TAX REFORM 2020

November 2019

On September 8th, 2019 the Executive Branch presented the 2020 Economic Package to the Congress.

As part of such package, reforms to several tax bills were submitted for consideration to the Legislative Branch, mainly, tax reforms to the Federal Tax Code (Código Fiscal de la Federación; "FTC"), Income Tax Law (Ley del Impuesto sobre la Renta; "ITL"), Value Added Tax Law (Ley del Impuesto al Valor Agregado; "VATL") and Special Tax on Products and Services Law (Ley del Impuesto Especial sobre Producción y Servicios; "STPSL")

After following the Constitutional legislative process, whereby both, the House of Representatives and the Senate, made revisions to the bills submitted by the Executive, reforms to the aforementioned laws were approved.
In our opinion, the most significant amendments are, as follows:

1. FEDERAL TAX CODE

A. Advanced E-Signature

The fifth paragraph of article 17-D of the FTC is modified to grant authorities the right to validate information pertaining to the identity, domicile and tax status of the taxpayer requesting his/her e-signature. In case the authorities are unable to validate such information, the issuance of the e-signature may be denied.

B. Cancellation of digital seal certificates

Article 17-H is modified and article 17-H Bis is added to establish a procedure for the cancellation of the digital seal certificates with respect to taxpayers falling in the following scenarios:
If tax authorities realize that the taxpayer did not submit an annual tax return, for more than a month after the date it should have been filed; or did not submit two monthly returns, consecutive or not consecutive, in a single fiscal year.

- If they vacate their tax domicile without filing a notice thereof or if such domicile is unknown.

- If pursuant to a tax review, the tax authorities realize that tax invoices were used to support non-existent, simulated or illegal operations.

- If pursuant to article 69-B, the tax authorities, even without conducting a tax review to validate taxpayers' information, realize that the taxpayer did not deny the presumption of non-existent operations evidenced in digital invoices.

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- If authorities realize that the taxpayer did neither demonstrate the acquisition of goods or services nor the taxpayer corrected his/her/its tax status, in terms of article 69-B.

- If tax authorities realize the domicile appointed by the taxpayer does not comply with the requirements set forth by article 10 of such law.

- If tax authorities realize the taxpayer's declared income or withholdings not matching the information included in the digital tax invoices or any other information held by the authorities.

- If the authorities realize that, for any reason attributable to the taxpayer, the contact information provided for purposes of the tax e-mailbox are incorrect or false.

- If tax authorities realize that the taxpayer committed any formal violation related to the RFC (Federal Taxpayers' Registry Number), tax returns, notices or any other information, as well as his/her/its bookkeeping obligation.

- If the tax authorities realize that the taxpayer improperly transferred tax losses in terms of article 69-B Bis.

In such cases, the authorities may temporarily restrict the use of digital seals by the taxpayer.

Taxpayers may file a clarification application through the process determined by the Tax Administration Service (Servicio de Administración Tributaria "SAT"), to correct the irregularities or detract the causes leading to such cancellation.

The following day to the filing of the clarification application, the authorities shall reinstate the use of the digital seal.

Tax authorities shall solve the clarification application within 10 days' period, counted as of the day following the submission of such application or as of the date on which the information requirements issued during the procedure, are domiciled.

Until the resolution of such procedure is issued, the tax authorities shall allow the use of the digital seal for the online issuance of digital tax invoices.

The tax authorities shall issue a resolution voiding the digital seal certificate to the extent that, after the review of the clarification application, it is determined that the irregularities were not clarified or if the causes leading to the provisional restriction of the digital certificate, were not detracted.

It is our opinion that the cancellation process of the digital seal certificates violates the due process of law (garantía de audiencia) of the taxpayer, inasmuch that, prior to being able to make a statement or submit evidence, there is a temporary restriction in the use of said certificates.

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The aforementioned may seriously lessen taxpayers given that, during the period of the temporarily restriction and reinstatement, the taxpayers will not be able to issue digital invoices, which can hinder their operation, even damaging their employees.

Likewise, the law does not explicitly establish any consequences in case the authorities fail to notify its resolution within the aforementioned ten days' period. Even if it can be presumed that the taxpayer can continue to use his/her/its certificate, the lack of consequences leads to legal uncertainty.

Furthermore, the scenarios which may cause a restriction and subsequent voidance of the certificates, also place the taxpayers in a state of legal uncertainty and violates the right to be heard and the due process of law.

Specifically, with respect to taxpayers who may have had transactions with a taxpayer published in the list referred to in the fourth paragraph of article 69-B, the authority may restrict the use of the certificate without allowing the affected taxpayer to detract the supposed irregularities, inasmuch the only procedural opportunity established by law to demonstrate the materiality of transactions is within the thirty days' term set forth in the eighth paragraph of the aforementioned article.

In this sense, the only mechanism for the taxpayer to reactivate his/her/its certificates, is through the self-correction mechanism by reverting the effects given to the corresponding tax returns.

Thus, in case the taxpayer intends to contest the resolution imposing the cancelation of his/her/its digital seals by the authority, the taxpayer will not be able to use them during the procedure inasmuch the Mexican Supreme Court of Justice has ruled that in such case, there is no suspension of the effects of the contested act or resolution.

C. Tax E-Mailbox

The third and fourth paragraphs of article 17-K are added to establish that, if a taxpayer does not enable his/her/its tax e-mailbox, or if the taxpayer provides false or non-existent contact information, the authority may notify the taxpayer through a public notice (estrado).

D. Joint and several liability

Section III of article 26 is amended so liquidators be jointly and severally liable for the taxes incurred by the companies while they hold their offices, if for any reason or circumstance the companies do not comply with their tax obligations.

Likewise, the second paragraph of section III, and sections X and XVII are amended to establish that directors, managers, administrators, partners, shareholders and associates shall be jointly and severally liable of the companies in which they hold offices, in the following scenarios:

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- The company did not apply for its RFC.

- When the authorities conduct their tax review, or after a tax credit has been notified, if the taxpayer changes his/her/its domicile without filing the corresponding notice.

- The company does not have bookkeeping, hides it or destroys it.

- The company vacates its tax domicile without filing notice.

- The company is not located at the domicile registered on the RFC files.

- The company fails to pay, within the legal term, withheld or collected taxes.

- The company did not detract the presumption of having issued invoices supporting non-existent operations.

