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# Newsletter 37



Von Wobeser y Sierra

# Editorial



We have moved into fourth-quarter 2017. The year so far has been characterized by major uncertainty in the international political arena as well as by large-scale natural disasters that also threaten the global economy. Despite everything, Mexico has remained relatively stable and has to this point managed to temper those circumstances' adverse effects.

The nation is fully engaged in re-negotiating the North American Free Trade Agreement (NAFTA). Though all evidence appears to indicate that its constituent parties have encountered acceptable starting considerations, the process has not been easy. Both Mexico and Canada have had to struggle with an array of threats from President Trump that aim to "strengthen" his nation's negotiating position.

There is still a risk that the United States leader will denounce NAFTA, not so much because this favors United States economic interests but rather as a way to signal he is keeping campaign promises, particularly in light of ongoing setbacks his political agenda has suffered. The fewer campaign promises he can keep, the greater the risk to the NAFTA re-negotiation, whose nullification Trump might point to as a means of burnishing his reputation, above all with his constituent base.

A great many of the United States government's actions pursue political—and not economic development-related—ends. One clear example was the White House's decision to cancel the DACA (Deferred Action for Childhood Arrivals) program which protects hundreds of thousands of undocumented young people, the great majority of Mexican origin, from deportation. Though its objects are productive men and women free from criminal records, their legal status in the United States has been placed in jeopardy. The future of the so-called "dreamers" now lies with the United States Congress which will need to legislate on the matter within a maximum six-month timeframe. Mexico must remain alert and where necessary, adopt such pressure mechanisms as may be advisable and within its reach, as well as leverage the necessary instruments required to face a massive deportation of Mexican citizens if this should come to pass.

Mexico's economic performance has been acceptable. While inflation has reached its highest annualized rate in the previous sixteen years, growth expectations have improved and the US-dollar exchange rate has remained relatively stable. Challenges are legion nonetheless. Public safety must be improved and the political uncertainty associated with upcoming elections, already formally underway and to be concluded in July 2018, must be mitigated.

Following the present edition's closing, Mexico was struck by its worst earthquake in decades. Von Wobeser y Sierra deeply laments the consequences of the temblor, including hundreds of lives lost and incalculable material damages. We reiterate our solidarity with the victims of the disaster and with the people of our nation.

**Claus von Wobeser**

# Income Tax administrative advantages relative to deposits and investments received in Mexico (capital repatriation)





On 15 May 2017 the "First Ruling on Modifications to Miscellaneous 2017 Tax Resolutions" (*Primera Resolución de Modificaciones a la Resolución Miscelánea Fiscal para 2017*; hereafter the "General Rules") was published in Mexico's *Official Federal Gazette*. It considers the general stipulations needed for the due and correct application of the "Decree Granting Various Administrative Advantages on Income Tax Matters Relative to Deposits or Investments Received in Mexico" (*Decreto que otorga diversas facilidades administrativas en materia del impuesto sobre la renta relativos a depósitos o inversiones que se reciban en México*; hereafter "the Decree"), published on 18 January 2017.

The Decree establishes a system of advantages that incentivize repatriation of resources held outside Mexico so these can be invested in productive activities that contribute to the nation's economic growth.

These include a stimulus for private individuals and corporations, resident in Mexico and abroad, who maintain permanent establishments in Mexico and who have retained income from direct and indirect investments abroad up to 31 December 2017.

The stimulus consists of an 8% income tax assessment with no deductions on the sum total of the resoures being repatriated. The determined tax is to be paid within 15 calendar days after the repatriation date.[1]

According to the Decree, a taxpayer is thought to hold an indirect investment when such an investment is made through foreign entities or legal structures in which the investor participated directly or indirectly, including those made through fiscally transparent foreign entities and legal structures.[2]

The resources to which the benefit will apply is income taxable according to Mexico's Income Tax Act (in terms of headings applicable to corporations and private individuals as well as income subject to preferential tax schedules). Such items as have been previously deducted are expressly excepted.

Parties to whom the benefit applies are said to be investing repatriated[3] resources when:

1. They acquire deductible fixed-asset goods;
2. They acquire real estate (property and structures) to be used for their activities in Mexico;
3. They invest in technology research and development for the execution of projects of their own;
4. They pay debts contracted with independent parties before 1 January 2017;
5. They allocate resources to paying tax contributions or benefits;
6. They allocate resources to paying wages or salaries for the provision of subordinate personal services throughout Mexico, and
7. They invest through credit institutions or brokerages incorporated according to Mexican law.[4]

Corporations that choose to apply the benefits must calculate the tax profits that will correspond to the total amount of the repatriated resources, from which Income Tax paid will be deducted. The resultant

1 It will be understood that resources have been repatriated to Mexico on their date of deposit into a Mexican credit institution or brokerage.

