December 2019

**Mexico's 2020 Tax Reform**

**2020 Tax Reform. Federal Tax Code Amendments.**

Below you will find a brief report on the Federal Tax Code ("FTC") amendments approved by Mexico´s Congress, which are pending and will be issued in the Federal Official Gazette.

| Concept | Amendments | Effects and issues to consider |
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| **1. Anti-Avoidance rule.**<br><br>*Article 5-A, FTC.* | Tax authorities, in exercise of their audit authority, are entitled to re-characterize any act that does not have a business reason and generates a tax benefit to the taxpayer, attributing to such acts the tax effects that would have been produced to obtain an economic benefit reasonably expected.[1]<br><br>For the application of the anti-avoidance rule, a "favorable opinion" issued by a committee (officials of the Ministry of Finance and Public Credit - "SHCP" – and the Tax Administration Service – "SAT") will be necessary. If such opinion is not issued within a two- month period, it will be considered as a negative resolution.<br><br>It is legally assumed, unless the taxpayer proves otherwise, that a transaction does not have a business reason when: *i)* the measurable economic benefit is a smaller amount than the tax benefit obtained; or *ii)* the reasonably expected economic benefit could have been reached with fewer acts and the tax effect would have been greater (fragmentation of operations). | We consider that this provision goes against the principle of "free economy choice" (the opportunity for taxpayers to form their economic and legal relationships in a way that is more tax efficient).<br><br>This principle reaches its limit when the taxpayer's objective is to avoid tax, a class characterized by using mechanisms aimed to prevent triggering a tax event.<br><br>There is a problem regarding quantifying the reasonably expected economic benefit vs. the tax benefit, as there are operations that involve a complex economic analysis that must be completed within a two-month period (favorable opinion). |

[1] The legal assumption shall be announced before the closing of the audit procedure, in order to give the taxpayer an opportunity to challenge such assumption.


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| | A tax benefit is considered any reduction, elimination or temporary deferral of a contribution. The FTX provides a non-limited list of situations to accomplish this goal.<br><br>For example, that there is a reasonably expected economic benefit when operations seek to generate income, reduce costs, increase the value of goods, or improve market positioning, among other cases; in order to measure such benefit, tax authorities may use the contemporary information related to the operation, including the projected economic benefit.<br><br>The application of this provision will not be used as a basis for criminal action. | If the favorable opinion is issued, the presumption could be challenged through legal remedies, so the tax assessment grounded on such assumption must demonstrate that the taxpayer complies with all the conditions set forth in the anti-avoidance provision so that the re-characterization holds.<br><br>It is recommended that taxpayers consider this new rule when making a decision to carry out any operation. In order to have elements to challenge the legal assumption, taxpayers must have the support to prove that there was an economic benefit greater than the tax benefit obtained and that ultimately, the operation chosen is the most burdensome among all the options.<br><br>Notwithstanding the negative effects of this new rule, we consider that the amendment gives more certainty on the application of anti-avoidance rules which have already been applied by the tax |



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| | | authorities without a regulation. |
| **2. Cancellation of digital certificates.**<br><br>*Articles 17-H and 17-H Bis, FTC.* | The use of digital certificates to issue digital electronic invoices ("CFDIs") will be temporarily restricted when authorities detect the following:<br><br>• The omission to file the annual tax return or two or more provisional or monthly tax returns;<br>• Determination that the status of a taxpayer as not located, missing or leaving his tax address without filing previous notice;<br>• Determine that a taxpayer issued CFDIs regarding non-existent operations;<br>• When a taxpayer issued CFDIs and did not prove against the assumption of non-existent operations and such taxpayer appears on the definitive listing as a Company issuing CFDIs for Simulated Operations ("EFOs" as its acronym in Spanish);<br>• When a taxpayer receiving CFDIs issued by an EFO (Company Deducting Simulated Operations or "EDOS" as its acronym in Spanish) did not prove the effective acquisition of goods or the existence of the services and did not correct their tax situation within the legal term;<br>• That the income accrued, the tax withheld or revealed tax does not match those indicated in the CFDIs, files, documents or databases held by the authorities;<br>• The registered e-mail, phone or address for contact in the tax mailbox are not correct or authentic;<br>• When a taxpayer commits one or more infractions;<br>• When taxpayers did not prove against the assumption of undue transfer of tax losses. | Companies must implement control and security measures that allow verifying the compliance of tax obligations, such as: *i)* identifying the dates and those responsible for submitting the tax returns; *ii)* keeping track of suppliers and making sure that they are not listed as EFOS; *iii)* prove against the assumption of inexistent operations; *iv)* have accounting records and proof of existence to support all operations for which a CFDI was issued.<br><br>The suspension and/or cancellation of the digital certificates implicates the impossibility to issue CFDIs, which complicates the daily operations of the companies and might have the consequence of breaching obligations with third parties (customers, buyers, or employees).<br><br>Although all the cases to cancel the digital certificate might derive from a common error, we have a particular concern regarding the one derived |



