THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

EIGHTH EDITION

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THE LAWREVIEWS

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

Eighth Edition

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THE LAWREVIEWS

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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-056-1

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

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PREFACE

In my foreword this year, I will focus on the continuing interest that is being devoted to the position of wealthy families and the markedly different approaches that prevail in Western Europe and the United States in terms of tax information exchange and anti-money laundering policy.

While public beneficial registers for companies will be introduced in the EU in the first quarter of 2020, the United States continues to pursue its own agenda where the primary focus of its anti-money laundering policy continues to be around financial institutions.

In broad terms, it is still accurate to say that the principal impetus for ongoing policy initiatives in this area is being driven by the EU, OECD and the Financial Action Task Force (FATF). This has been underlined by two important events in the past week or so as I finalise this foreword. Firstly, the decision of the UK Crown Dependencies[1] to voluntarily adopt public registers of beneficial ownership by 2023. Secondly, FATF's publication of its 2019 guidance for trust and corporate service providers (TCSPs) (the last version was published in 2008). I will return to both of these topics below but, in general terms, they underscore the sense of the 'transparency juggernaut' maintaining its momentum.

I will first deal with EU developments. The focus of activity here is the measures being introduced at Member State level to implement the Fourth and Fifth Anti-money Laundering Directives (4AMLD and 5AMLD, respectively). With some notable exceptions (including the UK, Malta Germany, Luxembourg, Portugal and Ireland), Member States have been quite slow to implement 4AMLD. In practice, implementation in other jurisdictions looks like it will be subsumed into the widened scope of 5AMLD.

So far as corporate registers are concerned, these are due to become public in the EU and wider EEA in early 2020 under 5AMLD (in the UK, the register was public from inception so the change here will be less marked). In the arena of trust registers, the scope of trusts that are within scope has been substantially expanded from those that generate tax consequences and those that are administered in the relevant jurisdiction. The Directive makes reference to 'express' trusts. There is significant uncertainty as to how this term will be construed as, on an expansive reading, it would require, in a UK context or co-ownership of land and joint bank accounts, to be reported. As a general proposition, trust registers are private and it would only be possible to gain access to the information on the beneficial owners of a trust where the applicant can demonstrate a legitimate interest.

It seems likely, from a consultation that has recently been launched by the UK government, that those seeking access to the trust register will have to demonstrate some

1 Jersey, Guernsey and the Isle of Man.

specific evidence of money laundering or terrorist financing activity to justify this. In essence, general 'fishing' expeditions by investigative journalists into the affairs of the wealthy will, hopefully, be discouraged.

Some curious features of the directive implementing 5AMLD have potentially wide-ranging consequences for trusts that are not regarded as resident in the EU or EEA. On a literal reading of the directive, it could be argued that such trusts will be required to register in circumstances where they have a business relationship with an obliged entity – this includes not only financial institutions but lawyers, accountants and other equivalent professionals. We will have to await the detailed regulations to see the final policy stance taken on this issue.

One other area where 5AMLD leads to a surprising outcome is in circumstances where a trust is deemed to control any company that is not incorporated within the EU or EEA. In these circumstances, the directive makes provision for public access to information about the trust; the logic here is that if the relevant company does not open up its information to public scrutiny then the trust that owns it should be disclosed instead. What is completely unclear at this stage is whether this will provide de facto public access to information about trusts that control non-EU or non-EEA companies or whether it will only afford such access in circumstances where the applicant already has detailed information about the relevant company or trust.

Another interesting issue that arises in Luxembourg, where a trust is the ultimate beneficial owner of a Luxembourg company, is that information about the settlor, beneficiaries, protectors and any other natural person exercising effective control will be publicly available on the corporate Register of Beneficial Owners from 31 August 2019. This is markedly different from the position under the UK Corporate register in the case of a trustee owner where the persons with significant control or 'PSC' rules look to those who control the trustee decisions alone rather than those who are beneficiaries of a trust.

The general scope of trust registers in the EU under 4AMLD is starting to become clearer. Following on from the UK and Malta, Ireland recently published its regulations at the end of January 2019. These regulations will, as noted, be potentially subject to material expansion once 5AMLD is implemented.

One general concept within 5AMLD is the proposal that trusts can be effectively passported; in other words, once the trust can evidence registration on one EU or EEA register, this will avoid the need for duplicate registrations. Whether this will result in any practical compliance gains or advantages remains to be seen. In terms of its scope, the information being provided on trusts in the centralised Beneficial Ownership Register will be restricted to information about individuals and will not address (as is the case with Common Reporting Standard (CRS)) asset values.

There are clear signs that the EU is intent upon exporting its concept of centralised trusts and corporate beneficial ownership registers to the rest of the world. Recent commentaries have suggested a move to a global standard in this regard by 2023. NGOs active in the transparency arena have started to advocate the creation of an overarching integrated global asset register for wealthy families although it is difficult to gauge policymakers' enthusiasm for such a radical step.

The position of the UK if Brexit finally happens is also interesting. The UK seems intent upon implementing 5AMLD and has shown no signs of losing its enthusiasm for expanding measures in this area along with its European neighbours. The UK has also been putting pressure on both its crown dependencies (CDs) and overseas territories (OTs)[2] to adopt the EU's position on public beneficial ownership registers for companies.

