Mexico: Budget Proposal 2020

September 9, 2019

In brief

The Executive branch of Mexico's federal government presented, on September 8, the 2020 Budget to Congress ('2020 Budget'). The 2020 Budget includes proposed changes to the Income Tax Law (MITL), the Value Added Tax Law (VATL), the Excise Tax Law (IEPS) and the Federal Fiscal Code (FFC), among others. The House of Representatives has until October 20 to discuss and approve the 2020 Budget. Both the House and Senate then have until October 31 to align and approve the final 2020 Budget.

The proposed changes to the tax law include significant new provisions, including a focus on aligning Mexican tax law with the OECD's BEPS initiative, the taxation of the digital economy, and a new obligation for reportable transactions.

In detail

Income Tax Law

Modification of permanent establishment rules

The 2020 Budget proposes a series of modifications to the definition of a permanent establishment (PE) under the MITL, including the following:

- An assumption that a Mexican resident is not an independent agent when such person acts almost exclusively on behalf of nonresident related parties
- Broader rules that would recharacterize a Mexican resident as a dependent agent
- An assumption of a PE when a nonresident, or a group of related parties, cohesively carries out business operations that, in the aggregate, are not preparatory and auxiliary.

Anti-hybrid legislation

- The proposed legislation would modify existing anti-hybrid rules and include provisions based on BEPS initiatives. For example, the 2020 Budget would not allow a foreign tax credit in Mexico for dividends received where the payor applied a related income tax deduction.
- A limitation on deductions is included related to a new concept of 'structured agreements', whereby an unrelated party is interposed among a series of related-party transactions.
- The Mexican CFC rules would be modified to apply to a broader group of entities or deemed entities, as well as inclusion of certain guidance or definitions aiming to clarify the application of this tax rule.

Limitation of interest deductibility

Taxpayers would have to apply an additional rule to the limitation tests for interest expense, such as the existing thin capitalization rules, among others. The 2020 Budget proposes a new test whereby the interest, net of the inflation adjustment, will be limited to 30% of the entity's adjusted taxable income.

The excess potentially would carry forward for three years. The proposed law includes exceptions for certain activities such as infrastructure projects and an exemption for the initial MXN$20,000,000 of annual interest expense.

Observation: Unrealized foreign exchange income or gain would not fall within the limitations on interest.

Shelter Maquiladoras

The proposed legislation would eliminate the four-year operational requirement for Shelter Maquiladoras. The law would impose new controls by the tax authority to deter abuse of the Shelter Maquiladora regime. Non-compliance with these requirements would trigger a PE for the foreign resident and the loss of its authorization to act as importer of record.

Other

- The 2020 Budget would eliminate the possibility of registering private Trusts for Infrastructure and Real Estate (FIBRA), with transitory rules to pay the tax deferred within the next two years.
- A new withholding obligation would be imposed on Mexican entities that sell goods to individuals, which, in turn, carry out business with the general public.
- As part of a formal audit, the tax authority could recharacterize or ignore legally effective transactions where the tax authority determines there is no business purpose.
- As of July 2020, a new obligation for reportable transactions would apply to both taxpayers and tax advisers when certain transactions are carried out and result in a reduction of Mexican tax.
- Mexican-resident individuals are specifically required to pay income tax on income generated through all types of digital platforms. This tax would be imposed pursuant to a withholding tax applied by Mexican resident entities or nonresident entities.

Value added tax

Digital economy

- As of April 2020, nonresident entities that provide digital services would be subject to VAT if the recipient is in Mexico and the service is provided through applications or digital content, over the internet, and the process is primarily automated. This provision specifically includes certain services such as the downloading of images, movies, text, videos, games, data storage, online training, as well as the mediation between unrelated parties for the acquisition of goods or services.
- The recipient would be considered located in Mexico when their domicile is in Mexico or when the recipient pays through an intermediary that has an IP address located in Mexico.
- The service provider that falls within the VAT provisions described above would be obligated to register for VAT purposes in Mexico, maintain certain books and records, and pay VAT at the 16% rate.
- Additionally, intermediaries would be obligated to withhold VAT on individuals with certain Mexican-resident individual clients.
- The VAT law would include a broader definition of revenue for purposes of determining the creditable factor of VAT for those taxpayers that have income both subject to VAT and not subject to VAT.

The obligations currently included in the VAT law related to validating compliance with VAT by subcontracted service providers would be replaced with a withholding mechanism for VAT.

The VAT law would specifically limit the off-setting of VAT favorable balances only against VAT due.

Excise tax

The excise tax on cigarettes and tobacco would be updated for inflation as from 2011. The mechanism for updating the excise tax on flavored beverages would be adjusted and the new tax would be MXN$1.2705 per liter.

The off-setting of excise tax favorable balances and amounts due would be calculated in separate baskets for the various category of goods sold.

The takeaway

Companies should analyze the impact of the proposed changes, particularly the limitation on the deduction of interest, the operations considered as hybrid, the new guidance for CFC rules, and the tax regime of digital operations.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

International Tax Services

David Cuellar
+52 55 5263 6000
david.cuellar@pwc.com

Lissett Margarita Tautfest
+52 55 5263 5756
lissett.margarita.tautfest@pwc.com

Mario Alberto Gutierrez
+52 55 5263 6000
mario.alberto.gutierrez@pwc.com