2 Foreign entities or legal structures are tax transparent when they are not considered income taxpayers in the nation where they are constituted, where their main administrative activities take place or where their effective administrative headquarters lies and their income is attributed to their members, partners, stockholders or beneficiaries (Mexico's Income Tax Act, Article 176).

3 It is also understood that the corporations to which the Decree refers invest repatriated resources when the investment is made in shares issued by corporations resident in Mexico.

4 The General Rules make clear that investments made in Mexico through Mexican financial system institutions can be carried out using financial instruments issued by Mexican corporations in domestic or foreign currencies.

amount can be added to the net-tax-profit account balance as provided for in Mexico's Income Tax Act and must be considered to determine taxable income, which in turn will serve as the base for determining workers' share of businesses' profits.

It is critical to point out that repatriated resources must remain invested in Mexico for at least two years. However, the beneficiary is permitted to apply the resources to a different investment from that originally chosen.[5]

In turn, private individuals are considered as having invested repatriated resources when:

1. They invest in financial instruments issued by residents in Mexico or invest in stock shares issued by corporations resident in Mexico;[6]
2. They acquire deductible fixed-asset goods, land or structures in which to carry out their activities in Mexico, and
3. They invest in technology research and development.

The Decree establishes that taxpayers can credit taxes that have been paid on the same resources abroad against the payable income taxes on the repatriated resources. The amount of the creditable tax paid abroad cannot exceed the amount resulting from the application of the 8% rate to the total amount of the repatriated resources.

In general, it is considered that the tax paid covers both the year in which payment is made as well as previous years.

Benefits conferred will not be considered cumulative income for Income Tax purposes nor will they be grounds for any refund or compensation.

Taxpayers for whom a desk review, home visit, tax-ruling or electronic review has been initiated in relation to the abovementioned taxed income can solicit the Decree's benefits provided they rectify their tax status through Income Tax payments.[7] Those who have presented a recourse of defense or any other administrative or jurisdictional protocol relative to the tax situation of the indicated income cannot apply this benefit unless they desist from the pursuit of such recourses.[8 and 9]

According to the issued General Rules, for taxpayers who have acquired stock shares or other equity or debt titles issued by residents abroad to opt for the Decree's benefit, they must divest and reinvest the resultant amount in Mexico. This will also apply in cases of capital-reduction repayments from corporations that reside abroad.

When the complete payment of an adjusted tax and its surcharges is not made by the date the General Rules[10] establishes, taxpayers cannot opt to pay these according to Decree terms and tax authorities will require payment of total omitted contributions.[11]

Finally, so that a greater number of taxpayers may take advantage of the Decree's benefits, the "Decree by which the decree granting several administrative advantages in income tax matters relative to deposits or investments received in Mexico is modified" (*Decreto por el que se modifica el diverso que otorga diversas facilidades administrativas en materia del impuesto sobre la renta relativos a depósitos o inversiones que se reciban en México*) was published in Mexico's *Official Federal Gazette* on 17 July. This Modifying Decree expands the life of the original Decree by nine months from the date of its entry into effect.[12] •

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5 According to the General Rules, when taxpayers switch to an investment other than the original, they must inform as much to pertinent parties within thirty days following the date on which the switch is made.

6 It is considered that private individuals to whom the Decree refers have invested repatriated resources in Mexico when they acquire shares issued by investment funds or rights certificates on wealth in trust, solely made up of shares from domestic issuers.

7 During any phase when verification powers are exercised and even following notice of the resolution of back taxes or any definitive resolution and provided the timeframes for presenting defense recourses against such measures have not expired.

8 Note there is an obligation to submit information related to desisting from any defense recourse or any other administrative or jurisdictional protocols that may have been presented against the abovementioned taxed income.

9 Such powers are called for in the General Rules and were later added to the Modifying Decree mentioned below.

10 It is important to indicate the General Rules established that payment of resultant taxes should be made no later than 3 August 2017, including amendments and surcharges that may have arisen. With the Modifying Decree's publication and the extended life of the incentive, it is quite likely new General Rules will be issued calling for a new payment deadline.

11 Resources for which it can be proven that such resources' acquisition was non-taxable, tax-exempt or that tax payments were effectively made can be excluded from the tax base.

12 The Decree would have originally enjoyed a six-month life, i.e., until 19 July 2017. The life-extension contained in the Modifying Decree implies the Decree will remain in effect for nine additional months starting on 18 July 2017.

# The Fundament Exclusive-Resolution Ruling and the Exclusive Fundament-Revocation Motion





On 27 January 2017, the "Decree by Which Various Dispositions of the Federal Contentious Administrative Procedures Act and the Federal Tax Code Are Reformed and Amended" (*Decreto por el que se reforman y adicionan diversas disposiciones de la Ley Federal del Procedimiento Contencioso Administrativo y al Código Fiscal de la Federación*; henceforward "the Decree") was published in Mexico's *Official Federal Gazette* and entered into effect the day following its publication.