Before the CD's announcement on 19 June 2019,[3] it seemed that the OTs were more likely to agree to the EU's position because of their constitutional status where the UK has a stronger formal say in how they make policy. What is interesting about the CD's position is, in the statement issued by the three Island Governments on 19 June, they describe a three-stage process as follows:

> 1. *the interconnection of the islands' registers of beneficial ownership of companies with those within the EU for access by law enforcement authorities and Financial Intelligence Units;*
> 2. *access for financial service businesses and certain other prescribed businesses for corporate due diligence purposes;*
> 3. *public access aligned to the approach taken in the EU Directive.*

It seems obvious that the CD's collective approach here is to forestall criticism from the EU in particular by being seen to take the lead in moving to public access in a phased manner. The fact that public access is the last stage of this process is revealing. The willingness in interim stages to share information with the EU and obliged entities in the regulated sector may well be a model that other jurisdictions will consider following.

Whether the voluntary adoption of public registers of beneficial ownership for companies in the CDs will stimulate other jurisdictions to follow suit remains to be seen. There have been some indications that the UK and EU stance here is to promote a new global standard of public registers for companies by 2023 mentioned above. Given the UK's pronouncements here, it seems inevitable that the OTs will be forced to adopt equivalent measures to the CDs. It will be interesting to see whether other major offshore jurisdictions such as Switzerland and the Bahamas will react to these events.

As a different matter, the separate subject of establishing centralised trust registers outside the EU is bound to be raised as a parallel issue. This may take longer to surface than pressure to establish corporate registers, but seems bound to raise its head at some stage.

From a wider FATF perspective, the key development in 2019 is the publication in late June 2019 of updated guidance to non-financial services professionals. Three sets of parallel guidance to lawyers, accountants and TCSPs[4] have been issued. There has been a significant time gap since the previous edition, which was published in 2008.

One area where the new guidance will have an important impact in the context of TCSPs is in defining 'beneficial ownership'. In this regard, the new guidance follows an expansive view of what constitutes 'control' for the purpose of beneficial ownership akin to the approach taken in the UK Trust Register. This will be potentially significant going forward in considering who needs to be disclosed in the context of trust structures in governance terms. In particular, holding powers as a minority member of a group or a veto power with respect not only to the appointment and removal of trustees but also to the addition and removal of beneficiaries, for example, will be enough to render an individual as being characterised as a 'natural person exercising effective control'. This is potentially very significant because there

2 A wider group that includes Bermuda, British Virgin Isles ,the Cayman Islands and Gibraltar.

3 https://www.gov.je/News/2019/Pages/BeneficialOwnership.aspx.

4 https://www.fatf-gafi.org/publications/fatfgeneral/documents/public-consultation-guidance-tcsp.html.

has been no guidance offered by FATF since it published its 2012 recommendations on how to interpret this expression.

It is still very early to try and discern what the impact of the information flows triggered under CRS has been. For compliant structures, the provision of CRS information should only confirm what has already been disclosed by a taxpayer to domestic tax authorities. However, given the growing concerns being expressed by politicians on the 'inequality' theme, the assembling of information about asset holding positions of wealthy individuals may be the tool that is deployed in assessing the potential impact of future wealth or inheritance taxes where these are not currently employed.

There is also a potentially significant crossover from the FATF domain into CRS reporting. In particular, a broader concept of who may be regarded as a 'controller' in the anti-money laundering context is likely to be applied for CRS purposes in due course, given the express linkage that exists in CRS that directly imports FATF definitions of beneficial ownership into the concept of who may be reportable in a trust context as a 'controlling person'.[5] This could, in particular, lead specifically to the disclosure of family members who have more subtle or 'indirect' means of influence over a family trust structure.

One development in an aligned field worth mentioning is the rules on substance for entities incorporated in offshore jurisdictions. These substance rules have taken on an increased significance recently.

The EU Council has created a code of conduct for business taxation to limit the impact of low tax regimes. In 2017, it established a code of conduct group tasked with considering the measures on business tax within a number of non-EU jurisdictions.

In response to assessments undertaken by the EU, the affected jurisdictions (which include a number of the CDs and OTs) have introduced new rules requiring economic substance that will take effect in 2019.

These rules impact companies carrying on 'relevant activities'. The substance requirements have three principal components. These are to demonstrate, that within the jurisdiction, the company:

a is directed and managed;
b undertakes core income-generating activities; and
c has physical presence.

While these measures are primarily relevant in a base erosion and profit shifting (BEPS) context, they are indicative of wider trends in terms of being able to demonstrate the overall substance of these measures that are operated in offshore jurisdictions. This is of potentially greater significance to private wealth structures that may be seen as more passive than active.

There are nine relevant activities that cover banking, insurance, fund management and financing. One specific area includes the role of pure equity holding companies (PEHs). While supposedly aimed at private equity structures, it could conceivably impact a conventional holding company holding varied investments for a family trust.

At this early stage, there is no clear guidance that delineates the boundaries of what constitutes a PEH; what can be said is that family structures could find themselves impacted if the guidance is couched in wide terms.

5 See page 59 of OECD publication in commenting on meaning of 'controlling person' for CRS purposes.

There is no doubt that the increased cost and complexity of regulation is driving trends towards simpler structures with fewer layers and involving fewer jurisdictions. There appears to be a greater reluctance on the part of corporate service providers to offer a purely passive role as a registered office without any detailed understanding of the operation of the underlying entities themselves. This appears to be coupled with a trend towards re-domiciling entities into jurisdictions where substance can be demonstrated.

