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# MEXICAN TAX REFORM PROVISIONS AFFECTING INTERNATIONAL OPERATIONS

## I. INTRODUCTION

The Mexican Congress has approved the Tax Reform Bill of 2020. It affects various provisions of the income tax, value added tax and the federal tax code. The purpose of the tax reform was to comply and align Mexican tax law with recommendations of the OECD. In this alert we focus on the provisions of the tax reform that affect international operations of Mexican companies and individuals.

## II. INCOME TAX CHANGES

The changes to the Mexican income tax are focused on international operations and arrangements with tax preferred tax regimes:

1. Payments made by a Mexican taxpayer to a foreign related party are denied if the foreign related party is subject to preferred tax regime (PTR), even if payments are at arm's length.

2. A preferred tax regime (PTR) exists if the effective tax rate is less than 75% of the Mexican tax rate (22.5%). The effective tax rate is determined by applying Mexican tax law and principles and companies to the actual foreign tax paid.

3. Parties are deemed related if one party participates in the capital or management of the other party or a third party participates in the capital or management of both. There is no minimum level of participation required.

4. Payments made to an unrelated party subject to PTR are also non-deductible if the third party is merely interposed between the Mexican taxpayer and a related party in a "structured agreement"

5. Payments made to a third party not subject to PTR are also denied if the third party is merely a conduct and makes a deductible payment to another entity that is subject to PTR. A look through rule applies to payments made to an entity if the receiving entity then makes payment to another PTR entity, and the payments are greater than or equal to 20% of the payments received from the Mexican entity.

6. For PTR entities, an exception to the non-deductibility rules apply if the receiving entity has a legitimate business activity, sufficient personnel and assets to carryout the business and the entity has a seat of management in the foreign jurisdiction, and Mexico has a broad exchange of information agreement.

7.The business activity exceptions do not apply to hybrid payments, i.e. if the payments is deductible in Mexico and not recognized in foreign jurisdictions.

8. Foreign companies and transparent companies are subject to Mexican taxation if they establish their principal place of management or its effective management is conducted in Mexico.

9. Mexican residents and foreign persons with a permanent establishment in Mexico are required to report and include in their taxable income their share of net profits of transparent entities, using Mexican accounting and tax principles.
10. Regardless if they have or do not have control, a transparent entity is defined as an entity which is not taxable in the foreign jurisdiction and its profits are attributable to its owners/members; this applies regardless if there is control or no control, mere ownership is enough.

## III. FEDERAL TAX CODE CHANGES

In addition to changes to the income tax laws there are several important changes to the Federal Tax Code. However, two important changes that may affect international operations are:

1. Any transaction that lacks business purpose will be recharacterized or deemed non-existed, if they do not provide economic benefit in excess of the tax benefit.

2. As of January 1st 2021 Mexican taxpayers and tax advisors are required to report reportable tax schemes to the Mexican tax authorities. The tax schemes are as listed on FTC Article 199.

## IV. CONCLUSION

The Mexican tax reforms of 2020 provides a complex set of tax laws and rules that require careful analysis of all foreign structures and international operations whether or not conducted with related parties.

Please let me know if you have any questions on these matters.

Sincerely,

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