By means of the Decree, the Federal Contentious Administrative Procedures Act is expanded to include a "Fundament Exclusive-Resolution Ruling" (*Juicio de Resolución Exclusiva de Fondo*; henceforward, "the Ruling") and Mexico's Federal Tax Code is amended to include an Exclusive Fundament-Revocation Motion (*Recurso de Revocación Exclusivo de Fondo*; henceforward, "the Motion").

We present the most relevant aspects of these new protocols below.

## THE FUNDAMENT EXCLUSIVE-RESOLUTION RULING

According to Mexico's Federal Executive Branch,[1] this new legal procedure seeks to strengthen the exercise of the human right to effective legal recourse.

The ruling's salient characteristics include:

1. Voluntary processing at the actor's request, within thirty days[2] subsequent to the date on which the notice of the contested ruling has given rise to effects, stating arguments whose object is to rule exclusively on the fundaments[3] of a dispute, i.e., those related to tax payments' essential elements (subject, object, base, percentage or rate);
2. The inclusion of principles of orality and speediness in the case;
3. Exclusive legitimacy against definitive rulings as may be derived from desk reviews, home visits or electronic reviews whenever the pertinent amount is greater than 200 times the current Unit of Measure and Periodicity (acronym in Spanish: UMA),[4] adjusted to the year corresponding to the time of the ruling's emission;
4. The exclusive admission of evidence presented and exhibited in: (i) the audit procedure from which the contested act derives; (ii) the Conclusive Agreement procedure regulated by Federal Tax Law; or (iii) the appropriate administrative recourse;
5. Granting flat suspension to the execution of the contested act from the moment the complaint is admitted until a definitive sentence is handed down, without such a concession requiring the issuance of any guarantee. This is clearly a novel benefit since in traditional procedural cases tax interest must be guaranteed for the suspension to enter into effect, and
6. A hearing to determine litigation, that is to take place orally before the Instructing Magistrate. At that hearing, it is expected the Instructing Magistrate will exercise a closer approach to litigants and will gather all arguments they present with regard to the litigation. As well, litigants will decide whether to appear at the hearing personally or through their legal representatives.

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1 Put forth in the "Iniciativa con proyecto de Decreto por el que se reforman y adicionan diversas disposiciones de la Ley Federal del Procedimiento Contencioso Administrativo," 8 September 2016.

2 In one of the Decree's transitory stipulations it was established that such a Ruling could be motioned for on the first business day following that on which Regional Specialty Chambers in matters related to exclusive fundament rulings begin operations (see note 5).

3 Arguments with regard to form or procedure will be considered unformulated.

4 Considering that the annual UMA's value as of 1 February 2017 is $27,538.80 MXN, this claim amount would need to exceed $5'507,760 MXN.

Additionally a new possibility allows litigants to request a private audience with the Instructing Magistrate or one of the Fundament Exclusive-Resolution Ruling Specialty-Chamber Magistrates during case instruction.[5] Any private audience must be held in the other party's presence unless—despite having been notified—that party fails to appear.

In addition to the requirements traditional calls for redress stipulate, the following have been added: (1) a statement declaring this Ruling has been sought;[6] (2) a brief, concrete statement of the underlying controversy; (3) the litigation's aim; (4) the origin of the grievance, which should specify if the same has arisen from an understanding of the facts or omissions, the interpretation or application of norms, of effects attributed to the taxpayer for non-compliance to formal or procedural requirements, or from the coincidence of two or more of the above, and (5) reasons underlying the contestation.

The contested ruling will be declared null when (1) facts or omissions that gave rise to the dispute did not occur or were insufficiently understood; (2) pertinent norms were wrongly interpreted or applied, or (3) the effects the issuing authority attributed to non-compliance with (formal or procedural) requirements are in fact excessive or disproportionate, given that the corresponding causation hypothesis did not occur.

With regard to contested rulings, sentences may have the following effects: confirm their validity, declare their nullification, modify claim amounts, reduce sanction amounts, recognize the existence of a subjective right, order a payment of indemnity for damages and harm afforded the taxpayer. The responding authority may file a review motion against such sentence.

It should be pointed out the Ruling will not move forward when the administrative motion presented in opposition to definitive rulings has been denied, dismissed or is considered unfiled. Neither will it move forward when it is alleged the definitive ruling was not disclosed or handed down illegally.