At the same time, an increasing awareness as to the implications of disclosure of beneficial ownership is also generating a more reflective view on the retention of control either by settlors or by beneficiaries or connected family members.

In summary, therefore, the theme of ever-greater levels of transparency and increased complexity of overlapping regulation continues. The dichotomy between Western Europe and the United States, in terms of their different approach to these issues, also remains very apparent to observers.

John Riches
RMW Law LLP
London
August 2019

Chapter 30

MEXICO

Edgar Klee Müdespacher and Joel González Lopez[1]

I INTRODUCTION

According to the Global Competitiveness Report issued by the World Economic Forum, in 2018 Mexico ranked 46th out of 140 economies and is placed as one of the most competitive economies in Latin America. Mexico's improvement is based on efficiency in trade, investments and productivity and, as a member of the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization, has become a champion of free trade, with a considerable network of tax treaties, which has given rise to a large amount of wealth being created. Unfortunately, however, this wealth is amassed in a small percentage of the population. The country has one of the highest rates of inequality in the world and certainly faces challenges in the future to achieving inclusive and sustained growth for all its citizens.

Over the past 18 months, certain events have created both opportunities and obstacles with regard to private investments in Mexico, such as the renegotiation of the North America Free Trade Agreement (NAFTA) and the US tax reform, and a new federal administration is in charge for the period 2018–2024.

In 2018, Mexico received US$31.6 billion of foreign direct investment. This demonstrates that foreign investors are increasingly interested in Mexican business, mostly in the manufacturing sector. According to the most recent report of the Central Bank, the Mexican economy is expected to grow between 1.1 per cent and 2.1 per cent in 2019.

With respect to NAFTA, after more than a year of negotiations, the United States, Mexico and Canada signed the new United States–Mexico–Canada Agreement (USMCA) on 30 November 2018. Among the most important changes as a result of NAFTA are chapters on labour, environment, digital trade, competitiveness and anticorruption. There are also significantly updated rules of origin covering not just autos, but also textiles, chemicals and other sectors.[2] This new treaty is pending ratification and approvals by each member of congress.

Another development with significant implications in Mexico is the US Tax Reform, approved on December 2017, which reduces business tax rates and substantially modifies the US international tax system. As a result, the reforms will have important consequences for companies and markets in Mexico, including the taxation of US corporations' foreign subsidiaries.

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1 Edgar Klee is a partner and Joel González Lopez is an associate at Haynes and Boone, SC.

2 The USMCA will not take effect until it is ratified by the parties. On 19 June 2019, Mexico became the first country to ratify the USMCA.

Another relevant aspect that all investors must consider in the global tax environment is the undergoing legal modifications that were triggered by of the Base Erosion and Profit Shifting (BEPS) Action Plan set forth by the OECD. BEPS actions are focused on information transparency and avoid the undue use of treaties, which reflects a minimum standard to combat 'treaty shopping'.

As a member of the OECD, Mexico has been actively involved in the design and development of BEPS, and began implementing many of the following recommended actions in 2014:

a anti-hybrid rules (Action 2);

b a form of mandatory disclosure requirement for taxpayers (Form 76) (Action 12);

c an obligation for taxpayers to present a country-by-country report, master file and local file (Action 13); and

d new OECD Transfer Pricing Guidelines (Actions 8–10).

Mexico is a signatory party to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, under which Mexico elected to supplement the principal purpose test with a simplified limitation on benefits provision.

Further, Mexico has broadened the scope of exchange of tax information under the Common Reporting Standard (CRS), with currently 100 active automatic exchanges relationships with other countries, as well as the Foreign Account Tax Compliance Act with the United States.

Related to the above, it is also worth mentioning that in 2017 Mexico attracted nearly 345.447 billion pesos in investments into the country through a tax repatriation plan. The repatriation programme was applicable to capital and resources held abroad either directly or indirectly by Mexican taxpayers. In the near future, we expect certain transactions carried out through this repatriation programme to be audited by the Mexican tax authorities, such as those where the repatriated funds were used to increase equity in a Mexican entity and the entity dispersed abroad. The two-year period requirement to maintain the repatriated funds in certain Mexican investments will end, and this will release such funds to be available for new types of ventures or investment (in Mexico or abroad).

Finally, on 1 December 2018, Andres Manuel Lopez Obrador launched his presidency. Eradication of corruption, boosting of economic growth, reduction of poverty and improvement of security are the four main objectives of the new Mexican government.

A new tax reform is expected to take place during the first half of the six-year term of the new government. The new administration announced plans to boost investment in Pemex that involve cutting taxes and refinancing the state oil company's debt.

The new administration will bring changes to various areas of the Mexican economy, which may bring new business opportunities for investors, but also new rules that will have to be reviewed to better capitalise on the opportunities in the new political environment.

The principal proposals with regard to fiscal policy comprise a boost in public investments and social programmes, a federal austerity programe, tax cuts and increased spending on public projects, and reducing income and payroll taxes. Many of these proposals would need to increase federal revenues and the federal government's budget.

II TAX

Mexico has a residence-based system under which if an individual resides in Mexico for tax purposes, he or she is subject to taxation over his or her worldwide income. An individual is a Mexican tax resident if he or she settles his or her habitual abode in Mexico. If an individual has a home in Mexico and another country, the centre of vital interests is the factor that determines the tax residence in Mexico. Mexican nationals are presumed tax resident in Mexico.