- The company does not evidence the actual transactions supported by the digital tax invoices and to which tax effects have been given, for an amount exceeding $7,804,230.00.

- The company has illegally transferred tax losses.

Considering the purpose of this reform, it does not seem adequate since its target was to attack companies issuing invoices supporting non-existent transactions, but it is affecting liquidators of all taxpayers, even those that do comply with their tax obligations.

It is our opinion that the joint and several liability of these officers should have been subject to the same conditions as that of the partners, shareholders and associates.

E. Registration in the Federal Taxpayers' Registry (RFC)

Article 27 is amended to identify those having the obligation to be registered in the RFC, their obligations and the functions of the tax authorities thereof.

Such article is divided into four sections, where those having obligations to file notices before the RFC are identified. It also includes the list of general obligations such subjects are bound to, the rights of the tax authorities and other special cases.

Besides the existing obligations regarding registration of taxpayers in the RFC, as well as the obligation to file for their e-signature and to provide several information for their identification, new obligations are added.

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Amongst the most relevant, public notaries before whom notarial instruments containing the incorporation, merger, spin-off or liquidation of companies are granted, shall evidence that the taxpayers file the corresponding notices according to the FTC and its Regulation.

Furthermore, it is set forth that the SAT has the right to conduct the necessary verifications to confirm the domicile, identity and veracity of the information filed before the RFC by the taxpayer, as well as the information filed in the taxpayers' returns and digital tax invoices. This, inter alia, to certify that those taxpayers are not entities issuing invoices for non-existent transactions.

F. Taxpayers' information

Article 31-A is amended to establish the taxpayers' obligation to quarterly file information with respect to the following transactions:

- Derivative transactions or financial transactions related to an underlying asset not listed in an exchange.

- Related parties transactions.

- Those related with the participation in the capital stock of companies and related to changes in tax domiciles.

- Those related to reorganizations and corporate restructures.

- Those related to, inter alia, the transfer of title and contribution of financial goods and assets, tax losses, capital reimbursements, payments of dividends.

G. Obligations of financial institutions and savings and loan cooperatives

Section V of article 32-B is amended to establish the obligation for said entities to collect e-mail, telephone number or any other means of electronic contact information determined by the SAT from their account holders, as well as the obligation to deliver that information to any tax authority so requiring it.

H. Private parties banned from relationships with governmental agencies

The scope of article 32-D is extended with the purpose of forbidding entities, individuals and companies who handle public federal resources to enter into agreements with taxpayers: not located at their tax domicile, that have been subject to a tax related final conviction, whom are considered to have issued tax invoices supporting non-existent transactions, whom illegally transferred tax losses, whose statements and declarations do not match the information held by the authorities.

Furthermore, tax incentives or subsidies will not be available for those incurring in in any of the aforementioned conducts.

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Likewise, companies listed in the stock exchange shall obtain, on a monthly basis, their favorable tax compliance opinion.

I. Penalties for Registered Public Accountants

Sections b) and c) of the second to last paragraph of article 52 are amended in order to correctly and precisely establish the timeframe during which the tax authority may issue penalties to Registered Public Accountants.

This corrects the error in the current law which led the Mexican Supreme Court of Justice to rule these provisions as unconstitutional.

J. Tax secrecy

New sections are added to the twelfth paragraph of article 69 to establish new scenarios in which the reservation of taxpayers' information is inapplicable, specifically, as follows:

- Authorities, entities, individuals or companies receiving and managing federal public resources failing to submit their tax returns.

- Public companies listed in the stock exchange market or the over-the-counter market when they have not obtained their favorable tax compliance opinion.

- Taxpayers giving tax effects to tax invoices supporting non-existent transactions and who have not been able to verify their materiality within the term established on article 69-B.

K. Third party tax collaborator

A new article is added - 69-B Ter – pursuant to which the third party tax collaborator is introduced so that tax authorities can collect additional information to identify potential issuers of tax invoices supporting non-existent transactions.

As a result of the foregoing, the third party tax collaborators may participate in the tax lottery as an incentive.

L. Tax off setting

The first paragraph of article 23 is amended in order to eliminate the universal off setting.

Now, taxpayers may only compensate their credit balance against tax balances derived from the same tax, and only with respect to his/her/its own debts.

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M. General anti-avoidance rule

Article 5-A is added allowing tax authorities, conducting a tax review, may be ignore the tax effects of legal acts lacking a business purpose and creating a tax benefit for the taxpayer.

This is a general anti-avoidance rule whereby authorities will be able to attribute the corresponding tax effects to the reasonably expected taxpayers' benefit from such legal acts.

In this sense, based on the facts and circumstances which the authority discovered during its tax review and from the assessment of such information and documents collected during said review, it may presume that one or more legal acts lack a business rationale (the business purpose test).

Prior to the issuance of the last partial minute, the observations letter or the corresponding preassessment, the tax authority shall submit the case before a committee integrated by officers from the Ministry of Finance and Public Credit ("SHCP") and the SAT, to obtain a favorable opinion to re-characterize one or more legal acts, in accordance with such article.

This means that tax authorities will only be able to presume that a legal act lacks a business rationale and, therefore, tax effects of a different act may be attributable if the committee so expressly resolves it.

In case such committee does not issue its opinion within two months, it will be understood that such opinion is negative and, therefore, the authority will not be able to ignore the tax effects of said act.

It is noteworthy mentioning that, as part of the authority's tax review, it shall inform the taxpayer, through the last partial minute, the observations letter or the corresponding preassessment, about the presumption that one or more legal acts lack a business rationale. This, so the taxpayer may provide, if so desired, arguments and evidences in such regard.

It is presumed that an action lacks a business purpose when the reasonably expected quantifiable economic benefit is less than the tax benefit obtained, or when the reasonably expected economic benefit may be achieved through less legal acts, and the tax effects of such acts would have been more burdensome.

In this regard, a tax benefit is any reduction, elimination or temporary deferral of a contribution, including, inter alia, those arising from deductions, exemptions and non-subjection.

A reasonably expected economic benefit is deemed to exist when, inter alia, the taxpayer's transaction seeks to generate income, reduce costs, increase the value of goods and assets, improve the taxpayer's position in the market.

In regard to such provision, section VII of article 46-A is also added, to establish that the statute of limitation to conclude a domicile review or cabinet review may be suspended for a term not exceeding two months, when the authority requests a favorable opinion to the committee.