## THE EXCLUSIVE FUNDAMENT-REVOCATION MOTION

We consider the Motion's[7] most relevant characteristics to be the following:

1. Its voluntary filing on the part of its appellant within 30 days following the date on which the respective ruling has entered into effect. Once this recourse has been chosen, the appellant cannot change his selection;
2. Exclusive legitimacy against definitive rulings derived from desk reviews, home visits or electronic reviews, provided the claim amount is greater than 200-times the Unit of Measure and Periodicity currently in effect,[8] adjusted to the year at the time of the ruling;
3. The possibility for the appellant to request an audience with the ruling authority to present arguments that support his position;

5 By means of "Acuerdo SS/8/2017 por el que se reforma la fracción XVII del artículo 22 y se adicionan una fracción V al artículo 23 y una fracción IX al artículo 23-Bis, todos del Reglamento Interior del Tribunal Federal de Justicia Fiscal y Administrativa," published in Mexico's *Official Federal Gazette* on 27 June 2017, the Fundament Exclusive-Resolution Ruling Specialty Chamber was created, with offices in Mexico City, and began operations on 1 July 2017, in compliance with general agreement G/JGA/64/2017 from the Federal Administrative Justice Tribunal's Government and Administration Board, published in Mexico's *Official Federal Gazette* on 7 July 2017.

6 Once the plaintiff has chosen this means of redress, he cannot change his selection.

7 The reform included revising acts' illegality and avoiding rulings' repositioning due to procedural errors in order to strengthen the means of self-control tax authorities enjoy to resolve issues' root causes.

8 Considering the UMA value in effect as of 1 February 2017 is $27,538.80 MXN, the claim amount would need to exceed $5'507,760.00 MXN.

4. A restriction to present only such arguments whose object is an exclusive ruling on the fundaments[9] of the dispute, i.e., those related to the tax payments' essential elements (subject, object, base, percentage or rate) and those liable to contest: (i) the facts or omissions surrounding compliance with liabilities under review; (ii) the application or interpretation of pertinent legal norms; (iii) the effects attributed to the taxpayer for non-compliance with formal or procedural requirements; or (iv) the evaluation or lack of understanding of proofs related to the above suppositions, and
5. The authority's obligation to issue an official Motion acceptance notice when the Motion includes:[10] (i) a declaration that this means of redress has been chosen; (ii) an account of the underlying grievances; and (iii) the source of the grievance with an indication of whether this is the outcome of an understanding of the facts or omissions, the interpretation or application of norms, the effects attributed to the taxpayer for non-compliance with formal or procedural requirements, or the coincidence of two or more of the above assumptions.

Finally, rulings will favor the appellant when: (1) the facts or omissions that originated the dispute did not occur or were wrongly understood; (2) the pertinent norms were wrongly interpreted or applied, or (3) the effects the issuing authority attributed to non-compliance with (formal or procedural) requirements are in fact excessive or disproportionate, given that the corresponding causation hypothesis did not occur.

## CONCLUSIONS

The Decree's proposed reform is beneficial to taxpayers seeking to resolve disputes whose claim is greater than that noted. Nevertheless, like every new legal recourse, it will be necessary to analyze how it functions in practice. It is likely that improvements should be made as a means of safeguarding its legal and administrative definition in favor of effective resolution of dispute fundaments.

As well, in our judgment, the following similarities exist between the Ruling and the Motion: an inclusion of the principle of orality, a limit to presenting arguments about root-causes only, the claim amount for legitimacy and the cases that will rule in favor of the taxpayer and whose purpose is to exclusively rule on the fundaments of the dispute.

Finally, the Regional Specialty Chamber on Fundament Exclusive-Resolution Rulings, based in Mexico City and with jurisdiction over the entire nation, whose operations began on 1 July 2017,[11] also operates as an Auxiliary Metropolitan Chamber to carry on hearing matters in process before the Fourth Regional Metropolitan Chamber.[12]

Considering the time that will be needed to entirely resolve such matters in process, the resolution of Fundament Exclusive-Resolution Rulings that may be processed before that chamber could be considerably delayed. •

9 Grievances related to form or procedure will be considered as unformulated.

10 Additionally, it must contain the requirements Federal Tax Code establishes for the recourse of revocation and all other motions filed with tax authorities.

11 See note 5.

12 By order of "Acuerdo SS/8/2017 del Pleno General de la Sala Superior del Tribunal Federal de Justicia Administrativa", published in Mexico's *Official Federal Gazette* on 27 June 2017, the "Cuarta Sala Regional Metropolitana" has been re-designated the "Sala Regional Especializada en Materia del Juicio de Resolución Exclusiva de Fondo."

# NAFTA Re-Negotiation Goals on Customs and Trade





As part of the North American Free Trade Agreement (NAFTA) revision process, on July 17th, 2017, the Office of the United States Trade Representative published a summary of the goals the US will pursue in re-negotiations. As conversations move forward, these objectives are subject to update and revision.

The summary shows an obvious shift in the Trump Administration's original position, given that previously the most likely scenario was a rejection of NAFTA. It is also clear United States efforts aim to reduce the trade deficit with Mexico and Canada and, presumably, create jobs in the United States.