Income tax liability is the income obtained by the taxpayer during a fiscal year (which coincides with the annual calendar). Mexican law does not provide a general definition of 'income'; however, in the context of the Income Tax Law, Mexican courts have defined it as a 'positive modification registered in the patrimony of a person that is susceptible of pecuniary valuation'. Individuals are taxed on income received in cash, in kind, in credit or in services. Individuals can apply certain personal deductions (education costs, charity donations, medical and dental) and most personal deductions are limited to 15 per cent of the yearly taxable income.

Personal income tax rates are progressive up to 35 per cent. Individuals with business activities or professional income are subject to income tax at the rate of 30 per cent and may deduct normal business expenses according to entities rules. In most cases, a tax return has to be filed by the end of April in the following year.

Non-resident individuals are taxed only with respect to income, which is sourced in Mexico with varying terms and conditions depending on the type of income. The tax rate varies between 5 per cent and 40 per cent. Double taxation agreements apply by reducing the taxable rates or even producing a non-taxable event.

The principal type of taxable income for individuals (residents in Mexico and non-residents) are the following.

i Sale of shares

Mexican resident individuals are taxed over the sale of goods, including shares issued by foreign entities. To assert the tax base, individuals are allowed to perform certain deductions. For such purposes, Mexican resident taxpayers will be able to deduct, among others, the updated amount of the acquisition cost of the shares, commissions and certain considerations paid to intermediaries, and some other taxes or duties paid.

With respect to foreign individuals, the sale of the shares will trigger a tax of 25 per cent on the net income, or 35 per cent on the gross amount, if the non-resident appoints a representative in Mexico. A tax return must be filed in conjunction with an auditor's opinion obtained from a Mexican public accountant certifying that the reported gain was correctly determined.

Income deriving from the sale of securities or publicly traded shares is subject to a 10 per cent tax on the gain (foreigners are subject to a 10 per cent withholding tax on the gain).

ii Dividend distributions

Resident individuals must include the dividends received from Mexican corporations (grossed up for the corporate income tax paid by the corporation) in their individual income tax returns and are able to claim the underlying corporate income tax paid as a credit against their personal tax liability.

Moreover, with respect to dividends paid from profits that were generated by the distributing entity after 2013, an additional 10 per cent tax on the net dividend will be withheld by the Mexican company. This tax is in addition to the tax paid with the annual tax return, and it cannot be credited. In the case of dividends paid to foreigners, the dividend amount will also be subject to this 10 per cent withholding rate.

Double taxation agreements, in certain cases, grant preferential withholding rates upon any profit or dividend distribution sourced in Mexico (reducing it by up to 5 per cent).

iii Interest income

Interest earned in accounts held in Mexican banks is subject to withholding tax and should be reported in the annual tax return.

Interest on bank accounts, bonds and other debt obligations issued by non-residents is fully taxable, and the taxable interest includes adjustments for inflationary losses and exchange gains and losses with respect to the principal.

Interest paid to a non-resident is subject to withholding tax at rates ranging from 4.9 per cent to 35 per cent and 40 per cent.

iv Real estate

Income deriving from the sale of real estate is taxable for income tax purposes considering the seller's gains (tax basis with recognition of the inflationary effect).

With respect to the acquirer, a local tax of approximately 2 to 6 per cent is applicable on the commercial or transaction value (whichever is greater).

If the real property is acquired as a gift or at under 10 per cent of the appraisal value, income tax will also be triggered by the acquirer.

With respect to foreign individuals, the sale of the real estate will trigger a tax of 25 per cent on the net income or 35 per cent on the gross amount if the non-resident appoints a representative in Mexico.

v Inheritance and gift taxes

There is no specific inheritance, estate or gift tax in Mexico. Inheritance and gifts are treated as income under the income tax law, but they may be exempted as long as certain requisites are complied with.

Income received by Mexican tax resident individuals from inheritance and donations (when applicable) in a given tax year, must be reported to the tax authorities in their annual tax return. Income received by resident individuals from donations shall be reported to the tax authorities when all donations (including prizes and loans) received in a tax year exceed 600,000 Mexican pesos.

Income received as a result of a gift from a spouse, lineal ancestors or lineal descendants is also exempt. However, gifts between siblings are not exempt, and gifts to parents are not exempt if the asset is later given or sold to a sibling of the original owner.

Other gifts are tax exempt, provided the gift does not exceed US$88,209 pesos. Any portion of the gift exceeding this amount would be subject to income tax.

vi Taxpayers subject to the preferential tax regime

Mexican tax residents will be subject to the preferential tax regime rules regarding income generated directly or indirectly through foreign legal entities or figures, including those considered transparent (i.e., flow-through for tax purposes), in which they participate directly or indirectly, in the proportion of their participation in the capital of such legal entities or figures.

Income subject to the preferential tax regime is subject to taxation in Mexico in the fiscal year that such income is generated abroad, even if the income, dividends or profits have not yet been distributed by the entity or figure in which the Mexican taxpayer directly or indirectly participates.

Taxpayers must file in February of each fiscal year an informative tax return regarding income subject to the preferential tax regime directly or indirectly; income generated in the previous tax year; income generated in blacklisted countries; and transactions carried out through tax-transparent foreign legal entities or figures.

There are several exceptions to this regime, especially regarding the absence of effective control on the foreign legal entity or legal figure. See Section IV.

