

Decree on Tax Incentives for the Northern Border Region

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On December 31, 2018 the Mexican government published the “Decree on Tax Incentives for the Northern Border Region” (the “Decree”) granting certain tax benefits to residents of a northern border strip area. The main reason for these incentives is to promote economic competitiveness in the northern region of the country.

On January 30, 2019 the Mexican Tax Administration Service (“SAT”) published in Mexico’s Official Federal Gazette (“OFG”) the general rules (“the Rules”) for the application of the Decree.

1. Benefits of the Stimulus for the Northern Border Region¹ (The “Region”)

A. Income Tax

Benefit. Application of a “tax credit” equivalent to one third of the income tax *triggered in the fiscal year or in the provisional payments*. Such tax credit will be credited against the income tax triggered in future periods only in the proportion represented by the income received in the Region with respect to the total income generated by the taxpayer in a fiscal year or in the period corresponding to the provisional payments.

The tax credit must be applied in the period that the income tax is triggered (either in the provisional payment or at the close of the fiscal year). If the credit is not applied in a specific period where the tax is triggered, the taxpayer will lose the right to apply it in future periods.²

Beneficiaries. Taxpayers — residents of Mexico or with a permanent establishment in the country — who earned income in the Region equivalent to at least 90 percent of their total income in the last fiscal year in the Region. Income originated by intangible assets and digital commerce is excluded from the 90 percent threshold.³

Taxpayers who initiate operations should estimate that 90 percent of their income will be earned in the Region.

Requirements to Apply the Benefit

1. The taxpayer must be registered in the “Registry for the Beneficiaries of the Northern Border Region Stimulus” no later than March 31 of the fiscal year in which the benefit will be

¹ The municipalities of the States of Baja California; Sonora; Chihuahua; Coahuila; Nuevo Leon and Tamaulipas are considered as the northern border region outlined in the First article of the Decree on Tax Incentives for the Northern Border Region.

² The amount of income obtained in the Region must be stated in the provisional and annual tax returns for the fiscal year; if the amount stated does not represent at least 90 percent of the total income obtained in that region, the taxpayer must submit supplementary tax returns for the fiscal year in which the Decree was wrongly applied.

³ The taxpayer will be able to verify that his income in the Region represents at least 90 percent of total income, by a declaration under oath that in the previous fiscal year he obtained at least 90 percent of income in the region, differentiating the amounts of the income obtained in the Region and those obtained outside of it; in which case, the integration of the income amounts must be by branch, agency or establishment, and the sum of these must match the amount reported in the balance sheet for December 31 of the corresponding year.

applicable or within the month following the registration in the Federal Taxpayer Registry (“RFC”) for taxpayers who initiate operations. To obtain the authorization, the taxpayers must prove that at least in the past 18 months before the registration application is filed, they had their tax domicile, a branch, agency or any other establishment within the Region.⁴

If taxpayers do not comply with the 18 month threshold or they initiate operations, they must prove that they: (i) have sufficient financial capacity, assets and the proper facilities to carry out their business operations in the Region⁵; and (ii) in order to perform their operations in the Region, they use new fixed assets⁶ and at least 90 percent of their total income is originated in the Region.

2. Have a valid electronic signature and access to the tax mailbox.
3. Collaborate bi-annually with the SAT in a real time verification program.
4. If tax authorities do not respond to the authorization request within the time frame specified in the Decree (one month), the authorization will be deemed as denied.
5. The authorization must be renewed no later than the date on which the tax return of the fiscal year in which the benefit was applied is due (March 31). If the authorization is not renewed it will be deemed as cancelled.
6. The benefit will not give rise to any refund or offset. The benefit will not be considered as taxable income for purposes of the income tax law.

Taxpayers not entitled to request the benefit. (i) financial institutions, insurance and bond companies, bonded warehouses, leasing companies and credit unions; (ii) taxpayers who carry out *maquila* operations ; (iii) taxpayers who carry out business activities through a trust; (iv) outsourcing companies; (v) taxpayers to whom in the past five years a tax assessment was determined and who did not correct their tax situation; (vi) taxpayers listed as issuers of invoices for nonexistent operations in terms of the Federal Tax Code or if any shareholder of the company is listed or if they have carried out operations with any taxpayer listed and they did not prove the materiality of the operation; (vii) any taxpayer to whom any special tax treatment or any other tax benefit was granted, including exemptions and subventions; and (viii) estate productive companies, as well as the contractors according to the Hydrocarbons Law.

⁴ The above can be proven with bank statements, service payments, or receipts of real estate taxes; in all cases the documents that are exhibited must be issued to the taxpayer and must contain the tax address or the address of the branch, agency or establishment.

⁵ Rule 11.11.8. of the Miscellaneous Tax Resolution provides the documentation to prove the financial capacity, assets and facilities, among which highlights: financial statements, accounting records of investments duly registered, supporting documents of sources and financing conditions, formalized minutes of capital contributions and, in general, any information that demonstrates the materiality of the operation that will be carried out in the Region.