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Finally, it is set forth that the application of this article will not have any criminal consequences.

In our opinion, this general anti-avoidance rule may lead to legal uncertainty to the taxpayer, since the conditions to determine whether a transaction lacks a business rationale are ample and vague; furthermore, the reasonably expected economic benefit of a transaction may not be immediately materialized or may not even materialized, but may rather have plain corporate efficiency reasons.

By being a general anti-avoidance rule, it should not sanction those actions or businesses not intending to avoid the application of a tax law, beyond the economic result of its implementation.

The structure and content of such rule is censurable since its effects are materialized considering the tax benefit obtained, in contrast to the reasonably expected economic benefit, without considering the taxpayer's intent to obtain such economic result, while eluding the application of tax Law, which is indirectly violated.

Article 5-A includes a series of presumptions from which it can be attributed that an action or series of actions lack a business rationale, by comparing the tax benefit and the expected economic results, which we insist does not imply an intent on behalf of the taxpayer to avoid the effects of the tax law. The thresholds for determining and quantifying the tax and economic benefits are uncertain and may even not correspond to an economic reality or business purpose.

Therefore, the exercise of the authority's right may be abusive in connection to the purpose of a "general anti-avoidance rule", which should be analyzed on a case by case basis.

N. Revelation of reportable schemes

Title Sixth is added to the FTC, establishing rules pursuant to which tax advisors and/or taxpayers shall disclose the tax structures they intend to implement.

The purpose of said rule is for tax advisors to provide information to the tax authorities on matters and operations identified as risky transactions, regarding aggressive tax strategies.

Information shall be delivered prior to the implementation of the strategy, allowing the authority to identify the users and promoters of said strategies and, thus, identify which structures are trying to take advantages of the tax system gaps.

A tax advisor is considered to be any individual or company that in his/her/its ordinary course of business, provides tax advisory and is responsible for, or involved in, the design, commercialization, organization, implementation or administration of the entirety of a reportable scheme, or who provides a complete reportable scheme to a third party for its implementation.

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A reportable scheme is defined as any plan, project, proposal, advice or recommendations given verbally or in written, aiming to materialize a series of legal actions from which a tax benefit will be obtained in Mexico.

A tax benefit is deemed to be any reduction, elimination, or temporary deferral of a contribution, including, inter alia, those generated by deductions, exemptions and non-subjections.

The tax advisor has the following obligations:

- Disclose the reportable schemes in which he/she/it participates.

- File an informative statement in February of every year, identifying all the taxpayers he/she/it advised.

- If the scheme was non-reportable or there were any legal constraints to disclose it, the tax advisor has an obligation to issue a certificate to the taxpayer detailing the reasons for it.

It is mentioned that the revelation of reportable schemes does not constitute a violation of professional secrecy.

If several advisors are bound to disclose a reportable scheme, the obligation is deemed fulfilled when one of them files the information on behalf of all advisors.

Likewise, if an individual provides tax advisory through a company, he/she will not be bound to disclose the schemes in which he/she participates, if the company discloses the structure.

The following are violations committed by tax advisors:

- Refrain from disclosing a reportable scheme, report it incomplete or with errors, or to do it out of the time frame, except if it was made in a spontaneous manner.

- Refrain from disclosing a generalized scheme that was not implemented.

- Refrain from providing the identification number of the reportable scheme of the taxpayers.

- Refrain from responding requests for information issued by the tax authority or to misrepresent that they do not have such information.

- Failure to issue the corresponding certificates.

- Refrain from informing the SAT of any change taking place after the revelation of the reportable scheme.

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- Failure to file the informative statement specifying the advised taxpayer's information.

Taxpayers are bound to disclose reportable schemes in the following cases:

- If the tax advisor does not provide the identification number of the reportable scheme issued by the SAT, nor the certificate appointing that said scheme is non reportable.

- When the reportable scheme was designed and implemented by the taxpayer.

- In case the reportable scheme was designed and implemented by a third party who is not considered a tax advisor.

- In case the tax advisor is a resident of another country and does not have a permanent establishment in Mexico.

- When there is a legal impediment for the tax advisor to disclose the reportable scheme.

- When there is an agreement between the tax advisor and the taxpayer whereby the latter is bound to disclose the reportable scheme.

The following are violations committed by taxpayers in connection with the disclosure of reportable schemes:

- Failing to disclose a reportable scheme, to disclose it incomplete or with errors.

- Refrain from including the identification number of the reportable scheme in his/her/its tax return.

- Refrain from responding requests for information issued by the tax authority or to misrepresent that they do not have such information.

- Refrain from informing the SAT of any change taking place after the revelation of the reportable scheme.

Article 199 lists the areas representing a risk identified by the authority, in which there is an obligation to report schemes intended to obtain the benefits therein established.

In our opinion, the most relevant are the following:

- Avoids the exchange of tax or financial information with foreign authorities.

- Avoids the application of income rules from preferential tax regimes, foreign legal entities or transparent tax entities.

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- Has the purpose of transferring losses to persons other than those generating them.

- Consists in a series of payments or related actions, whereby the first payment is fully or partially reimbursed to the person making such payment or to a related party.

- Seeks the application of a treaty to avoid double taxation, when there is actually not double taxation.

- Involves carrying out transactions with related parties, which are difficult to valuate or where there are non-reliable comparable, implying a corporate restructure or legal acts without compensation, or using a unilateral protection regime.

- Avoids the creation of a permanent establishment.

- A totally or partially depreciated asset is transferred, so that a related party can depreciate it again.

- Involves a hybrid mechanism.

- Involves carrying out transactions to generate tax profits that can be applied towards soon-to-expire tax losses, to the extent those transactions generate an authorized deduction.

- Avoids the application of an additional 10% rate pursuant to articles 140, 142 and 164 of the ITL.

- Consists in the granting of temporary use or possession of a good and the lessee, in turn, grants such rights back to the lessor or to a related party.

- Transactions with accounting and tax records with differences of more than 20%.

Two types of reportable schemes are foreseen (i) generalized, when they aim to be commercialized to all types of taxpayers, or to a specific group of taxpayers; and (ii) personalized, when they are designed, commercialized and implemented according to the specific circumstances of each taxpayer.

The law clearly establishes that the disclosure of a reportable scheme does not imply the authority's acceptance or rejection of its tax effects.