III SUCCESSION

Succession is a part of civil law that, for purposes of Mexican legislation, is regulated in the federal and local civil codes. Mexico has 32 federal states or entities, including the capital, Mexico City. The federal and local civil codes have mostly the same regulations but there may be specific conditions that differ among them.

The Federal Constitution establishes that the powers not expressly granted to the Federation are understood to be reserved to the states. Therefore, since succession is not a federal matter, depending on the state where the succession takes place, their local civil code will be the applicable one.

The transfer of an estate could take place by operation of a will (which will determine to whom and how the decedent patrimony will be divided) or in the absence of a will, through a set of specific rules contained in the local state-applicable civil code, which will determine who is entitled to receive assets and how the assets of the successor will be transferred. In an intestate succession, the descendants, ascendants, collateral relatives, spouses and concubines have the right to inherit.[3] Heirs can resign their inheritance rights. The probate process in Mexico is carried out before a Mexican notary or a judge.[4] Further, there are specific non-probate rules for certain assets, such as bank accounts with a beneficiary.

The administration of an estate of inheritance commences with the death of the decedent according to the testament given before a notary public, as an intestate or legitimate

3 Currently, most states allow same-sex marriages (including Mexico City). The Supreme Court declared, in a binding precedent, that the state laws that prohibit marriage between persons of the same sex are unconstitutional for being discriminatory. Therefore, same-sex marriages can be carried out in all the states of Mexico. On the other hand, for unmarried couples that have lived together in a constant and permanent way for a minimum period of two years or have a child in common, there is a special term: concubinage. These couples have the right to reciprocally inherit from one another as if they were spouses (in the event of an intestate succession). The Supreme Court declared, in non-binding precedents, that concubinage is considered for same or different sex couples in accordance with the reasons that allow for same-sex marriage (non-discriminatory principles).

4 On 23 July 2012, the last significant amendment made to the Mexico City's Civil Code relating to succession was published, in which the different types of testaments that could be granted were eliminated (public, private, handwritten, military and maritime), with only ones made before a notary public remaining as valid.

succession when there is no testament, or where the testament that was granted is invalid; the testator did not dispose of all the assets; or there is no heir (because of death, repudiation or a condition that is not fulfilled).

Upon the death of the successor, the administration of the estate will be managed by an executor, who is appointed by the decedent in its will or named by a majority of the heirs if there is an intestate procedure. An heir could also be designed or appointed as executor. The executor needs to accept his or her duty or resign. The executor will perform an inventory of the assets, pay debtors of the estate and proceed with a partition and distribution of the assets. A will made in a foreign country could have legal effects in Mexico City or other states when made according to the laws of the country in which it was granted and if it is not considered invalid under Mexican legislation.

A foreign person may inherit in Mexico. In this scenario, the inheritor must comply with certain Mexican rules. In this regard, generally, foreigners can acquire real estate (including through inheritance) in Mexico if they agree to consider themselves as nationals with respect to said property and not to invoke the protection of their governments.

In relation to the above, the Mexican Foreign Investment Law regulates how and in which cases foreigners can acquire real estate. Foreigners, individuals and legal entities can acquire real estate if they are located outside a restricted zone (100 kilometres from borders and 50 kilometres from beaches).There are special requirements that must be fulfilled. The acquisition of other kind of assets besides real estate and shares is not prohibited or restricted. With respect to prenuptial agreements and their effects on personal property and transfer of such under a will or intestate succession, a couple may enter into a prenuptial agreement before the wedding to constitute the patrimonial regime of their marriage (joint property, separated property or a mixed regime) and to regulate the administration of the assets. However, this agreement does not grant inheritance rights and is not commonly executed.

As for the tax effects that derive from a succession, these can generally be divided between those applicable to the estate before it is divided and awarded to the corresponding heirs, and those applicable for the acquisition of the assets.

The executor will be the one responsible (being also jointly liable) for the calculation of the taxes generated under the estate probation and filing of the tax returns.

Currently, there is no applicable inheritance tax in Mexico. For income tax purposes, any transmission of assets made via a succession is exempt so long as the acquisition is reported in the annual tax return corresponding to the year when the assets are adjudicated to the heir. Life insurance payments are tax free if the insurance company is a Mexican insurer. There is a carry-over basis where the heir will also 'inherit' the tax basis of the transferor (normally the cost of acquisition). On August 2018, a congressman submitted to the Mexican Congress a bill that proposed to modify the Mexican Income Tax Law to limit the inherence tax exemption. The bill aimed to tax inheritance, legacies and gifts when they exceed 10 million pesos.[5] Although the bill was not even subject to discussion in the Mexican House of Representatives and ultimately this proposal was discarded, it led to huge discussions over the need, pros and cons of a new tax reform that targets the transfer of wealth.

5 According to the bill, the taxpayer would be required to make a pre-installment tax payment that would be computed by applying the following progressive tax rates to the amount that exceeds 10 million pesos: (1) 10 per cent tax rate on the amount that exceeds 10 million pesos up to 50 million pesos; (2) 20 per cent tax rate on the amount that exceeds 50 million pesos up to 100 million pesos; and (3) 30 per cent tax rate on the amount that exceeds 100 million pesos.

There are several factors that could facilitate the implementation, in the short term, of a tax on inheritances. Recently, the OECD recommended that Mexico adopt a tax on inheritances.[6] The recommendations of this organisation have always been significant in the design and implementation of public policies in Mexico, being that, in many instances, Mexico has been a pioneer in the implementation of such policies.