The re-negotiation's objectives encompass not only the various areas directly related to trade in goods—like customs, trade facilitation and rules of origin, as well as technical barriers to trade—but also other areas that had been addressed in the Trans-Pacific Partnership (TPP). The intention, presumably, is to maintain NAFTA's benefits but bringing the treaty up to date, in line with current needs when it comes to trade in goods and services.

The most relevant stated goals related to international trade and customs include:

Regarding trade in goods, the United States would seek to maintain and expand reciprocal duty-free access to industrial and agricultural products, fundamentally securing the elimination of the customs barriers applicable to those products both in Mexico and Canada.

Regarding sanitary and phytosanitary arrangements, the United States would negotiate their standardization in accordance with the commitments made by the three countries under the auspices of the World Trade Organization (WTO). Each country would determine its protection level according to its specific circumstances. It would also seek to define communications and cooperation channels between governments for the implementation and revision of these measures.

With regard to customs and trade facilitation, the United States would seek greater transparency with respect to importers' and exporters' obligations as goods clear customs, so that the requirements applicable to their operations may be better known in advance, including via the internet. In addition, the United States would seek to establish pathways for reducing the time it takes to clear customs and release goods. A third goal would be automation of tax- and penalty-paying processes.

As regards rules of origin, the United States would seek to tighten rules application, so preferential tariffs under the agreement would apply to products actually made in the United States and throughout North America. The United States would also encourage materials provision from these territories. It is anticipated that special attention will be paid to goods in the automotive industry, implying possible repercussions in current supply chains.

These objectives will be driving the negotiations. All parties involved are aware of them. We sincerely hope Mexican negotiators will have sufficient resources to oppose those proposals that might harm Mexico. •

# Legal Considerations for Crowd-Funding in Mexico





## INTRODUCTION

*Fintech* "is a compound word that comes from the notion of *financial technology* and describes a financial-services sector that has emerged in the twenty-first century. Originally the term applied to technologies used for sales to end-point consumers as well as to financial institution operations. Since the end of the first decade of the twenty-first century, given the sector's important evolution, the term has broadened to include any technological innovation in the financial sector, including innovations in areas of literacy and education, retail banking, investing and crypto currencies […]."[1]

Furthermore, "the same concept can also cover all activities that generally imply the use of innovation and technological developments in the financial sector, adding a differentiator when it comes to the way the financial-services industry and consumers perceive financial products and services."[2]

In line with the above, we can include collective financing instruments that operate through electronic systems and platforms as part of fintech. Their principal objective is to connect financing supply and demand, through the assistance of an intermediary, known as the "matchmaker." The matchmaker is in charge of (1) receiving requests from investors who want to finance a project and (2) putting said investors in touch with the investment mechanisms that meet their requirements. Depending on the type of investment mechanism, we will have different financing types; the most popular is known as crowd-funding (collective financing).

Below is a brief review of the present legal situation with regard to crowd-funding in Mexico for investors who are interested in participating in this market.

## THE CROWD-FUNDING MARKET

Overall we can say that there are three models of collective financing or crowd-funding: (1) a capital-based model, (2) a model based on rewards and donations, and (3) a debt-based model.[3]

### 1. The Capital-Based Model

In this model, investors place their capital with a given endeavor in exchange for an equity stake in the business that will develop it. Generally, at the beginning of the project, investors commit to a certain number of shares as a guarantee of their involvement. However, the investors do not pay their agreed-upon share (investment) until the business raises all required capital.

Thus, the value of their investment (equity stake) along with the distribution of the potential profits will depend on the project's success in its capital-raising phase.

The matchmaker's goal, always supported by an electronic platform, involves putting investors who want to place capital in touch with the business that requires project financing.

### 2. The Rewards- and Donations-Model

Although certain "rewards" do exist in the capital- and debt-based models, these are only economic. However, in this second crowd-funding model, rewards can be of any type: film merchandising, use of a particular service, thanking the public for their support, etc.[4]

Unlike the other models, in this model the investor does not seek a return based on the capital invested,

1 <http://www.investopedia.com/terms/f/fintech.asp>, 25 October 2016.

2 *Libro blanco de la regulación fintech en España*, Asociación Española Fintech e Insurtech, p. 12.

3 Asociación de Plataformas de Fondeo Colectivo, A.C. <http://afico.org/>, 8 March 2017.

4 <http://www.crowdsourcing-blog.org/crowdfunding-que-es-y-que-tipos-existen/>

but looks only for the satisfaction of having helped realize a project in exchange for an in-kind reward or a simple mention of their support.

In this model, the matchmaker's participation also consists of putting both parties in contact with each other via an electronic platform; i.e., connecting the investor who seeks to support a project (and who can almost be considered a donor) with the project in need of financing.

### 3. The Debt-Based Model

This crowd-funding model is commonly known as "peer-to-peer lending" (hereafter referred to as P2PL). The money-lending operations take place between parties, whether they are private individuals or legal entities (commonly known as "peers"), without involvement on the part of financial intermediaries.