The information submitted to the tax authority for the disclosure of a reportable scheme, shall not be used by said authority as a precedent to investigate potential tax felonies, except for those related to the issuance of tax invoices supporting non-existent operations.
In such respect, article 42, first paragraph is also amended and section XI is added in order to provide the SAT the right to verify the compliance by the tax advisors of said obligations.

Likewise, sections I and VI of article 49 are amended to establish the rights of the tax authority to execute their tax reviews in the modality of a domicile visit (visita domiciliaria) to tax advisors.

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Furthermore, it is also set forth that the SHCP will establish the minimum amounts of economic benefits that a scheme should generate in order for it to be disclosed pursuant to the foregoing.

Finally, the period to comply with the disclosure obligations will commence as of January 1, 2021; however, the schemes generated in 2020 will be subject to disclosure.

Likewise, taxpayers shall be the only subjects obliged to disclose a reportable scheme if same are designed, organized, commercialized, implemented or managed prior to 2020, to the extent their tax effects are reflected in subsequent years.

Penalties to tax advisors can be up to $20,000,000.00 MXP when the schemes are not disclosed or when the disclosures are incomplete.

On the other hand, penalties for taxpayers failing to disclose a scheme or doing so incompletely, will range between 50% and 75% of the tax benefit obtained or expected, during all involved fiscal years.

It is our opinion that this obligation for tax advisors violates the professional secrecy these advisors should keep, notwithstanding the established on the law.

It is also questionable the lack of specification with respect to the use given by the authorities to the information submitted by the tax advisors, inasmuch there is not an established process whereby the authority informs the taxpayer and the tax advisor whether the reported scheme is considered legal or not.

In this sense, considering article 5-A, we can conclude that the information related to the reportable schemes will be used by the authority within its tax review functions and, in any case, the legal actions will be submitted to the committee which will determine if they have a business rationale or not.

This implies that the taxpayer will not be forbidden from implementing the reportable scheme, being subject to the tax review by the authority, and, if any, the determination of omitted contributions.

O. Self-correction Period

Those persons that, prior to the 2020 fiscal year had given effect to invoices issued by a taxpayer listed in terms of article 69-B and had not evidence the actual acquisition of goods or services covered by such invoices, within the thirty days' period set forth in such provision, may correct their tax status before March 31, 2020 through submitting complementary tax returns.

This transitory provision is relevant inasmuch that, failing to correct its tax status, the taxpayer will face formal infractions and the use of its digital seal certificate may be restricted or such certificate may be cancelled pursuant to articles 17-H and 17-H Bis.

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In our opinion, this provision violates the right to be heard and the due process of law, inasmuch it bounds the taxpayers to correct their tax status and, if any, pay the differences resulting thereof, even when the transactions evidenced by the invoices were real.

I.e., the taxpayer will not have the opportunity to evidence the correct acquisition of goods and services for purposes of not incurring in a penalty and being subject to the digital seal certificate cancellation procedure.

2. INCOME TAX LAW

A. Permanent establishment

Articles 2 and 3 are amended to determine that a person residing abroad shall have permanent establishment when he/she/it carries out transactions through an individual or entity (other than an independent agent) to the extent said person usually executes agreements or performs the main role leading to the execution of agreements, entered into by the foreign resident.

There is a permanent establishment if such agreements are executed in the name of, or on behalf of, the foreign resident, if they imply the transfer or granting of temporary use or possession of his/her/its assets upon of which he/she/it has the temporary use or possession, or if it mandates the foreign resident to render a service.

A presumption is added, establishing that an individual or company is not an independent agent when he/she/it acts exclusively, or almost exclusively, on behalf of foreign residents who are related parties.

With respect to activities that are not deemed to create a permanent establishment (storage, exhibition, transformation of merchandise, advertisement, supply of information or scientific research, among others), such exceptions are conditioned if the activities are preparatory or ancillary.

A permanent establishment is deemed to exist, notwithstanding that the activities carried out, by themselves, would not create a permanent establishment, when such activities are jointly deemed to be a cohesive business transaction, and are not preparatory or ancillary in nature.

The proposed amendments derive from action 7 of the BEPS Project, by means of which the concept of permanent establishment was reviewed to establish new scenarios related to strategies related to fighting tax evasion.

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B. Fiscal transparent and foreign disregarded entities

a. Taxation of foreign fiscal transparent and disregarded entities

Article 4-A of the ITL is added to establish that foreign transparent fiscal entities and foreign disregarded entities, regardless of their fiscal regime and that of its partners in their country of residence, shall pay the corresponding taxes as companies for purposes of the ITL.

If the management of the business or its headquarters are in national territory, they shall be considered Mexican residents.

As such, for purposes of the ITL, these entities shall not be considered as transparent legal entities.

According to article 4-A, companies and other entities incorporated under international law shall be deemed foreign legal entities if they have their own legal personality, as well than those companies incorporated under Mexican law that are residents abroad.

Trusts, associations, investment funds and any other similar foreign entity are foreign disregarded entities, to the extent they do not have their own legal personality.

Such foreign legal and disregarded entities are deemed to be fiscally transparent, when they are not tax residents for purposes of the ITL in the country or jurisdiction where they were incorporated, nor where they have their business management or headquarters and its income is attributable to its members, partners, shareholders or beneficiaries.

These rules will not be applicable if there is a Double Taxation Treaty with the country in which they reside or where they were incorporated. In such case, the international treaty shall remain applicable.

According to this article, foreign transparent fiscal entities and foreign disregarded entities shall not be regulated according to preferential fiscal regimes provisions (Title VI of the ITL).

This new rule is a control mechanism for these types of entities, so they are taxable in Mexico as companies under their applicable Title of the law.

Article 4-A shall be effective as of January 1, 2021.

b. Income from foreign transparent fiscal entities and foreign disregarded entities

The addition of article 4-B establishes a plan to regulate income obtained by residents in Mexico and foreigners with a permanent establishment in the country, by means of transparent foreign entities or foreign disregarded entities.

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If the income is from a transparent foreign entity, the tax profits of said entity shall be calculated, according to Title II of the ITL and the taxpayer shall accrue the corresponding amount, according to its participation in such entity.

If the income is from a foreign disregarded entity and said entity is transparent for tax purposes, the taxpayer shall accrue the income in terms of the corresponding Title of the ITL.