The acquisition via a succession of real estate is taxed at a local tax rate that ranges from 2 per cent to 6 per cent, and the basis for the tax is usually considered to be the appraisal value of the asset to be transferred.

Foreigners acquiring real estate or shares of Mexican entities will also be taxed at the rate of 25 per cent on the fair market value (appraisal) without being able to credit or deduct a cost basis.

IV WEALTH STRUCTURING AND REGULATION

i Investments made by Mexican tax residents in Mexican structures

One of the most commonly used structures is the *fideicomiso* (a Mexican trust), which is a commercial agreement governed by Mexico's general law of credit instruments and operations.

A Mexican trust normally consists of three parties: the trustor or settlor, the trustee and the beneficiary, although the beneficiary is not required in some trusts. The trustor or settlor can either be an individual or an entity and is the party that usually transfers title or management of certain assets, rights and benefits to the trustee, who holds them in the trust.

The trustee is the party who holds the assets in the trust, and the party that is given the responsibility of performing and complying with the specific purposes and goals of the trust. The beneficiary, although often named, is not a party that appears in all trusts. The beneficiary of the trust is the party that stands to benefit from the assets and trust, whether by using and enjoying the assets, by having privileges or special rights to the assets, such as a security interest, or by receiving income from the assets.

The trustee must always be a Mexican bank or financial entity, and it must act in accordance with the trust's purpose.

Mexican trusts are always created for specific purposes, and trustees are bound and limited to act in accordance with such purposes. However, in practice, trustees usually take a passive role during most of the trust's life, further allowing management and other duties to be taken by the beneficiary or other third parties.

By law, trusts are considered irrevocable, unless otherwise provided in the trust itself, and also by law, trusts can also hold most types of properties and rights.

When properties and rights are transferred to the trust, the trustor may 'hold back' or 'reserve' for itself, certain portions of a particular asset, or only do so under a partial or limited assignment. This means the trustor may also keep and maintain for him or herself, certain rights over the assets held in trust.

Trusts must be in writing and prepared (or amended) following the same formalities required for the transfer of the properties that will be subject to the trust. For instance, if the

6 S Araújo, B Brys and K Killmeier, 'Strengthening Mexico's fiscal policy.' *Getting it Right: Strategic Priorities for Mexico* (OECD Publishing, Paris, 2018, https://doi.org/10.1787/9789264292062-3-en OCDE).

property to be transferred to the trust is real property, then the trust must be created with the same requirements as when real property is transferred in Mexico. That includes the formalisation of the trust in a public deed in front of a Mexican notary public.

Trusts are normally created for specific period of time and cannot exceed 50 years, except under certain specific cases where this term may be exceeded.

The trust can be framed under two different fiscal effects, depending on the operation carried out in the trust: if the assets affected by the trust are transferred in ownership, all the effects inherent to property transfer would be presented; however, if the patrimony affected by the trust is a commercial activity, the effects inherent to the performance of business activities would be presented.

No sale is deemed for tax purposes when asset contributions are made to a trust and the settlor reserves the right to reacquire such assets. The income tax is triggered when such reacquisition right is lost or when a third party is the beneficiary of the trust.

The property transfer tax is triggered in real estate transactions in Mexico.

If the Mexican trust carries out commercial activities (receiving active income, namely income from sales) it will be considered as an entrepreneurial trust for Mexican tax purposes. In this scenario, the Mexican trust will determine the taxable profit and such will be allocated to the beneficiaries. Losses are not allocated to the beneficiaries (they remain in the trust and can be offset only against profits derived from the trust activities).

ii Insurance as an investment vehicle

Other forms of wealth structuring have included the usage of insurances (survival or with some savings component) on a stand-alone basis or combined with other structures (such as foreign trusts).

Payments obtained by Mexican tax residents derived from insurance agreements could be considered as tax-exempt income as long as the following requirements are fulfilled:

a Survival insurance: when the risk covered by the insurance is the survival of the insured person, the payments will be considered tax-exempt income provided they are paid when the insured person reaches 65 years of age and at least five years have passed since the insurance was contracted.

b Life insurance paid by individual: if life insurance was not paid directly by the employer for its employees, the payments will be considered tax-exempt income as long as the risk covered is the death, disability, loss of limb or incapability of the insured individual to perform a remunerated personal job in terms of social welfare provisions.

c Retirement and healthcare insurance: payments derived from departure, pension or retirement insurance, as well as healthcare expense insurance, may be considered as partially tax exempt as long as certain specific requirement are met.

The aforementioned exemptions are only applicable if the amounts are paid by an insurance company that is incorporated in terms of Mexican law; payments or income obtained from foreign insurers are not considered exempted.

iii Tax incentives for certain bond interest and capital gains on initial public offering share sales

The Mexican government granted certain income tax benefits to incentivise the markets listed on the stock exchange, as detailed below:[7]

a The incentive for income obtained from corporate bonds. Corporations or individuals that are resident in Mexico, who are required to withhold the income tax for the interest paid derived from corporate bonds, may apply a tax credit equal to 100 per cent of the income tax they are required to withhold from interest paid on publicly traded bonds issued by Mexican companies in accordance with the Stock Market Law, which will be credited against the income tax that should be paid for the withholding. This implies exempting the interest from withholding income tax in Mexico.

