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MEXICAN LEGAL NEWS

Modifications to the tax provisions for 2022

On November 12, 2021, the Decree ("**Decree**") amending, adding and eliminating several provisions of the Income Tax Law ("**IT**"), Value Added Tax Law ("**VAT**"), Special Tax on Production and Services Law ("**STPS**"), and the Federal Tax Code ("**FTC**") was published in the Official Federal Gazette ("**DOF**"), which, with few exceptions, will become effective as of January 1, 2022.

Below you will find a general summary of the topics we consider relevant:

1. INCOME TAX LAW:

LEGAL ENTITIES:

A. INCOME

Foreign exchange gains and losses

Beginning in 2022, foreign exchange gains may not be less than the amount that would result from applying the exchange rate established by the Bank of Mexico to settle obligations agreed in foreign currency payable in Mexico.

Usufruct

When the usufruct and the bare ownership are disposed of, the gain will be determined by subtracting from the income obtained from the sale the original amount of the investment in proportion to the price corresponding to the transferred attribute, according to the appraisal to be performed by a person authorized by the tax authorities.

In addition, it is specified that the consolidation of the bare ownership and the usufruct of an asset is considered taxable income.

This measure is aimed to avoid certain tax planning in which the bare ownership of a real estate was disposed of (taking advantage of all its tax cost) and it was not considered as income when, at the end of the usufruct, the property was consolidated again. This reform went far beyond its intended purpose, since it was not limited to real estate, covering any type of property.

B. DEDUCTIONS

Technical assistance, technology transfer and royalties

Payments made for technical assistance, technology transfer or royalties, rendered through third parties, will be deductible only in the case of specialized services.

Bad debts

In the case of bad debts whose principal amount at the maturity date is greater than 30 thousand UDIS, may only be deducted when the creditor:

I. Obtains a definitive resolution issued by the competent authority, with which the taxpayer evidences having concluded the collection efforts or,

II. Evidences that it was impossible to execute the favorable resolution.

Original investment amount

The payments made for the installation, assembly, handling, delivery, as well as those related to the services contracted for the investment to work, are included, among others, as part of the original investment amount for the deduction of investments.

Pre-operating expense

Intangible assets that allow the exploration or exploitation of public property will not be considered as pre-operating expenses but deferred expenses.

Tax losses from spin-off

In the case of a corporate spin-off, the pending tax loss carryforwards should be divided between the spin-off entities and the spun-off entities engaged in the same business.

Tax losses from merger

Currently, when the partners or controlling shareholders of an entity that has tax loss carryforwards from prior years, and that the sum of its income in the last three years has been less than the updated amount of such losses, change after a merger, the losses may only be reduced against the tax profits derived from the operation of the same business in which such losses were incurred.

As of 2022, the hypotheses in which a change of partners or shareholders that have control of a company are increased, adding, among others, the following: (***i***) change of the holders of more than 50% of shares or partnership interests with voting rights of the corresponding entity; (***ii***) change of the holders of the rights to impose decisions in the meetings or to appoint or remove the majority of the directors, administrators or their equivalents, or those that allow directing the administration, strategy or main policies of the entity; and (***iii***) when after merging the corresponding entity and its partner or shareholder, which is a legal entity, cease to consolidate their financial statements.

C. OBLIGATIONS

Transfer Pricing Study

The obligation to have a transfer pricing study is extended to also expressly cover transactions carried out between related parties resident in Mexico.

Notice of sale of shares issued by Mexican companies

Mexican entities will be required to give notice to the tax authorities when shares issued by such entity are sold between tax residents abroad without a permanent establishment in Mexico. If such notice is not filed, Mexican companies will become jointly and severally liable for the calculation and payment of the tax corresponding to the foreign tax resident.

D. SIMPLIFIED TRUST REGIME FOR LEGAL ENTITIES

Legal entities resident in Mexico whose shareholders are only individuals, and their total income in the immediately preceding fiscal year does not exceed 35 million pesos or who are starting operations and estimate that their income will not exceed this amount, may be taxed under this new regime.

Regardless of the foregoing, any company that is in any of the following hypotheses may not be taxed under this regime:

- Legal entities when any of their partners, shareholders or members participate in other commercial companies in which they have control of them or their administration, or when they are related parties thereof.

- Entities that carry out activities through trusts or joint ventures.

- Entities taxed under Chapters IV (credit, insurance and bonding institutions, general deposit warehouses, financial leasing entities and credit unions), VI (optional regime for groups of companies), VII (coordinated) and VIII (agricultural, livestock, forestry and fishing activities) of Title II and those of Title III (nonprofit entities) of the IT Law.