⁶ Rule 11.11.10 of the Miscellaneous Tax Resolution states that in order to verify that the asset is new, the following documentation must be available: (i) CFDI for the acquisition, not greater than two years as of the date of the filing of the request for the authorization to apply the tax benefit; a bank statement to prove the payment and the accounting records. For used goods, the acquisition can be proved with the CFDI issued to the seller for the original acquisition of the asset and with the CFDI for the sale issued by the seller to the taxpayer. Additionally, a document must be signed by the legal representative or taxpayer stating under oath the Tax ID of all related parties and that the asset has not been sold more than once.

B. Value Added Tax

Benefit. Application of a tax credit equivalent to 50 percent of the Value Added Tax (“VAT”) rate (16 percent). The credit will be applied directly, so the VAT transferred will be eight percent.

Beneficiaries. Individuals and companies who carry out the following operations on the premises or establishments situated within the Region: (i) sale of goods; (ii) independent services; or (iii) real estate leasing.

Taxpayers not entitled to request the benefit. Those taxpayers who (i) sell real estate or intangible assets; (ii) provide digital content; (iii) taxpayers listed as issuers of invoices for nonexistent operations in terms of the Federal Tax Code or if any shareholder of the company is listed or if they have carried out operations with any taxpayer listed and they did not prove the materiality of the operation.

Requirements to enjoy the benefits. The material delivery of the goods or the services rendered must be performed within the Region and the “Notice to Apply the VAT Tax Benefit in the Northern Border Region” must be filed by February 7, 2019. For those taxpayers who initiate operations, they must file said notice along with the registration to the Federal Taxpayer Registry (“RFC”).

Taxpayers are entitled to apply the tax stimulus benefit as of January 1, 2019 if they obtain receipt of filing the abovementioned notice.

Digital Tax Receipt (“CFDI”). The taxpayer will select the “VAT Credit applied 50 percent” option in the -Rate or Fee- space, which applies the VAT stimulus.

The issuance of receipts applying the tax benefit from January 1 to April 30, 2019 may be delayed until **May 1, 2019**.

2. Some Issues to Be Considered for the Application of the Benefits

A. For the Income Tax Incentive

- The Decree and the Rules are not clear regarding income whose origin is difficult to identify, such as interest or currency exchange rate gain.
- The Decree is not clear as of when the benefit shall be applied. According to the “Questions and Answers” published by the SAT, it is considered that the right to apply the benefit begins at the moment when the authorization is obtained, therefore taxpayers should apply the incentive on the next provisional payment to avoid losing the right to apply it.
- If the authorization is denied, an appeal remedy or annulment procedure may be filed. If the authorization is not renewed or it is canceled, it cannot be requested again.
- It is important to analyze case by case those taxpayers who are restricted from the tax benefit, because in some cases an unfair (unconstitutional) treatment could be generated in relation to those taxpayers who are entitled to obtain the authorization (for example, carrying out business

operations through a trust with entrepreneurial activities, *maquiladoras*, or outsourcing service providers, among others).

- If the taxpayer applies the incentive, it will be necessary to analyze the implications that will be generated in the Net Tax Profit Account, because there might be some negative effects for individuals that pay the income tax for dividend distributions because the corporate tax credit applied will be lower.
- One of the requirements to apply the incentive is that the taxpayer should not apply it simultaneously with "other tax treatment that provides a tax benefit or any incentive." This requirement is too broad and could be interpreted as if any tax benefit would exclude the application of the incentive for income tax purposes, such as any exemption or any special tax regime applicable.

B. VAT Incentive

- The tax authorities have indicated that in order to be able to apply this incentive, it is necessary to have premises or an establishment situated within the Region and also to carry out the material delivery of goods or render services in the Region and establishment. However, the Decree is not clear regarding what is to be understood as premises or an establishment because it does not differentiate whether the establishment refers to the seller or service provider, or to the buyer or recipient of the services.
- Finally, the Decree and the Rules do not indicate how the material delivery or the provision of services in the Region must be proven.

Therefore, it is necessary to have all the documentation to prove that the material delivery of the goods or that the services were actually rendered in the Region, such as: (i) documents that prove the formalization of the transaction that clearly indicate that the delivery will be made in the Region (contracts); and, (ii) documents to prove the receipt and delivery of products or materials sold.

In the case of rendering services, there must be: (i) documents to prove the materiality of the services; (ii) records of the individuals involved in each project; (iii) meeting minutes; (iv) documents that prove the supervision of the work; (v) reports that describe the services rendered; and, (vi) documents and accounting records evidencing the payment, among others.

Definitions	
Federal Official Gazette	OFG
Tax Administration Service	SAT
Value Added Tax	VAT