In other models, generally, the matchmaker brings together the people who have capital and want to lend it (investors) with the people who need resources (borrowers), an operation in which parties need not know one other. Between-peer lending operations are generally documented in a loan contract with interest. The matchmaker never receives the economic resources as if they were its own, nor is the matchmaker obliged to provide a profit or return to investors. The revenues the matchmaker collects consist of the fees accrued by providing the services that connect the parties, analyzing credit applications, providing a risk-profile for each loan, receiving loan payments and managing the technological platform through which it delivers its services.

P2PL eliminates involvement from banks as traditional intermediaries, allowing borrowers to pay lower interest rates for the loans they obtain while at the same time investors enjoy a higher rate of return than in a traditional, bank-based arrangement.

## CROWD-FUNDING'S LEGAL SITUATION IN MEXICO

Currently, crowd-funding is not subject to specific regulation from Mexico's financial authorities. However, the Treasury Department ("Secretaría de Hacienda y Crédito Público"; acronym in Spanish: SHCP) through its National Commission on Banking and Securities ("Comisión Nacional Bancaria y de Valores"; acronym in Spanish: CNBV)—a supervisory and regulatory authority principally for the banking and securities-exchange sectors—is promoting a regulatory body that will grant the CNBV with powers of oversight and supervision especially for crowd-funding activities, designed to protect investors and borrowers.

Among the many reasons usually given for justifying specific regulation in this area, the following are of note:

1. The absence of guarantees to investors that their capital will be used for desired aims;
2. The participation of unqualified investors needing protection. The profile of investors participating in this market usually does not correspond to "institutional or qualified investors." Because they lack specific subject-area knowledge, they are unaware of the risk incurred by their investment (capital risk) and do not know how to devise strategies for proper investment (i.e., diversification); they therefore are at ongoing risk of irreparable loss or fraud;
3. A portfolio with notes in arrears (*cartera vencida*) is generally hard to finance. Since loan amounts tend to be low, in case of payment default, collections become expensive. In a significant percentage of cases the logical outcome is to penalize the portfolio, meaning investors cannot recover even the contributions that funded the loan; and
4. The risks these investments imply for the financial system. The fact that loans provided through this model are not guaranteed could imply risk for the

# Service Levels in Technology Contracts





overall financial system, especially since aggregate amounts are continually increasing.

Given the above, the CNBV has decided that in this model, the actions undertaken by intermediaries (matchmakers) may be viewed as a type of "irregular fundraising" in terms established by Mexico's Credit Institutions Act.

We can identify two types of fundraising in the P2PL debt model: direct (regular) and indirect (irregular).

**1. Direct Fundraising (Regular)**

According to the interpretation compatible with the aforementioned provisions, it is clear that, in the debt model, the borrower undertakes direct fundraising, since the borrower is the one who requests the funds or resources from an unspecified person, which confers the borrower a direct liability and obliges him or her to cover the principal and any interest.

**2. Indirect Fundraising (Irregular)**

Likewise, an interpretation consistent with the aforementioned provisions could indicate that the matchmaker is the party that carries out indirect fundraising if it offers or promotes raising funds from unspecified people, usually via mass media.

For the moment, however, that classification and that interpretation are not binding since the SHCP has not handed down any interpretation on the matter. Any categorization of the aforementioned actions is speculative at this time.

Because of the importance and ongoing growth of the crowd-funding market in Mexico, we are seeing a constant creation of partnerships and/or other groups looking to protect the interests of market participants as they offer the industry programs that lend transparency to crowd-funding platforms according to principles established by the CNBV as well as by best international industry practices. •

Although Mexico's Commercial Code does not establish a specific protocol for technology contracts, they are actually very common. Service level agreements (acronym in English: SLAs), in conjunction with the main contract, should be drawn up according to companies' needs. SLAs generally measure a service's quality, availability, capacity, reliability, speed and effectiveness. They should focus on the most important parts of those services and limit themselves to those that can be objectively measured.

This briefing analyzes how our clients can establish and use service levels in contracts with providers, along with the arrangements they can make to incentivize good information technology (IT) services.

## METRICS

Clients need a "yardstick" (i.e., a metric) to measure each service level's performance. Each service level must be contractually binding and it is advisable the metric cover the entire service.

The method of measurement will affect the reported results. Because of this, it is important to involve the relevant IT team since it can propose measurement systems and consider their accuracy and cost as well as appropriate access to outputs.

The measurement timeframe should be monthly or quarterly. The customer must take into account that longer periods can give the provider greater opportunity to correct poor performance. Likewise, specific timeframes should be established during which the customer expects the service to be available, for example 24/7.

SLAs should include the frequency with which performance reports will be issued, the information to appear in them and the customer's right to request more information, such as an analysis of the causes behind any flaws or failures.