If the foreign disregarded entity has tax residency, whether it be in Mexico or abroad, the income will correspond to the tax profit of the entity, calculated pursuant to Title II of the ITL.

The provisions of such article will only be applicable if the residents in Mexico have a direct participation in these types of entities, or if they hold an indirect participation through other transparent fiscal foreign entities or foreign disregarded entities.

In case the indirect participation involves an entity considered non-fiscally transparent, the income shall be subject to, and shall pay, taxes according to the Chapter regulating preferential tax regimes, i.e., through an anticipated accumulation.

Likewise, it is established that such income shall be considered as directly generated by the taxpayer; the taxes paid by or through foreign disregarded entities shall be deemed to be directly paid by the taxpayer, in the same proportion as to the corresponding accumulated income.

If the income of the transparent fiscal entity or foreign disregarded entity are subject to income tax and such tax was paid in terms of article 4-A, such amount may be entirely credited considering the same proportion in which the income was previously accumulated.

The purpose of the aforementioned is to avoid double taxation by applying article 4-A (taxes upon entities and disregarded entities) and 4-B (taxes upon its members).

As for individuals who are members of an entity, the purpose is for them to pay only the income tax regarding the differential between the ITL rates, i.e., 30% corresponding to entities and 35% to members.

As it can be appreciated, articles 4-A and 4-B conform a complementary system of rules that shall be understood jointly.

The regime established in this article is applicable even if the entity has not delivered the income to the taxpayer; furthermore, the accounting of the entity shall be made available to the tax authority so that the expenses or investments deductions can be used.

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c. Crediting of income tax paid abroad

The last paragraph of article 5 is added with the purpose of not recognizing the crediting of income tax paid abroad, when such tax has been credited in another country or jurisdiction, if such benefit was taken for a reason other than the indirect crediting of the tax for distribution of profits.

Likewise, the crediting of the income tax paid abroad for the payment of dividends or profits is forbidden if such are deductible by whoever makes the payment.

The proposed reforms derive from action 2 of Project BEPS.

d. No deduction of payments made to preferential tax regimes by means of structured agreements and hybrid mechanisms
In terms of article 28 section XXIII, payments to related parties or through a structured agreement shall not be deductible, when the income of the counterparty is subject to a preferential tax regime.

If the counterparty's income is not subject to a preferential tax regime, but the direct or indirect recipient of such income makes a further deductible payment to other members of the group, or by virtue of a structured agreement, in such a manner that it becomes an income subject to a preferential tax regime, such expenditure shall not be deductible.

I.e., when the payment is made first to an entity which, in turn, makes another payment to a third related party whose income pays taxes according to a preferential tax regime.

The foregoing is applicable even when the recipient makes the referred payment prior to receiving the payment from the taxpayer, this is assumed when the payments made by the recipient are equal or higher than 20% of the payment made by the taxpayer; the foregoing is applicable to related parties transactions or through structured agreements transactions.

A structured agreement is deemed as any agreement in which a taxpayer or any of its related parties participate and the compensation depends upon payments made to preferential tax regimes favoring the taxpayer or any of its related parties, or when based on the facts or circumstances it can be concluded that the agreement was made for this purpose.

The limitation established on this section shall not be applicable when payments considered income subject to preferential tax regimes derive from the business activity of its recipient, to the extent it can evidence that it has the staff and assets necessary for the performance of such activity, and resides in a country or jurisdiction that has an agreement for vast exchange of information with Mexico; i.e., when the substance of the recipient of the income is evidenced, which matter that has been amply sought by the tax authority exercising its tax review authorities.

The exception set forth in the previous paragraph shall not be applicable if the entity receiving the

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payment is incorporated as a hybrid mechanism and, therefore, the income is considered to be subject to a preferential tax regime.

For these purposes, there will be a hybrid mechanism when the Mexican and foreign legislations treat differently a company, a disregarded entity, an income or a payment, resulting in a deduction in Mexico and in the payment not being subject, totally or partially, to pay taxes abroad.

e. No deduction of payments which are deductible for its recipient

Section XXIX of article 28 is amended to forbid deduction of payments made by taxpayers, which in turn are deductible for a member of the same group and, as of 2020, also for the taxpayer in a country or jurisdiction where the taxpayer is also considered a tax resident.

In case the taxpayer is a permanent establishment of a foreign resident, payment will not be deductible if it is also deductible for the headquarters in the country or jurisdiction of its tax residence.

Payment shall be deductible to the extent the other member of the group or headquarters for whom payment is deductible, accrue the generated income by the taxpayer in the corresponding proportion to its participation; for the taxpayer itself, the payment shall be deductible if the taxable income in Mexico is also taxable in its tax residence.

In any case, payments made to the aforementioned persons shall not be deductible if such payments are higher than the amount of income accrued by its recipients (only with respect to the surplus).

C. Limitation to the deduction of interest

Section XXXII to article 28 of the ITL is added to establish that net interests of the fiscal year exceeding the amount resulting from multiplying the adjusted net tax profits by 30% shall not be deductible.

It is noteworthy to inform that this law will be applicable to all interests paid by taxpayers, without distinguishing if the recipient is a related or an independent third party, or if it is a Mexican resident or not.

Such limitation shall only be applicable to taxpayers whose accrued interest expense during the fiscal year exceed $20,000,000.00 pesos; this amount shall be divided between the members of the group or related parties (including permanent establishments of foreign residents), in proportion to the previous fiscal year's income.

Net interest of the fiscal year will be equal to the amount of the total due interest from the taxpayer's debts less the total income for accrued interests and the amount mentioned in the previous paragraph.

The adjusted net tax profits shall be the equal to the tax profits calculated pursuant to section I of Article

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9 of the ITL, plus the total due interest from the taxpayer's debts and the total deducted amount in the fiscal year for investments and expenses during a pre-operative period.

The adjusted net tax profits shall be determined even if there is no tax profits or it results in a tax loss for the fiscal year.

In case of tax loss, its amount shall be subtracted from the aforementioned concepts (interest expense, deductions for investments and expenses during a pre-operative period).

If the amount of the adjusted net tax profits is zero or a negative number, the deduction of the total interest expense of the taxpayer shall be denied, except for the amount of $20,000,000.00 pesos.

The limitation to the deductibility of interest expense shall only be applicable when the non-deductible amount is higher than the amount that is non-deductible for the application of the rule of thin capitalization referred to in the ITL.