- Entities that pay taxes in accordance with Chapter VII (production cooperative entities) of Title VII of this Law.

- Legal entities that cease to be taxed under the Simplified Trust Regime.

Income will be considered accruable at the time it is effectively received, while authorized deductions must be effectively disbursed in the corresponding fiscal year.

This regime establishes the obligation to make provisional payments, for which purpose, entities will determine their tax profit by deducting from their income the authorized deductions, employee profit sharing and, if applicable, tax loss carryforwards pending application; to the result obtained, the rate contained in Article 9 of the IT Law (30% tax rate) will be applied, granting the possibility of crediting, among other items, withholdings, as well as provisional payments made prior to the month being calculated.

There are special rules for the deduction of expenses and investments.

INDIVIDUALS:

A. SIMPLIFIED TRUST REGIME FOR INDIVIDUALS

The following persons can opt for this regime:

- Individual taxpayers who only carry out business or professional activities or grant the temporary use or advantages of goods, provided that their total income from the aforementioned activity or activities, obtained in the immediately preceding fiscal year, does not exceed three million five hundred thousand pesos.

- Taxpayers who carry out such activities and also obtain income from those indicated in Chapters I (salaries) and VI (interest) of Title IV of the IT Law, provided that the total income obtained in the immediately preceding fiscal year from the aforementioned activities, as a whole, does not exceed three million five hundred thousand pesos.

The following persons lose the right to this regime:

- Taxpayers whose income exceeds three million five hundred thousand pesos, at any time of the year, but have the possibility to be taxed again under this regime when their income for the immediately preceding year does not exceed such amount and they are up to date with their tax obligations.

- Failure to comply with the obligations of the simplified regime for individuals. In this case it will not be possible to pay taxes under this regime.

Benefits:

- Paying IT at a rate of 1% to 2.5% (on gross income without any deductions).

- Simplification in the payment of IT.

- Not having the obligation to keep electronic accounting.

The following cannot opt for this regime:

- Partners, shareholders or members of legal entities or when they are related parties.

- Those who are residents abroad and have one or more permanent establishments in the country.

- Those with income subject to preferential tax regimes.

- Those who receive the income referred to in Sections III (directors, statutory auditors, general managers), IV (receive fees mainly from one person), V (those who receive fees and opt to be treated as salaried employees) and VI (those who carry out business activities and opt to be treated as salaried employees) of Article 94 of the IT Law.

With the incorporation of this regime, the regimes established for individuals engaged in agricultural, livestock, forestry or fishing activities, as well as the tax incorporation regime, are repealed.

B. LEASE INCOME

Pursuant to the reform to the IT Law, taxpayers who obtain income from leasing and choose to deduct 35% of the income (known as blind deduction), will also be required to keep accounting records in accordance with the FTC and its Regulations.

C. PERSONAL DEDUCTIONS

Deductions for donations are included within the limit of personal deductions, so that all of them (as a whole) may not exceed the lesser of five times the annual value of the Measurement and Inflation Unit (UMA) or 15% of the taxpayer's total income, including those for which the tax is not paid.

TAX RESIDENTS ABROAD:

Determination of income

The obligation for foreign tax residents to determine income, gains, profits and, if applicable, deductions derived from transactions with related parties, considering the prices, amounts of consideration or profit margins that they would have used or obtained with or between independent parties in comparable transactions, is confirmed.

Sale of shares

When a foreign tax resident sells, to a related party, shares issued by Mexican companies and chooses to pay IT on the profit, he or she must include in the public accountant's report the supporting documentation evidencing that the sale price of the shares sold corresponds to the price that would have been used by independent parties in comparable transactions.

Damages in judgment or arbitration award

Pursuant to Article 172, Section III of the IT Law, income paid by tax residents in Mexico to tax residents abroad, as a compensation for damages, is considered to be income with source of wealth in Mexico.

In this sense, the IT Law is amended to specify that when the judgments or arbitration awards condemn a payment without indicating whether it is a compensation for damages, the payer should make the withholding on the total income, leaving the burden of proof on the foreign resident receiving such income so that, at the time of requesting the refund of the tax withheld in excess, he or she should evidence before the tax authorities the nature of the payment that has been received.

Representation of a tax resident abroad

As of 2022, the legal representatives of tax residents abroad who are appointed to be entitled to exercise the options provided in the IT Law should also voluntarily assume the joint and several liability, and have sufficient assets to respond as a joint and several obligor. The liability will not exceed the contributions payable by the foreign resident.