b The incentive for income obtained from the sale of shares issued by Mexican entities. Gains derived by Mexican individuals and non-residents from the sale of publicly traded shares of Mexican companies are generally taxed at a rate of 10 per cent provided the shares are sold on a stock exchange or derivatives market recognised under the Mexican Stock Market Law. However, the rate may increase to up to 35 per cent where the shares sold on the stock exchange were acquired outside a stock exchange or market recognised abroad. For 2019, 2020 and 2021, the Mexican government allows Mexican individuals and non-residents to be taxed at a 10 per cent rate on gains from sales of shares of Mexican companies listed on recognised stock exchanges where certain requirements are met.[8]

c The incentive for the sale of shares acquired by a venture capital investment trust. The benefit foreseen in (b) above (a 10 per cent rate on income tax on the profits obtained from the sale of shares) will also be applicable to taxpayers who constitute a control group – in accordance with Article 129, final paragraph, No. 2 of the Income Tax Law – provided that at least 20 per cent of the shares of the Mexican entity have been acquired by a venture capital investment trust in Mexico, whose certificates are placed among the large investing public through a licensed stock exchange, in terms of the Stock Market Law or in any other recognised markets, and that the transfer refers to a process of transition of divestment by the trust fund to initiate the public listing of the entity object of investment.

iv Investments made by Mexican tax residents in foreign structures

It is customary for Mexican individuals to set up structures abroad using a certain type of legal figure for inheritance, confidential and tax-deferral purposes.

In these cases, Mexican tax residents could be targeted with certain anti-deferral tax rules (a preferential tax regime) when they generate income directly or indirectly through foreign legal figures (such as a trust) or entities (such as limited liability companies) and as

7 A presidential decree published in Mexico's Official Gazette on 8 January 2019 grants certain benefits that are designed to encourage investment in the domestic corporate bond and private equity markets, applying as from 9 January 2019.

8 The sale of shares is carried out through an initial public offer of a Mexican entity that has not previously been traded on the stock exchange or any other recognised markets; the value of the stockholders' equity of the Mexican entity is at least $1 million pesos (US$50,000) or greater; and the sale is not part of the disposition of a 10 per cent or greater direct or indirect participation within a 24-month period, does not take place outside a stock exchange and does not involve a corporate merger or split-off.

long as said income is not taxed abroad or the income is not effectively taxed by at least 75 per cent of the Mexican tax rate. For such purposes, this special regime considers as income all passive income (including certain types of services, charters, etc.).

Income obtained directly or indirectly through transparent foreign legal entities or legal figures would also trigger this special regime.

For these purposes, a legal figure or entity is consider to be transparent when two conditions are met: when they are not considered as a taxpayer in the country in which they are incorporated or in which their main administration is established; and when their income is attributed to their members, partners, shareholders or beneficiaries.

The consequence of being targeted with this special regime is that the income generated in the investment vehicle is subject to taxation in Mexico in the tax year in which it is generated; the income is taxable irrespective of whether it is received by the Mexican individual as it is the anticipation of an accrual.

There are certain exceptions to this special regime, and the one that is most common to encounter within this type of structures is the lack of control over the vehicle or over its management such that the Mexican investor cannot decide when the income, profits or dividends are to be paid out.

It is important to note that the Mexican investor is considered, by operation of law, to have control over the investment vehicle; therefore, the individual has the burden of proof and will be required to gather and maintain sufficient evidence to demonstrate that no control exists.

Similarly, Mexican taxpayers must file an information tax return with the Mexican tax authorities regarding:

a income that is subject to the aforementioned special regime;

b income generated in countries listed under the Mexican Income Tax Law, which are considered to be tax havens (blacklisted territories); and

c transactions carried out through foreign transparent tax structures or entities.

With respect to the tax return described in (a), this obligation is not present where the taxpayer does not have effective control of the vehicle or the vehicle's management, which includes the authority to control the timing of distribution of income, profits or dividends, whether directly or through third parties.

With respect to the informative return mentioned in (b) (transactions carried out through foreign transparent tax legal structures or entities), this obligation was previously not present in those cases where the foreign transparent tax structure was created in a country with which Mexico had an ample exchange-of-information mechanism. However, this exception was contained in a certain administrative rule that was eliminated on 14 August 2016.

From the above, the inclusion of certain transparent entities or figures (such as some trusts) will trigger the obligation to report the structure even if there is no control over the moment or timing to distribute income. Thus, a careful review should take place for any structure that has these types of entities or figures.

If there is a noncompliance with the filing of the above-described informative returns, this may be considered a tax crime.

v Investments made in Mexico by foreign investors

Wealth tax structures for foreigners would vary depending on the type of investment and also how the individuals have accommodated their structure abroad. Normally, it is common to have investments that derive interest, dividends, capital gains and real estate, of which tax effects are discussed in Section IV.iii.

Nevertheless, several foreign structures put into place in Mexico, with respect to private capital (normally related to investments in real estate), the use of transparent figures that are considered for Mexican tax purposes as flow-through entities. It is customary to encounter the usage of partnership agreements (generally from provinces in Canada).

As mentioned, for Mexican tax purposes, the partnership will be viewed as a transparent figure, and all the income received from a Mexican taxable source will be considered received by the members of the partnership, even granting in the case of foreigners the benefits of double taxation conventions (if the member of the partnership qualifies).