Non-deductible interest shall be equal to the net interests of the fiscal year less an amount equivalent to 30% of the adjusted net tax profits. If the result of this calculation is zero or a negative number, the deduction for the total accrued interest expense of the taxpayer shall be allowed.

Non-deductible net interests of the fiscal year may be deductible during the following 10 fiscal years to the extent they are added to the net interest expense of the following fiscal year.

FX profits or losses accrued by the fluctuation of foreign currencies shall not be treated as interest expense, unless they derive from an instrument which yield is considered an interest.

The deduction of interests shall not be limited to interest deriving from acquired debt to finance public works, constructions, hydrocarbon related projects, extractive industry related projects, electricity and water related projects, as well as yields of public works.

This section will not be applied to Companies that are part of the financial system, regarding the performance of their core transactions.

This provision shall be applied in a consolidated manner, with respect to companies of the same corporate group.

We consider this provision will affect taxpayers who require to finance operations through debt, and will limit the deduction of a strictly indispensable expense for the development of projects and for the mere survival of the company.

In our opinion, it is a disproportionate measure that is far from ideal to fight tax evasion practices; but, on the contrary, it grants a differentiated, unjustified and disproportionate treatment which turns it unconstitutional.

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Furthermore, there are several elements that directly impact for determining the non-deductible interest and are not properly defined in the law, such as the concept of "instrument which yield is considered an interest", for purposes of the tax treatment of FX variations.

Likewise, the $20,000,000.00 MXP threshold of deductible interest expense and its distribution among members of the same group, considers an alien element for its attribution, such as the income of each company, which places it in an unequal and unfair situation before other taxpayers.

Finally, from our perspective, the ten-year term and other rules of future application of non-deductible interest expense, as well as the list of activities not subject to this provision, may be questioned from a constitutional perspective.

D. Outsourcing

For the deduction of expenses made for labor outsourcing, the requirement of obtaining tax invoices for salaries paid, the declaration of tax withholding payments and the payment of duties for employer/employee contributions to the Mexican Social Security Institute by the contractor, is eliminated.

The requirement for the deduction shall be to comply with the obligation of withholding and paying the VAT applicable for the rendering of services, or in its case, to collect from the service providers, proof of payment of such taxes.

E. Income for rendering services or transferring goods through IT apps

Section III of Chapter II of Title IV is added to regulate income obtained by individuals for transferring goods or rendering services through internet, technology platforms, apps and other similar means.

Individuals shall pay income tax through a withholding scheme for the total income actually earned, as well as for the payments received for any additional concept, without including VAT.

Companies residing in Mexico, residing abroad with or without permanent establishment in the country, foreign disregarded entities or other entities providing the use of platforms, technology apps or other similar means shall withhold taxes, pursuant to the rates set forth in article 113-A.

Individuals may consider that the referred withholdings are definite payments, when the income in the previous fiscal year does not exceed $300,000.00 MXP, besides complying with the requirements set forth in article 113-B.

Individuals shall provide to companies residing in Mexico or abroad with or without permanent establishment in the country, as well as foreign disregarding entities providing the use of said technology platforms, apps and similar means, the following information pertaining to his/her name, business name, CURP (Unique Population Registry Code), RFC, tax domicile, among others.

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Failing to provide such information will cause the withholding to be 20% of the gross income.

Article 113-C provides a series of obligations for said companies, such as:

- Foreign residents without permanent establishment in the country, as well as foreign disregarded entities shall comply with the obligations set forth in articles 18-D and 18-J of the VATL (explained below).

- Deliver a digital tax invoice through internet to individuals for the withholdings made.

- Deliver to the SAT the information pertaining to the individuals who, through its platforms or apps, transfer goods, render services or grant a temporary use or possession of goods.

- Withhold and pay the corresponding income tax.

Non-compliance of the aforementioned obligations by foreign residents without permanent establishment in the country and foreign disregarded entities will cause the same consequence set forth in article 18-H of the VATL (which is explained below).

F. Controlled foreign corporations subject to preferential tax regimes

Several provisions of Chapter I of Title VI are amended, specifically articles 176 and 177, pertaining to income obtained through controlled foreign corporations subject to preferential tax regimes, in order to address the recommendations of the Final Report of Action 3 of Project BEPS and to clarify certain provisions that have caused confusion in its interpretation.

Substantially, the rules to determine in which cases a Mexican resident for tax purposes has control over a corporation subject to a preferential tax regime are amended, since now there is not an automatic reference to the related parties' rules.

As of 2020, it shall be considered that a taxpayer has effective control over the corresponding foreign corporation, when it holds more than 50% of the value of shares, over than 50% of the voting rights, veto power or casting vote, as well as the right to unilaterally make decisions; or when it has right to more than 50% of the assets or profits of the entity upon liquidation or capital decrease; or when the financial statements are consolidated.

Income is deemed as subject to a preferential tax regime when such income is not taxable abroad or when it is, but with an income tax lower than 75% (equivalent to a 22.5% rate) of what would have been paid in Mexico for such income.

For these purposes, the profit or loss generated by all operations made by each foreign corporation in which the taxpayer participates, shall be considered; if it has participations in two or more residents

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of the same country or jurisdiction and they consolidate their financial statements, the determination may be made in a consolidated manner.

Likewise, all income tax paid by the foreign corporation shall be considered, being in its country of residence or a different one, as well as any of the corresponding levels of government; for these purposes, the income tax shall not be considered as paid if it was credited with another income tax or fiscal incentives.

If the foreign corporation which income is subject to a preferential tax regime is distributed to other foreign corporation, the income tax can be deemed paid by the second entity, for the previous purposes.

Therefore, the tax paid by the foreign corporation shall not be compared to that which would have been triggered or paid in Mexico; on the contrary, the comparison shall be made according to the rate established in Article 9 of the ITL (companies) or the maximum rate established in article 152 (individuals).

The exception for not considering income from royalties as subject to a preferential tax regime, is eliminated.

G. Income from leases

A second paragraph to article 118, Section III is added, related to the obligation to issue tax invoices to individuals obtaining income from the lease of real properties.

In such paragraph, it is established that upon a lease proceeding whereby the lessee is imposed to pay overdue rents, the judge will require the lessor to prove that he/she has issued the corresponding tax invoices.

In case of not being able to confirm the issuance of said invoices, the judge shall inform SAT of such omission.