2. VALUE ADDED TAX LAW:

Customs declaration

In order to be able to credit the VAT paid on the import, it is expressly established as a requirement that the customs declaration should be in the name of the taxpayer.

Acts or activities not subject to VAT

Additionally, it was clarified that the VAT transferred to the taxpayer for expenses incurred to carry out activities that are not subject to the tax will not be creditable. In connection with the above, a definition of acts or activities not subject to VAT was incorporated to the VAT Law.

Temporary use or advantage of property in national territory

Furthermore, the amendment is proposed to indicate that the temporary use or advantage of goods in national territory will always be subject to the payment of the tax regardless of the material delivery of such goods.

Pre-operating period

In addition, the obligation to file a notice in the month in which the taxpayer begins its activities for VAT purposes is incorporated. The purpose of this is to correctly determine the adjustment of the VAT crediting in the pre-operating period.

3. SPECIAL TAX ON PRODUCTION AND SERVICES LAW:

Electronic authorized label

Along with the technological updating reforms of recent years, a definition of electronic authorized label was included, establishing its material and operational difference with respect to the physical label.

Establishment of final consumption

On the other hand, the definition of "establishment of final consumption" is incorporated by means of an indicative list of the places where alcoholic beverages are regularly sold for final consumption in the establishment itself.

Destruction of containers

In addition, taxpayers who sell alcoholic beverages to the general public for consumption in the same place or establishment in which they are sold are required to destroy their containers immediately after their contents have been used up (except in the cases established by the Tax Administration Service).

Denatured alcohol and uncrystallizable honeys

The obligation of manufacturers, producers, bottlers and importers of denatured alcohol and uncrystallizable honeys to be registered in the Alcoholic Beverages Taxpayers' Registry is eliminated.

4. FEDERAL TAX CODE

Business purpose

Recently, the *Business Purpose* theory for tax purposes was introduced in Article 5-A of the FTC establishing it as a requirement for: (i) obtaining authorizations for corporate restructurings, (ii) to be considered that there is no alienation in mergers and spin-offs and (iii) credit transactions.

Corporate restructurings, mergers and spin-offs

In order to be entitled to request an authorization for a restructuring (and to transfer the shares at tax cost), as well as not to be considered as an alienation in the case of mergers and spin-offs, it is necessary to have a business purpose when such transactions are carried out.

As a requirement for authorization to be granted for the corporate restructuring, the authority should be notified of all relevant transactions (related to the same) that have been carried out in the 5 years prior to the authorization request.

The tax authority will have 5 years to determine whether or not the requirement of having a business reason was complied with. In the event that the authority considers that this requirement was not complied with, then, it will invalidate the authorization (for the restructuring) and, in the case of mergers and spin-offs, it will consider that there was an alienation.

When, within five years after an authorization for a restructuring is granted or a merger or spin-off is carried out, a relevant transaction is carried out, an informative return must be filed in this respect.

Among the operations considered relevant to determine whether or not the requirement of having a business reason was met are the following:

- The transfer of ownership, advantage or use of the shares or of the voting or veto rights in the decisions of the entity or of the favorable vote necessary for taking of decisions in the entity.

- The right to the company's assets or profits is granted in the event of any type of capital reduction or liquidation.

- The book value of the company's shares is decreased or increased by more than 30%.

- The capital stock of the company is decreased or increased.

- A partner or shareholder increases or decreases its percentage of direct or indirect participation in the capital stock of the company and, as a consequence, increases or decreases the percentage of participation of another partner or shareholder of the merging, spin-off or spun-off entities.

- Change of tax residence of partners or shareholders who received shares.

- One or more segments of the entity's business related to one or more segments of the business are transferred.

In addition to all of the above, for purposes of the restructuring authorization, it is also considered as a relevant event when the legal entity ceases to consolidate its financial statements in accordance with the provisions that regulate accounting and financial matters, or that it is obliged to apply.

Credit operations

If a credit operation has no business reason, it will be considered as a back-to-back loan with all its consequences (non-deductibility, recharacterization as dividends, etc.).

Residence

Individuals or legal entities that fail to evidence their new tax residence or, even evidencing it, when such change of residence is to a country or territory where their income is subject to a preferential tax regime (REFIPRE), will not lose their status as residents of Mexico.

The foregoing will apply unless such country or territory has entered into a comprehensive tax information exchange agreement with Mexico and, additionally, an international treaty that allows mutual administrative assistance in the notification, collection and recovery of taxes.