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| | Taxpayers may submit a request to clarify anomalies and/or prove against the cases described for the application of such measure. The digital certificate will be restored the day after the request is submitted. The tax authority will issue the resolution within a ten-days period and until the resolution is issued, the use of the digital certificate will be allowed.<br><br>If the anomalies are not corrected or the taxpayer does not prove that any wrongdoing was committed, the authority will confirm the cancellation of the digital certificate. | from receiving invoices issued by taxpayers considered as EFOS, because if the taxpayer did not prove against the legal assumption of non-existence within the legal time frame, despite having actually received the services or goods, the authority may confirm the cancellation of the digital certificate in the clarification procedure.<br><br>In such case, the company will not be allowed to issue tax invoices, even during a litigation procedure. This situation will prevent the taxpayer to operate normally, compelling him to pay the presumably omitted taxes.<br><br>Due to the seriousness of this issue, it is strongly recommended to analyze the legal options available to continue operating in case of the temporary cancellation of the digital certificate, such as the possibility of issuing CFDIs through a third party. |
| **3. Limitation for universal offset.**<br><br>*Article 23, FTC.* | The universal offset rule is eliminated (the restriction was already introduced by the Federal Revenue Law in 2019). | Only contributions derived from the same tax might be offset. Taxpayers must review the damage regarding cash flow and if a |



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| | | positive balance is generated, they will have to evaluate the convenience to file a reimbursement request. In this case, during the reimbursement procedure, tax authorities might request a very comprehensive list of information to the taxpayers, which in some cases is similar to an audit procedure. Therefore, taxpayers need to have enough information to support the existence of the positive balance. |
| **4. Several and joint liability.**<br><br>*Article 26, sections III, X and XVII, FTC.* | The cases to release liquidators and trustees from joint liability derived from omitted taxes during the period they held such position were eliminated.<br><br>The joint and several liability for partners, shareholders and associates will be in connection to the activities performed by the company during the period they held such position and only for the portion that is not guaranteed by the taxpayer, without exceeding their participation in the company´s equity and if one of the following cases is triggered:<br><br>• The company is not registered in the Federal Tax Registry ("RFC");<br>• Not filing the tax domicile modification notice or vacating the facilities (tax domicile) without filing the proper notice or being considered as not reachable;<br>• Not having accounting records, hiding them or destroying them; | The administrators, general directors and general managers of the companies, as well as the partners and shareholders can be jointly liable for the unpaid taxes regarding the compliance of tax obligations during they held such positions.<br><br>It is recommended that taxpayers implement control measures to verify the compliance of all tax obligations that could trigger a joint liability, as mechanisms to limit this effects regarding sole administrators, directors and general managers to guarantee any possible economic damage derived |



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| | • Failing to pay withheld contributions.<br>• Being considered as an EFO or an EDO that within a tax year received CFDIs issued by one or various EFOS for an amount higher than MXP$7´804,230 (USD$390,211).<br>• Taxpayers that did not prove against the legal assumption for illegal transfer of tax losses.<br><br>Regarding the several and joint liability of managing directors, general managers and sole administrators, such liability will be for the contributions triggered, not paid and/or withheld during the time they held such position, for the portion of the tax assessment that is not guaranteed by the taxpayer. They will only be jointly liable if one of the described cases is triggered. | from tax assessment for unpaid taxes.<br><br>Such mechanisms must be implemented including in the employee agreements certain warrants, which we recommend to be included as well in the Company's by-laws. |
| **5. Tax obligation compliance opinion.**<br><br>*Article 32-D, FTC.* | Any authority that receives and uses federal public funds will be unable to enter into agreements with any individuals or corporations that: *i)* have a definitive tax assessment issued by the tax authorities; *ii)* have a tax assessment (definitive or not) that has not been paid or guaranteed; *iii)* are not registered in the RFC; *iv)* have not filed any tax return (provisional or not definitive), withholding tax returns regardless of whether there was an amount to be paid, as well as any informative tax return; *v)* is considered as not reachable at its tax domicile; *vi)* have a final conviction for a tax offense; *vii)* are taxpayers who are considered as an EFO, or that have not proven against the legal assumption for illegal transfer of tax losses; or *viii)* have stated in the tax return, definitive or annual, income and withholdings that do not match their CFDIs or | Those companies that enter into agreements with the government must establish mechanisms or controls to avoid falling into any of the cases provided for in the rules, a situation that could be implemented through manuals or compliance guides. |