In this manner, imposing resolutions to a lessee is conditioned to the fact that the lessor has issued tax invoices, as a measure to prevent tax evasion for this type of income.

Furthermore, according to the National Assets Forfeiture Law (Ley Nacional de Extinción de Dominio), good faith in the lease of real properties shall be proved to the extent it can be evidenced that taxes derived from this act were paid, for which it is necessary to have the corresponding tax invoices.

H. Maquiladora Shelter Program ("IMMEX")

The rules applicable to the IMMEX Program in the modality of shelter are amended, as provided in article 183, in order to consider that foreign residents providing raw materials, machinery and equipment for conducting manufacturing activities under the modality of shelter, shall not be deemed as permanent

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establishment, to the extent the foreign resident is not a related party to the company that has an IMMEX Program.

For it not to be considered as a permanent establishment, the resident abroad shall, through the resident in Mexico with whom it carries out such activities, request its registration before the RFC, file its provisional and annual tax return and an informative return for its manufacturing activities, as well as filing a notice when such activities cease.

Article 183-Bis is added to establish the requirements that companies that have the IMMEX Program under the modality of shelter should comply with, so that the rules of article 183 become applicable; specifically, the tax profit of each of the residents abroad with whom they have manufacturing operations should be determined and to have the information corresponding to each one of those residents available for the authorities.

I. Elimination of private REITS ("FIBRAS")

Section V of article 187 which regulates Real Estate and Infrastructure Trusts (FIBRAS) is amended so that their participation certificates can only be placed among public investors.

Thus, private FIBRAS are eliminated.

In the transitory provisions of the ITL it is established that the settlors who have contributed their real estate property to a trust, shall accrue their profits for the transfer of such property, when they transfer the certificates obtained from such contribution, or when the trust transfers the contributed property; the foregoing, in both scenarios, to the extent the profits have not been previously accumulated.

If as of December 31, 2021 neither of the aforementioned scenarios have occurred, the settlors shall have to accrue their profits for the contribution of their real estate property to the trust.

In our opinion, this transitory regime may be deemed as violating the fundamental non-retroactivity right, and it might be appealed through an amparo proceeding.

J. Tax incentive applicable to foreign legal entities

Article 205 provides a tax incentive for transparent foreign legal entities managing private equity funds investing in companies residing in Mexico, consisting in considering them transparent for purposes of the ITL, to the extent they comply with all the requirements set forth in such article.

Such incentive shall be applicable only for the income obtained from interest expense, dividends, capital gains or the lease of real estate property.

Partners of such entities shall pay taxes according to the applicable ITL provided that it can be a Mexican or foreign resident with or without permanent establishment.

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3. VALUE ADDED TAX LAW

A. VAT withholding on labor outsourcing payments

A new VAT withholding item is added to article 1-A of the VATL, so that whoever receives labor outsourcing services, withholds and pays the transferred VAT pursuant to a 6% rate on the value of the compensation paid for such services.

Outsourcing services referred to in the new provision are those by means of which personnel working in facilities or even outside the facilities, are made available to the contracting party, whether the employees are or not under their direction, supervision, coordination or dependency.

In this sense, if the taxpayer fails to withhold and pay the corresponding tax withholdings, it will be jointly and severally liable for such VAT, besides the fact that it will not be able to credit the input VAT nor deduct the expense for purposes of the ITL.

With this, it becomes evident that labor outsourcing services are subject to taxes, contrary to the ruling of the Third Circuit Administrative Tribunal, in jurisprudence PC.III.A. J/18 A (10a.).

B. VAT Withholding for digital services

Article 1-A Bis is added with a new obligation for Mexican residents providing intermediation digital services in a goods or services marketplace, to beneficiaries of those goods or services located in Mexico.

Such obligation consists in withholding VAT for those transferring goods or rendering services or those granting the temporary use or possession of a good, in the terms and proportions set forth in article 18-J.

C. Favorable balances off-setting

Article 6 is amended to establish that the VAT favorable balances shall only be off set against the tax for subsequent months, or a request for refund can be made.

With this, the possibility to off-set such balances against other taxes owed is eliminated, following the amendment to article 23 of the FTC.

D. Digital services provided by foreign residents without an establishment in Mexico

Chapter III Bis is added to establish the regime applicable to rendering digital services in Mexico by foreign residents abroad without a permanent establishment.

The rules applicable to these activities are, substantially, the following:

a. Purpose of the tax

According to article 18-B, the digital services that are subject to the VAT, as long as a consideration thereof is charged, are the following:

- Downloading multimedia audiovisual contents, except for books, newspapers and magazines.
- Intermediation of third parties offering and receiving goods or services, with the exception of the transfer of used goods.
- Online clubs and online dating services.
- Long distance education or exercise tests.

b. Criteria to consider that the recipient of the service is located in Mexico

According to article 18-C, it is considered that the recipient of the service is in Mexico and, therefore, the service is rendered in Mexican territory, when:

- The recipient has provided the service provider with a domicile in Mexico.
- The recipient has made the payment through an intermediary located in Mexico.
- The IP domicile used by the devices of the recipient corresponds to those assigned to Mexico.
- The recipient has provided the service provider with a Mexican telephone number.

c. VAT transfer and payment and other obligations

Foreign residents without a permanent establishment in Mexico rendering digital services to users located in Mexico shall transfer the tax, charge the corresponding amounts and pay it to the tax authorities.

For such purposes, they shall comply with other obligations, such as:

- Being registered in the RFC.
- Offer and charge VAT jointly with the services price.
- Provide on a quarterly basis to the SAT the number of transactions made with the recipient of the service.
- Calculate the VAT applying a 16% rate only for their corresponding digital services, when they are

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rendered jointly with other services that are not subject to the tax. When it is not possible to differentiate the services, it shall be considered that 70% of the income correspond to digital services.

- Provide an electronic invoice with a break-down of the VAT to clients in Mexico so requesting it.

- Appoint a legal representative and a domicile for notices and supervision purposes for the compliance of obligations before the SAT.

Compliance with the aforementioned obligations shall not imply that the foreign resident has a permanent establishment in Mexico.

Specifically, those operating as intermediaries in activities carried out by third parties, shall have the following obligations in addition to the aforementioned obligations:

- Publish on their website, app or platform the corresponding VAT.

- Withhold 50% of the charged VAT from individuals transferring goods, rendering services or granting the temporary use or possession of goods.