Likewise, it is expressly established that persons who fail to file the notice of change of residence will not lose their status as residents of Mexico.

Advanced electronic signature ("**e.firma**") or Digital Stamp Certificate ("**CSD**") in the case of legal entities.

First, it is stated that the Tax Authority will deny the granting of the e.firma, as well as the CSD when it identifies that the legal entity requesting them has a partner or shareholder (with effective control over the same) in an irregular tax situation without having corrected it, or such partner has effective control over another legal entity in an irregular tax situation without having corrected its tax situation.

Self-correction through the application of credit balances

Now, with respect to favorable balances in audits, a procedure is provided so that taxpayers who are being subject to the exercise of review powers may correct their tax situation by requesting the application of the balances in their favor against the amounts owed as a result of the observations made by the tax authority.

This provision will be effective until January 1, 2023.

Digital Tax Invoices ("**CFDI**")

Among other changes regarding CFDIs, it is established that in the event that CFDIs are issued without the documentary support that credits the refunds, discounts or bonuses, they cannot be deducted from the taxpayer's income.

The aforementioned has been added since it was detected that there are taxpayers who issue income CFDIs that, due to an error in their issuance, should be cancelled, but instead, expense CFDIs are issued to reduce income.

Moreover, it is specified that in those cases in which the information corresponding to the service, goods, merchandise or use or advantage indicated in the CFDI does not coincide with the economic activity registered in the Federal Taxpayer Registry ("**RFC**"), the authority will proceed to update the economic activity of the taxpayer in the RFC.

Now it is established that the CFDI should include the name, company name or corporate name and the zip code of the taxpayer to whom it is issued.

Finally, it is stated that the cancellation of CFDIs should be made in the fiscal year in which they are issued, unless the tax provisions provide for a shorter term.

Obligation to audit financial statements and information on fiscal situation

The obligation to have the financial statements audited by a registered public accountant is established in the case of certain specified legal entities that previously did so optionally.

In this regard, entities under the general regime of the IT Law, which in the immediately preceding fiscal year recorded an accumulable income equal to or greater than 1'650,490,600 pesos or which at the end of such fiscal year have shares placed among investors at large in a stock exchange, will be obliged to audit their financial statements.

It should be noted that the deadline for the filing of such report was changed to May 15 of the year immediately following the end of the fiscal year (instead of July 15).

Likewise, it is established that taxpayers that are related parties of those who are obliged to report their financial statements should file an informative tax return on their fiscal situation.

On the other hand, the registered public accountant will be obliged to report to the tax authority, when as a result of the preparation of the report, the accountant identifies that the taxpayer has not complied with the tax and/or customs provisions or has carried out any conduct that may constitute the commission of a tax offense.

Failure to do so may subject the registered public accountant to a fine and even criminal liability for concealment of tax offenses.

Powers of the tax authorities and conclusive agreements

It is specified that the tax authorities will have the power to cancel or suspend the registration in the RFC in certain cases of inactivity.

Moreover, it is clarified that the tax authorities may appraise all types of assets or rights referred to in Article 32 of the IT Law (fixed assets, deferred expenses and charges and expenditures made in pre-operating periods) and all types of services.

The amendments to the FTC also include the inclusion of the express power of the tax authorities to determine the simulation of legal acts, exclusively for tax purposes, in the exercise of their review powers.

In addition, several amendments are made to the procedures for onsite inspections, desk review and review of a tax report, as well as the statute of limitations.

Finally, with respect to conclusive agreements, it is established that the maximum term of the procedure before the Tax Defense Agency (PRODECON) will be 12 months from the date the request is filed.

Non-existence of transactions covered by CFDIs issued by a third party

The following are introduced as a presumption of non-existence of the transactions covered by CFDIs, when a taxpayer has been:

1. Issuing CFDIs that support transactions carried out by another taxpayer, during the period in which the latter's use of the CSD has been temporarily suspended or restricted without the irregularities observed by the tax authority having been corrected, or

2. Issuing CFDIs that support operations carried out with the assets, personnel, infrastructure or material capacity of such person.

Tax offenses

Regarding labor outsourcing, the use of the Simplified Trust Regime to hide labor relations is established as a qualifier of the crime of tax fraud or its equivalent, in order to increase the corresponding penalty by half.

Additionally, the cases of qualified tax fraud and qualified comparable tax fraud now include the deduction, crediting or application of any stimulus or tax benefit with respect to expenditures made in violation of the anti-corruption legislation, such as expenditures consisting of giving, itself or through an intermediary, money, goods or services to public servants or third parties, nationals or foreigners.

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