

Tax Agenda Mexico

July 2024



Building a better working world

| No. | Fact | Action |
|-----|------|--------|
|-----|------|--------|

General anti-avoidance rule (GAAR)

- Business transactions may be recharacterized if the Mexican Tax Authorities determine that they do not align with a business purpose. Pursuant to the Mexican Tax Code, the Mexican Tax Authorities are allowed to presume that a transaction lacks a business purpose if the “reasonably expected” economic benefit is less than the tax benefit.

Companies should review all their business transactions and assess if they have a clear business purpose that goes beyond tax considerations.

Maintain comprehensive records of the analysis conducted and supporting documentation to substantiate the business purpose of transactions in case of a tax audit.



Mexican Mandatory Disclosure Rules (MDR)

- As of 01 January 2020, tax advisors and taxpayers are subject to MDR for reportable transactions. The Mexican provisions include 14 hallmarks that would lead to a transaction being reportable if a Mexican resident or non-resident obtains a tax benefit in Mexico directly or indirectly. The hallmarks include, among others: hybrid mechanisms, transactions in which the accounting and tax values differ by more than 20% and transfers of net operating losses. Taxpayer and tax advisor subject to penalties for failure to comply with MDR filing. Note, that MDR filing is due within 30 days after the advice is provided by tax advisor, regardless of whether the transaction is implemented or not.

The hallmarks are broadly phrased and may apply to mergers, tax treaties, refreshing tax losses, among others.

Taxpayers should evaluate their business transactions to determine if they meet any of the 14 hallmarks outlined under the MDR provisions.

Failure to comply with MDR rules could result in USD 1,000,000 penalty and disallowance of any tax benefit that may result of the transaction.



Payments to Low Tax Jurisdictions (LTJ)

- Payments to related parties residents in LTJ or through a structured arrangement, are not deductible for Mexican income tax purposes. Payments to LTJ may be allowed to the extent that the related parties can support that they are engaged in a business activity and have sufficient personnel and assets required to conduct such activities.

Mexican companies should prepare supporting documentation and tax audit support files to serve as evidence of compliance with LTJ payments provisions.



Use the timeline above to plan your actions for coming months

| No. | Fact | Action |
|-----|---|---|
| 4 | <p>Financing transactions subject to an interest limitation rule</p> <p>In addition to the 3:1 debt to equity limitation, net interest expense is subject to a deduction limitation equal to 30% of tax EBITDA. The limitation applies to related and non-related party transactions as well as debt between Mexican and nonresident entities.</p> | <p>Taxpayers should review their level of debt and confirm interest limitation tax rules to determine the impact.</p> <p>Taxpayers should assess any necessary adjustments to maintain compliance with regulations and prepare potential tax exposures effectively.</p> |
| 5 | <p>Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)</p> <p>Mexico formally deposited the instrument of ratification to the OECD on 15 March 2023. The MLI entered into force on 01 July 2023 and is applicable for all Mexican tax purposes since 01 January 2024.</p> | <p>Entities should review the affected tax treaties, analyze the modifications introduced by the MLI, and consider how it may impact cross-border transactions and considerations on Fiscal Year (FY) 24.</p> |
| 6 | <p>BEPS 2.0 – Pillar Two</p> <p>Mexico has asserted its intention to embrace the GLoBE rules, which encompass several key components such as the income inclusion rule (IRR), under tax payments rule (UTPR), and subject to tax rule (STTR). The Mexican government has not presented a formal reform to include these rules within the domestic framework for the FY 24, but it is likely that these rules could be included starting the FY 25.</p> | <p>Mexican groups included within the scope of Pillar 2 should carefully evaluate the potential impacts of these rules, considering their potential entry into force in the years to follow; additionally, foreign groups with presence in Mexico may be eventually impacted by said rules. These groups should proactively prepare the necessary information flow to conduct the required analysis, which can be particularly challenging given the diverse jurisdictions and accounting systems that may be involved.</p> |
| 7 | <p>Mexico – Netherlands Double Tax Treaty (DTT) - Technical Assistance</p> <p>In June 2023, the Federal Tax Court of Administrative Justice (TFJA) published a precedent denying the application of the benefit granted by the DTT for Business Profits. This denial occurred specifically in relation to payments made by Mexican residents for technical assistance, requiring the withholding of income tax at rates of 25% and 35% respectively.</p> <p>Please note that this analysis made by the Federal Tax Court could potentially be used by the Mexican Tax Authorities as part of their tax audits and extent its application to other tax treaties supported by Mexico (and to other items of income similar in nature to the technical assistance).</p> | <p>Entities resident in Mexico which apply a tax treaty should thoroughly analyze and define the nature of transactions, such as determining whether a service qualifies as technical assistance or an independent personal service.</p> <p>Said entities should develop and maintain a comprehensive tax audit support file containing all necessary supporting documentation related to the tax treatment of payments abroad.</p> |