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| | the documentation to which the tax authority has access. | |
| **6. Disclosure of tax planning structures.**<br><br>*Article 82-A to 82-D and 197 to 202, FTC.* | The tax reform for 2020 sets a *new* regime of “reportable tax planning structures” which establishes an obligation for tax advisors [2] and in some cases for taxpayers to disclose certain tax planning structures to the tax authorities.<br><br>The disclosure does not breach the tax advisor’s professional secret obligation.<br><br>A reportable tax planning structure is one that generates or may generate, directly or indirectly, a tax benefit in Mexico and has some of the characteristics identified in a list as "risk areas" such as (for example): *i)* preventing foreign authorities from exchanging tax or financial information with Mexican authorities; *ii)* allowing the transfer of tax losses to another individual or entity than the one that generated them; *iii)* involving a foreign resident who applies a tax treaty to avoid double taxation signed by Mexico regarding income that is not taxed in the country or jurisdiction of tax residence of the taxpayer; *iv)* avoiding the identification of a beneficial owner; or *v)* avoiding constituting a permanent establishment (“PE”).<br><br>The authorities will issue administrative rules on minimum amounts for which there will not be an obligation to report.<br><br>Tax advisors must provide an identification number of the reported tax planning structure | It is required to disclosure tax planning structures considered reportable by the tax authorities.<br><br>Although a "risk area" is not triggered if a tax planning structure generates tax benefits, the advisor must disclose it to the client through a certificate, which will be based on what the tax authority determines by administrative rules.<br><br>Taxpayers and advisors should confirm: *i)* what is considered as a reportable tax planning structure; and *ii)* who will be the subject obliged to file the report to the tax authorities.<br><br>Regarding tax planning structures implemented prior to 2020 that have effects in such tax year or further, they must be reported by the taxpayer. Therefore it is necessary to analyze their scope and the way they must be reported. |

[2] A tax advisor is any individual or entity who, in the ordinary course of business, performs tax advisory activities, and is responsible for or involved in the design, marketing, organization, implementation or administration of the whole reportable structure or who makes available the whole reportable structure to be implemented by a third party.



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| | to taxpayers so that they can include it in the tax return. If the tax advisors do not report the tax planning structure, then the taxpayer will be obliged to report it (for example, if there is an agreement between the advisor and the taxpayer in which the taxpayer relieves the tax advisor from reporting the tax planning structure).<br><br>Tax authorities are entitled to review the tax advisors to verify the compliance of their reporting obligations.<br><br>If the transaction is not considered as a tax planning reportable structure, but the taxpayer obtained a tax benefit, the tax advisor shall issue a certificate to the taxpayer supporting a non-reportable tax planning structure or the prohibition to reveal it.<br><br>The penalty to be imposed on a tax advisor for not disclosing a reportable tax planning structure or doing it incorrectly or incompletely goes from $2,500 to $1,000,000 USD (approximately), while not complying with other obligations regarding the report such as providing the identification number of the reportable tax planning structure to the taxpayer, not attending official requirements of information, not issuing the certificate supporting a non-reportable structure or the prohibition to reveal it, not informing the tax authorities of any change in the reportable tax planning structure or not filing the annual informative tax return, will be subject to a fine of USD$1,000 to $25,000.<br><br>The penalty for the taxpayer for not disclosing a reportable tax planning structure or doing so incorrectly or incompletely will be the rejection of the whole tax benefit obtained by | If there are several advisors involved, only one report should be filed, so it is important to determine who will be the reporting party.<br><br>If the tax planning structure is fragmented or given by a foreign advisor, then the taxpayer will have to report it.<br><br>The tax authority will issue administrative rules by which they will have to clarify any question raised and the scope for the application of the new reporting obligation.<br><br>Therefore, it is recommended that all tax planning structures that may be reportable after 2021 are analyzed jointly with the tax advisor to determine how to report it and the scope of the obligation. |



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| | the application of such structure plus a fine of 50% to 75% of the amount of the benefit that was obtained or expected to be obtained in all the years involved. The taxpayer will be subject to a fine of USD$2,500 to $100,000 for not including the identification number of the reportable structure in the tax return, not attending official requests or not informing the tax authorities of any change in the reportable structure.<br><br>The new tax planning structure report will enter into force on January 1, 2021.<br><br>Tax advisors shall report the tax planning structures on the date that the new regime enters into force regarding the reportable tax planning structures implemented, designed, organized or managed as of January 1, 2020.<br><br>However, taxpayers will be obligated to report all tax planning structures implemented, designed, organized or managed before 2020 that still produce tax consequences in such fiscal year. | |
| **7. Penalties related to CFDIs.**<br><br>*Articles 83, section XVIII, 84 section XVI, 89, section IV, 90 and 113 bis, FTC.* | Penalties derived from CFDIs issued by EFOS regarding which the recipient taxpayer did not prove the existence of the operation will be 55% to 75% of the amount of each CFDI (currently USD $603 to $3,450).<br><br>The taxpayer is entitled to correct its tax situation to avoid such penalties, as long as such correction is filed before tax authorities initiate an audit process regarding such operations.<br><br>Regarding criminal offenses, the penalties range from 2 to 9 years imprisonment for anyone who, by himself or through an | Companies need to review their internal procedures to detect suppliers considered as EFOS.<br><br>It is important to consider that the penalties described are independent from the ones determined for the rejection of the deduction of such operations. |



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| | intermediary, issues, sells, buys or acquires CFDIs for non-existent, false or simulated operations. | |



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