## SERVICE CREDITS

When unmet service levels exist, the provider can grant the client service credits (acronym in English: SC). Generally, SCs include the customer's right to apply them to future services. Often they have an *at-risk cap amount* that can be a percentage of the invoiced services.

These models may vary. In some cases, SLAs allow the provider to recover the SC after a certain amount of time has elapsed and service provision improves. Likewise, a cap higher than the *at-risk* amount can be agreed upon when the measured services are critical.

It is advisable customers retain their right to claim damage amounts and—when negotiation with the provider permits it—losses, since SCs may not be sufficient to remedy a breach. A well-worded accountability clause is crucial in this regard.

A contract for the delivery of IT services can be terminated for material non-compliance. A number of SLA non-compliances are likely to be considered material breaches. The SLA must be clearly drafted so that it can be determined without controversy whether a breach, or a set of breaches, is sufficient to constitute a material breach allowing the contract's termination.

Among other benefits, an effective SLA helps the customer (1) meet their own expectations, (2) prevent suppliers from taking advantage of weak points in the contract's language, and (3) provide a clear exit in case of low quality services. •



# Electricity sector: long-term auction opportunities

According to requirements established by Mexico's Energy Regulatory Commission, load-responsible entities (i.e., power plants) must cover certain quotas for output, cumulative electricity and Clean-Energy Certificates (in Spanish: CELS) via long-term contracts. Long-term auctions are designed to allow power plants to competitively enter into these types of contracts. The contracts are valid for 15 years in the case of electric output and energy and 20 years when it comes to CELS.

To date, two long-term auctions have been carried out successfully. The first (SLP-1/2015) ended on 30 March 2016. Outcomes were able to assign 84.9% of the energy Mexico's Federal Electricity Commission (*Comisión Federal de Electricidad*; acronym in Spanish: CFE) requested in its capacity as a basic supplier, alongside 84.6% of the requested CELS. The second auction (SLP-1/2016) ended on 28 September 2016, with an 83.8% energy assignation, 87.3% of CELS assigned and 80.1% of output assigned as requested by the CFE as a basic services supplier.

As of 2017, the third long-term auction (SLP-1/2017) is underway. Mexico's National Energy Center (*Centro Nacional de Energía*; acronym in Spanish: Cenace) published bidding guidelines on 27 June 2017. They are addressed to any parties interested in participating in long-term electrical coverage contract-awards for output, cumulative electricity and CELS trading.

## SLP-1/2017

Bidding guidelines can be consulted on the Cenace website at no cost. Nevertheless, to be able to participate in SLP-1/2017, interested parties must cover the payment associated with acquiring bidding guidelines, which confers eligibility to participate in subsequent auction protocols. The bidding guidelines cost the Mexican-peso equivalent of 5000 UDIS plus Mexico's added-value sales tax (IVA). In addition to covering this payment, interested parties must request

registry as potential buyers or by means of pre-qualification for one or more sales offers, as necessary.

To date, SLP-1/2017's completed phases are (1) realization of the Clarifications Meeting; (2) the publication of final bidding protocols and (3) the registry of four potential buyers. As well, on 25 July 2017, Cenace received a purchase offer corresponding to SLP-1/2017 from the CFE's Basic Provision Division.

The next major auction phases are (1) receipt of pre-qualification requests (12-20 September 2017) and the publication of pre-qualification confirmations (30 October 2017). Ruling-disclosure and contract awards will take place 22 November 2017; the awarded contracts will be signed 16 March 2018.

SLP-1/2017 is of eminent importance. It represents a landmark in a new energy-related outlook in that—unlike the first two auctions—it opens up the possibility for inclusion of new energy-provision, output- and CEL players through a new entity known as the Compensation Chamber (*Cámara de Compensación*).

## THE COMPENSATION CHAMBER OPERATIONS GUIDELINES

As part of well-known advances to Mexico's energy-regulations framework, the *Guía operativa de la Cámara de Compensación* ("Compensation Chamber Operations Guide," i.e., "the Guide") was published in Mexico's *Official Federal Gazette* (*Diario Oficial de la Federación*) on 23 June 2017.

Alongside the so-called *Manual de subastas a largo plazo* ("Long-Term Auctions Manual," i.e., "the Manual") the Guide establishes the operations, formulae and procedures that constitute Mexico's Wholesale Electrical Market.

The Chamber's creation corresponds to the third long-term auction, as stipulated in the Manual and in Mexico's Energy Transition Act (*Ley de Transición Energética*). According to the Manual (Chapter 3, item 3.2), the Chamber seeks to neutrally administer the relations that arise between energy-sector buyers and sellers as derived from contract awards resultant from long-term auctions, and with all corresponding implications.

The Guide's principal goal is to issue necessary criteria so that awarded contracts that come out of the auction can be entered into with all appropriate compliance guarantees. In complement to the Manual, creditworthiness requirements to be met to maintain a balance between buyers' and sellers' liabilities will also be established.