- Pay the withheld VAT.

- Issue a tax invoice for the withholdings and provide payments information.

- Register itself before the SAT as a withholding agent.

- Provide, on a monthly basis to the SAT a list of its clients and their information, even if they have not charged a consideration and the corresponding VAT.

In regards to residents abroad without a permanent establishment in Mexico, we consider that binding service providers to withhold and report VAT is not the best mechanism to achieve an efficient and effective tax collection.

We consider it would be more effective to allocate to the financial institutions through which payments are made, the ancillary capacity to collect said taxes.

d. Sanctions for non-compliance of obligations

Article 18-H establishes that as a consequence for the non-compliance of the aforementioned obligations, access to digital services can be blocked, so that the recipients of such services shall not be able to access their platforms until the obligations are complied with.

For purposes of the foregoing, it is set forth that the concessionaires of public telecommunication networks shall be bound to block access to the digital platforms of the defaulting taxpayers.

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In our opinion, the aforementioned sanctions are neither proportionate nor ideal to achieve the tax objectives intended by the law, which derives precisely from attributing the service providers the obligation to withhold and pay the taxes, instead of implementing a different mechanism ensuring the effective tax collection.

Furthermore, such sanctions will damage the users inasmuch downloading or access to multimedia or audiovisual content will be blocked without the guarantee that the service provider will cancel or suspend charging the corresponding consideration; while those using the intermediation services will not be able to offer their goods and services through such platforms and, therefore, will not be able to receive their corresponding income.

As previously mentioned, such rule establishes the obligation for the concessionaires of public telecommunication networks, as auxiliary parties in the tax collection, to block access to said digital platforms, imposing them with a non-ideal obligation derived from the non-compliance of an obligation by a third party. The sanction to such concessionaries for not complying with the blocking order ranges between $500,000.00 to $1,000,000.00 MXP, on a monthly basis.

Therefore, we consider that blocking the access to the service is an unproportioned and excessive sanction, besides imposing obligations upon third parties different from the taxpayers, making it an unconstitutional measure.

e. Importation of digital services

When foreign residents offering digital services are not on the taxpayers list registered before the RFC published by the SAT, recipients of such services shall deem it to be an importation of services and shall, therefore, pay the corresponding taxes.

Such provision is unreasonable since the non-compliance of a formal obligation by the foreign service provider without permanent establishment, modifies the nature of the transaction for VAT purposes from a provision of services to an importation.

This implies that the user of the service will be triggering the VAT and, thus, be bound to pay it, which will prevent an effective collection, due to the great amount of people receiving such services.

Additionally, the recipients of the services shall be bound to comply with a tax obligation, derived from the non-compliance of another obligation by a third party, i.e., from the service provider.

f. Effectiveness

Pursuant to the transitory provisions, Chapter III Bis shall become effective as of June 1, 2020.

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However, those who are already providing digital services to recipients in Mexico, shall register themselves in the RFC and shall appoint a legal representative and tax domicile no later than June 30, 2020.

E. Authorized donees for purposes of the ITL

Sections X of article 9, VII of article 15 and I of article 20 are added, to exempt authorized donees from paying VAT for the transfer of goods, rendering of services and for transferring temporary use or possession of goods.

Notwithstanding the fact that the intent of the reform is to grant a benefit to these entities, it is our opinion that the proposed measure represents a burden for said taxpayers, inasmuch they will not be able to credit the input VAT transferred by their suppliers and service providers, and they will have to absorb such financial burden or, in any case, include it in the corresponding compensations.

F. Private transportation service

Article 15, section V of the VATL is amended, to establish that transportation of persons hired by means of digital platforms with the use of private vehicles, is not considered to be a public transportation service and, therefore, it is not an exempted service.

4. SPECIAL TAX ON PRODUCTS AND SERVICES LAW

A. Duties regarding carved tobacco and flavored beverages

Article 2, section I, subsection C) and G) is amended to establish the annual updating method of the duties for carved tobacco and flavored beverages, which will become effective on January 1st of every fiscal year.

B. Off-setting of favorable balances

Paragraphs fourth, fifth and sixth of article 5 were amended, as well as paragraphs fifth, sixth and seventh of article 5-D, to establish that the favorable balances of the STPS can only be off-set against amounts of the same tax, and not against those generated by other contributions.

C. Definition of energizing beverages

The definition of energizing beverages established on article 3, section XVII is amended to eliminate the reference to the amount of milligrams of caffeine for each 100 milliliters, and to consider as such, beverages that have a mixture of caffeine and taurine or glucuronolactone or thiamine and/or any other substance that produces similar stimulating effects.

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In our opinion, this rule violates the constitutional principles of legal certainty and tax legality since it opens the possibility for the tax authority to determine the substances which, in its judgement, produce "similar stimulating effects".

5. FEDERAL INCOME LAW ("FIL")

Pursuant to the FIL (Ley de Ingresos de la Federación) for 2020, the Federal Government estimates to obtain an income of $6,096,335.8 million MXP.

Regarding administrative installments, it is established that in cases of extensions for the payment of tax credits, the default interest rates will be: 0.98% monthly of the outstanding balance, 1.26% monthly, in case of payments in installments of up to 12 months, 1.53% monthly if the payment is in installments of 12-24 months, and 1.82% monthly when the term exceeds 24 months.

Regarding the determination of fines for formal infractions, taxpayers shall pay 50% of such fines if they make the payments before the last partial minute is issued or the observations letter is notified; however if the payment is made after the issuance of said documents, but prior to the notification of the final assessment, the payment shall be 60% of the fine.

Certain cases for the granting of tax incentives are eliminated in contrast to the FIL for 2019. The following tax incentives remain:

- Accreditation of the STPS paid for the acquisition or importation of diesel, or biodiesel, against the income tax.

- Accreditation of up to 50% of the toll payment for the use of the National Network of Tollways (Red Nacional de Autopistas de Cuota), in favor of taxpayers that are in the public and private land cargo, passenger or tourism transportation business.

- Accreditation of the special mining duties against the income tax of the fiscal year, in favor of mining concessionaires, whose gross annual income for the sale or transfer of minerals are lower than $50'000,000.00 MXP.

- Importation of natural gas is exempt from payment of customs processing fees.

A relevant amendment to the FIL, is that the annual withholding rate for banking and stock exchange interests increased from 1.04% in 2019 to 1.45%.

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