This transparency treatment is recognised owing to civil law recognition of the non-legal separate personality of the partnership from its members, irrespective of the tax treatment in the country of origin or creation of the partnership. Unfortunately, this eliminates structuring using entities that have a separate legal personality.

vi Anti-money laundering and other applicable regulations

The anti-money laundering regime is fairly new in Mexico, introduced in 2014; however, despite this, the financial sector and others who have been especially vulnerable to the negative effects of money laundering have strongly supported its implementation.

Mexican anti-money laundering operates through a legal system that forces financial institutions and persons involved in vulnerable transactions to identify and monitor their clients to prevent, detect and report money laundering (specific transactions include real estate acquisitions, loans not granted by the banking system, lending of real estate, acquisition of jewellery, gambling and other customary activities that are identified with money laundering).

On 14 June 2018, a Decree was published in the Federal Official Gazette that reforms the General Corporations Law. The Decree will enter into force on 15 December 2018. The amendment imposes on limited liability companies and business corporations the obligation to inform the Ministry of Economy of any change in the structure of their capital stock. These reforms promote the report and exchange of information between authorities with the purpose of fighting against money laundering from taxpayers.

These changes will have an effect in terms of the enforcement of the Anti-Money Laundering Law (Federal Law for the Prevention and Identification of Operations with Illegal Assets), since through the aforementioned report and exchange of information, authorities may now verify the accuracy of the data collected to see if any vulnerable activity is being carried out.

Tax authorities (which are the authorities with the power to review and impose penalties related to the compliance of anti-money laundering regulations) have been issuing fines to a considerable amount of individuals and corporations who did not identify clients who carried out vulnerable activities or who did not present the corresponding information required by the Anti-Money Laundering Law.

Nevertheless, the Federal Revenue Law for 2019 sets forth that taxpayers obliged to comply with Anti-Money Laundering Law obligations are entitled to implement regularisation programmes by requesting and obtaining them from the tax authorities. This regards obligations triggered from 1 July 2013 to 31 December 2018.

The Federal Revenue Law for 2019 states that no penalties shall be determined for the regularisation programme period (July 2013 to December 2018), and the tax authorities can cancel fines already imposed during the regularisation programme period.

vii Mexican fintech regulations

In 2018, the Mexican Fintech ecosystem grew up to 300 fintech startups, this represent an annual growth rate of 40 per cent. Thus Mexico reinforces its position as the second largest Fintech ecosystem in Latin America.

For the supervision of this sector, on 10 September 2018, the Mexican National Banking and Securities Commission issued general provisions applicable to financial technology institutions (FTIs), which, as of 10 March 2018, are regulated by the Law that Regulates Financial Technology Institutions, commonly referred to as the 'Fintech Law'.

The Fintech Law develop an integral framework that considers the different business models in a single law, including virtual assets (cryptocurrencies). The main figures in this law are the FTIs comprising crowdfunding institutions and electronic payment institutions.

The Fintech Law enables FTIs to carry out transactions with virtual assets and regulates innovative models – such as cryptocurrencies – or other types of assets referred to or traded from blockchain technology. To act as an FTI, it is necessary to comply with certain requirements and have the authorisation of the Mexican National Banking and Securities Commission

Mexico is positioned as an attraction to investors seeking to develop this sector, owing to the fact that half of the population still does not have access to financial services, which results in a wide margin for the expansion of fintech companies.

V OUTLOOK AND CONCLUSIONS

The current investments and wealth management climate cannot be disassociated from international efforts towards transparency and avoidance of double non-taxation agreements and implemented mainly and among others by the OECD with its BEPS project and the CRS platform.

Today, the automatic exchange of information is a reality that the tax authorities around the world have embraced. This situation implies that wealth structuring cannot rely on having the objective of 'catch me if you can' or secrecy. It is required to be fully compliant with the tax laws of multiple jurisdictions, to pass the test of substance and also to be aware that a large amount of compliance or informative returns (not just tax returns) must be taken into account. The wealth-management world has changed.

Mexico has been a part of this change and it is likely that there will be a higher focus on reviewing wealth structuring by the Mexican tax authorities. Tax enforcement will be facilitated through collaboration with other countries, and the amount of information that the Mexican tax authorities might have about a particular individual or transaction will be remarkable. Structures that in the past were non-compliant where they relied purely on confidentiality will be tackled and fought by the tax authorities with all the new tools available.

These changes have led, in some part, to the high amount of revenue collected by the 2017 repatriation programme, successfully implemented by the Mexican tax authorities. Even now, some audits are beginning to review whether the compliance of the requisites set forth in such programme were observed by the taxpayer. Also, certain public leaks related to investments in locations regarded as secret offshore tax havens have piled pressure on the tax authorities to increment their reviews on Mexican high net worth individuals on compliance and the need to increment public awareness about compliance, as well as the possibility of voluntary disclosure and regularisation. Further, the outcome of the NAFTA renegotiations and understanding the international effects of the US tax reform may also have repercussions with regard to current structures of high net worth individuals.

Finally, the most profound element of change will come about through the new administration. This new presidency, with control over both the House of Representatives and the Senate, could with further alliances gain the power to amend the Constitution, implementing programmes that will increase social spending, which will have to be funded in some part through an increase of tax revenues. From the above, we can expect in the future a larger amount of tax enforcement actions, rather than a change of tax policies or modifications to the current tax legal framework. This is a situation to take into account, whether with the current wealth structures or those to be implemented in the future.

Appendix 1

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Law
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ISBN 978-1-83862-056-1