| No. | Fact | Action |
|-----|---|--|
| 8 | <p>Subcontracting reform</p> <p>On 23 April 2021, the reform to limit outsourcing and insourcing in Mexico was approved, resulting in the prohibition of the subcontracting of personnel, which is considered as the service consisting of an individual or legal entity providing or making its own workers available to another. The initiative allows companies to subcontract the services required, only if they do not provide personnel related to the main economic activity of the company. If these new rules are not met, the payment for these services will not be deductible for Mexican income tax purposes and the Value Added Tax (VAT) will not be creditable.</p> | <p>Mexican companies should review operational model in Mexico to confirm that the services provided by related and/or unrelated parties complies with these new legislation. This action should be applied to mitigate potential income tax and VAT exposures with respect to the deductibility and credit, respectively.</p>  |
| 9 | <p>Tax controversy: Substance in transactions</p> <p>Pursuant to Mexican tax legislation, corporate expenses are deductible for income tax purposes to the extent those expenses are considered as strictly indispensable for the carrying out of the business activities of the taxpayer and the applicable formalities are met. Moreover, taxpayers must be able to evidence that all transactions were effectively conducted. Recently, the Mexican Tax Authorities have increased the review on this, by requesting evidence regarding the substance of the transactions; in the case of tax attributes, they are requesting that such attributes should be properly documented and supported.</p> | <p>Taxpayers should conduct a detailed analysis to confirm that their expenses incurred have the proper support and also, that their tax attributes are properly documented.</p>  |
| 10 | <p>VAT – Civil compensation</p> <p>On 15 March 2023, Federal Supreme Court of Justice dictated that civil compensation (i.e., setting-off of account receivables and payables) does not constitute a method of VAT payment and, consequently, cannot be used to request a refund or credit of a favorable tax balance. This pronouncement clarifies that civil compensation merely determines the timing of the payment for services, which in turn establishes when the obligation to pay VAT is considered fulfilled.</p> | <p>Taxpayers should review their current VAT payment and compensation practices (if any), to identify potential transactions that the Mexican Tax Authorities may challenge under this ruling. For instance, cash pooling structures should be carefully reviewed through FY 2024.</p>  |
| 11 | <p>2025 Economic Package</p> <p>It is anticipated that in November 2024, Mexico's Ministry of Finance will present the Economic Package for 2025. This package is expected to provide greater clarity and visibility on the tax reforms for FY 2025, which may potentially include Pillar 2 rules. Despite that 2024 marks a year of governmental changeover, the incumbent political party will continue to hold authority, necessitating a thorough examination of any new tax-related issues that arise.</p> | <p>Taxpayers should closely track new tax developments arising from the 2025 Economic Package to properly address any modifications that may be part of a 2025 tax reform.</p>  |

Contacts:

Enrique Ríos
Partner, International Tax
and Transaction Services- Mexico
EY México
enrique.rios@mx.ey.com

Jorge B. Ruiz
Partner, International Tax
and Transaction Services - Mexico
EY México
bibiano.ruiz@mx.ey.com

Rodrigo A. Maldonado
Senior Manager, International Tax
and Transaction Services - Mexico
EY México
rodrigo.a.maldonado@ey.com

EY | Building a better working world

EY exists to build a better working world, helping create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data, and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws.

For more information about our organization, please visit ey.com.

© 2024 EYGM Limited.

All Rights Reserved.

EYG no. 006560-24Gbl

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal, or other professional advice. Please refer to your advisors for specific advice.

ey.com