statutory audit for 2021	Dec. 31, 2022	July 15, 2022
Local country report – For taxpayers that waive the option for the statutory audit for 2021	Dec. 31, 2022	July 15, 2022 (if certain other conditions are met)
Master file	Dec. 31, 2022	Not available
Country-by-country report	Dec. 31, 2022	Not available

# Overview of Mexico's 2022 Tax Reform

## Tax residency - Individuals

- Under the new provisions, Mexican nationals are deemed to be **tax residents of Mexico** until they prove otherwise
  - Mexican tax residents are subject to taxation in Mexico on their world-wide income
- A taxpayer that abandons Mexican tax residency with the sole purpose of obtaining a tax benefit will still be considered a Mexican tax resident **even if they live in another country**
  - Affects individuals that intend to move to a lower tax jurisdiction, or a territorial tax jurisdiction
  - Individuals that have a non-tax reason to move to another country must keep supporting documentation
    - Employment contracts or job offers in another country
    - Secondment contracts
    - Investment plans in a foreign country
    - Letters of intent or confidential memoranda for joint ventures or investments in foreign enterprises
- **Maintaining tax residency in Mexico while living in another country may lead to a true (and undesirable) double taxation scenario**

# Overview of Mexico's 2022 Tax Reform

## Tax residency - Individuals

- Individuals that cease to be Mexican tax residents must file a notice of abandonment with the SAT within fifteen business days following the date the tax residency ends
- Failure to file the notice will cause that the SAT considers the delinquent individual as a tax resident of Mexico, even if they live in another country
  - Mexican nationals that prior to 2022 left Mexico to reside in the U.S. must consider filing the notice sooner rather than later

# Overview of Mexico's 2022 Tax Reform

## Tax residency – legal entities

- Legal entities are deemed tax residents of Mexico (thus subject to taxation in Mexico on their world-wide income) if:
  - They are formed under Mexican laws, or
  - They establish their principal center of management in Mexico
  - A company formed under U.S. law, but administered from Mexico will be considered a Mexican tax resident – **Potential double taxation**
- Legal entities that expatriate with the **sole purpose of obtaining a tax benefit** will still be considered Mexican tax residents, subject to taxation in Mexico on their world-wide income
  - Companies that expatriate must produce and maintain documentation that supports the non-tax, business reasons for moving to another country



# Overview of Mexico's 2022 Tax Reform

## Tax residency – legal entities

- Like individuals, Mexican legal entities that move to another tax jurisdiction must file a notice with the SAT within fifteen business days following the date the move is legally executed

# Overview of Mexico's 2022 Tax Reform

## Tax residency – preferential tax regimes

- Legal entities and individuals that move to another tax jurisdiction will be considered tax residents of Mexico during a period of five years following the filing of the Notice, **if that other tax jurisdiction has a preferential tax regime**
  - A preferential tax regime exists when the tax imposed in that jurisdiction is 75% or less than the applicable tax rate in Mexico
  - With the current statutory tax rates in Mexico...
    - For legal entities a preferential tax regime is one that has a tax rate of 22.5% or lower (30% X 75%)
    - For individuals in the highest income tax bracket, a preferential tax regime is one that has a tax rate of 26.25% or lower (35% X 75%)

## The return of the mandatory audit for tax purposes

- Mexican tax law contemplates a special purpose audit performed by an independent CPA (“Dictamen Fiscal”)
  - The audit includes the examination of the taxpayers’ financial statements (as is the case in a traditional independent audit), but also includes the examination of the taxpayer’s tax return and tax postures
  - In addition to the traditional independent audit report, the CPA must also issue a report on the taxpayer’s tax situation and postures
  - The above two reports have to be filed with the SAT, along with multiple annexes and schedules containing detailed tax and customs information on the audited taxpayer

# Overview of Mexico's 2022 Tax Reform

## The return of the mandatory audit for tax purposes - Chronology

Tax years	Attributes
Until 2013	<u>Mandatory</u> for taxpayers that in the previous tax year had: <ul style="list-style-type: none"><li>• Gross receipts or more than MX\$ 34,803,950, or</li><li>• Assets with a tax basis of MX\$ 69,607,920</li></ul>
2014 - 2021	<u>Optional</u> for taxpayers that in the previous tax year had: <ul style="list-style-type: none"><li>• Gross receipts of more than MX\$ 122,814,830; or</li><li>• Assets with a tax basis of more than MX\$ 97,023,720</li></ul> (No mandatory audit existed)
2021 -	<u>Optional</u> for taxpayers that in the previous tax year had: <ul style="list-style-type: none"><li>• Gross receipts of more than MX\$ 122,814,830; or</li><li>• Assets with a tax basis of more than MX\$ 97,023,720</li></ul> <u>Mandatory</u> for taxpayers that in the previous year had: <ul style="list-style-type: none"><li>• Gross receipts equal to or more than MX\$ 1,650,490,600</li><li>• Listed shares in a recognized stock market</li></ul> Taxpayers that have a mandatory audit requirement can only apply the benefits of a tax treaty if they meet those requirements

## Strengthening of the “Business Purpose” doctrine

- Historically, the Mexican tax system has been primarily focused on form over substance
- Progressively, the focus has migrated more towards substance
- Today, the focus is mostly balanced, with equal weight on substance and form
  - With an increased focus on form, the “Business Purpose” doctrine becomes more and more relevant
  - The “Business Purpose” doctrine states that the competent tax authorities may recharacterize a transaction if, in the opinion of the agents, (i) the economic benefits obtained thereof are lower than the tax benefits attained, or (ii) in a stepped transaction, the transaction could have been accomplished in fewer steps, and the tax liability resulting thereof would have been higher than the actual tax liability derived from the executed steps

## Strengthening of the “Business Purpose” doctrine

- 2022 “Business Purpose” changes include, among other:
  - Negation of change in tax residency if the change lacks a business purpose
  - Tax exempt mergers and divestitures will become taxable if the transaction lacks a business purpose
  - Requests for tax-deferral corporate reorganizations will be denied if the contemplated reorganization lacks a business purpose
  - Negation of a tax write-off on assets, if the disposition or depletion of the assets lacks a business purpose
  - Loans that lack a business purpose may be considered back-to-back loans
    - The interest attached to such a back-to-back loan is re-characterized as deemed dividends

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## Other

- Digital images (NFTs) are considered intellectual property and therefore, its purchase from a non-resident taxpayer triggers a withholding tax (25% domestic law / 10% treaty)
- Individuals 18 years or older are required to obtain a tax ID# even if they earn no income
- “Beneficial Controller” disclosure requirements
  - Mexican taxpayers are required to disclose the identity of their ultimate Beneficial Controllers
- New “Trusted Taxpayer Regime” for certain individuals
- New cash-basis regime for small co-ops (gross receipts of MX\$ 35 Million or less)
- Limitations on recoverability of VAT if certain non-VATable transactions are carried out

THANK YOU FOR  
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## RSM US LLP

30 S Wacker Drive  
Chicago  
312.634.3400

+1 800 274 3978  
rsmus.com

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