## CONCLUSION

With the third long-term auction, more openness and transparency are starting to be seen, alongside greater equilibrium among wholesale electricity market players. These auctions' regulatory framework is expanding so that State and private entities can provide clearer processes to both buyers and sellers. •

# Electronic Payroll Receipts (CFDIs)





As a result of technological advances, as well as related tax reforms, traditional or paper payroll receipts have been replaced by electronic-format receipts (*comprobantes fiscales digitales por internet*; acronym in Spanish: CFDI). The format guarantees, among other elements, the receipts' legitimate origin and the integrity of their content. Because they are archived on databases or in digital formats, this also allows for greater efficiency when it comes to receipt handling and storage.

Starting when tax laws required employers issue CFDIs to make payments issued to their employees deductible, it has become more common for those receipts to be sent to employees via e-mail, eliminating the need for the employees' autograph signature.

Nevertheless this has led to uncertainty. Criteria from Reconciliation and Arbitration boards claimed a requirement that payroll receipts be printed and bear the autograph signature of the employee to be admitted as evidence when it came to salary payments and benefits delivery. The conservative nature of labor authorities led to the presumption that—in cases of labor-related rulings—these criteria could be contradictory and in many cases contrary to businesses' interests.

To put an end to contradictions and ambiguities, the 25 November 2016 First-Circuit Sixth Collegiate Labor Court handed down a ruling (in reiteration) that established the necessary conditions for clear admissibility to be granted in a labor-related judgment with respect to wages paid via CFDIs that do not contain the employee's autograph signature. The wording of the precedent is as follows:

> SALARY. PAYROLL RECEIPTS CORRESPONDING TO ELECTRONIC DEPOSITS, THOUGH THEY DO NOT BEAR THE WORKER'S SIGNATURE, ARE ADMISSIBLE AS PROOFS OF PAYMENT AS LONG AS THE QUANTITIES LISTED THEREIN COINCIDE WITH THOSE THAT APPEAR IN BANK STATEMENTS WITH A NOTATION OF "PAYROLL PAYMENT" OR OTHER SUCH LEGEND. Even when electronic-deposit payroll receipts do not bear the worker's signature, they are admissible as corresponding to salary payments and serve as proof of as much if the quantities listed on them coincide with those that appear on bank account statements, if such statements detail deposits the employer has made to workers' accounts under the concept of "payroll payment" or other such legend, bear a certain periodicity and the name of the emitting bank appears.

In accordance with this criterion, the employee's autograph signature is no longer necessary on CFDIs to verify salary payments, provided the following conditions are met:

1. The amounts recorded in the CFDIs fully coincide with the transfer amounts that appear on bank account statements. The payment date on the CFDI must coincide with the day the payment is made (regardless of the period corresponding to the items that are covered);
2. Transfers appear on account statements under the concept of "payroll payment" or some similar legend;
3. Payments are made periodically (weekly, every two weeks or twice monthly, as may be the case), and
4. The name of the emitting bank appears.

Additionally, for employers to accredit salary or benefits payments without the autograph signature on payroll receipts, we suggest the establishment of workplace kiosks where employees can access their electronic payroll receipts using a password and that these kiosks allow for printing the cited CFDIs, since some employees may not personally possess the means to electronically download and print their CFDIs. It is also advisable to offer tutorials in the use of these media to all employees and to keep a record of that training.

Finally, it is advisable that the employer keep copies of bank transfers and that information relative to the employee, pay periods covered, dates of payment and the nature of those payments—as well as deductions realized—appears clearly on the CFDIs. •



# Constitutional Labor Reform





Last February 24th saw the publication of the decree to amend the Mexican constitution's articles 107 and 123. The goal is to transform the administration of justice in labor-related matters.

In accordance with this decree, Mexico's Congress and state legislatures have one year from its date of promulgation to undertake changes in secondary legislation that will allow the constitutional amendments' enforcement.

The decree's fundamental changes were as follows:

1. Elimination of the local and federal councils of Conciliation and Arbitration, and as a consequence, the integration of labor-related justice into the judicial branch through the creation of labor tribunals.
2. The creation of a decentralized federal agency with power to register labor union organizations, as well as to serve as registrar and repository of collective labor agreements.
3. The collective bargaining strike process will require the union to present proof it is the workers' legitimate representative.
4. In accordance with treaties and international agreements concerning collective bargaining and freedom of association, it seeks to guarantee workers' freedom and secrecy when they vote to resolve collective disputes, elect union representatives, enter into contracts and exercise the right to strike.
5. In order to reduce the number of cases brought to trial, conciliation will be mandatory as a pre-trial process undertaken before cases can proceed to the newly created, decentralized agency.

Note that at this writing the relevant changes have not been made. Monitoring the situation will be essential given that, in principle, the new system of labor justice should begin operating on February 24, 2018 and that many related tasks are still pending. •

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