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2022 Federal Budget
Overview of Proposed Tax Reforms

On September 8, 2021, President López Obrador sent a proposal to the Mexican Congress to amend, add and repeal, among others, several provisions of the Income Tax Law, the Value Added Tax Law, the Excise Tax Law and the Federal Fiscal Code (the "Proposal").

The Proposal includes important changes and additions to relevant tax provisions. Even though we will publish a detailed analysis in the next few days, this memorandum provides a brief overview of some of the most relevant tax topics.

Mexican Income Tax Law

The Proposal includes changes to provisions related to the calculation of FX gains; new scenarios that are considered as back-to-back loans; rules that seek to avoid planning through usufruct structures; additional requirements to obtain authorization for the transfer of shares at tax cost and for the deduction of interest (thin capitalization), investments (usufruct and mining sector), uncollectible loans and purchased fuels.

Regarding calculations based on thin capitalization rules, the exception that allows to exclude debts incurred with the members of the financial system when carrying out their corporate purpose, would not be applicable to unregulated multiple purpose financial entities ("*SOFOM NR"*) that mainly conduct activities with local or foreign related parties.

Additional limitations to carry forward tax losses in mergers and spin-offs are also proposed. Regarding transfer pricing obligations, the Proposal clarifies that such obligations also apply to transactions carried out between Mexican related parties and include a set of rules for the application of comparables and market ranges other than the interquartile range; and to eliminate the possibility for *maquilas* to request Advanced Pricing Arrangements (APAs), leaving the safe harbor option as the only available.

With regards to foreign residents' income, the Proposal includes additional requirements to obtain tax deferrals in multinational groups' restructurings, and specifies the scope of certain limitations for the application of reduced withholding rates on interest. The Proposal also establishes as requirements for persons acting as legal representatives of foreign residents to voluntarily assume joint and several liability for tax payments, and the obligation to prove that they have enough assets to face any potential liabilities.

For *REFIPRES*, the Proposal clarifies that FX and inflationary effects should not be considered for purposes of the calculations related to such regime. The Proposal intends to replace the Tax Incorporation Regime applicable to individuals, and the incentive for legal entities to recognize income under a "cash flow" basis, with a new "good faith" simplified regime (*regímenes simplificados "de confianza"*). The main corporate benefits for legal entities include a taxation/deduction regime on a "cash flow" basis, pre-filled tax returns and the possibility of deducting investments at higher annual rates. For individuals, benefits include a progressive rate taxation system, simplified compliance and a waiver to file informative returns.

Value Added Tax Law

The Proposal intends to clarify that (i) VAT related to expenses or investments that are used exclusively to carry out activities "not subject to VAT" is not creditable, and that (ii) VAT related to expenses or investments that are used to carry out activities both "subject to VAT" and "not triggering VAT", including activities "not subject to VAT", will be creditable in the same proportion as the value of those activities "subject to VAT" relative to the total value of activities both "subject to VAT" and "not triggering VAT". For such purposes, the Proposal includes a definition of activities "not subject to VAT".

In the case of VAT paid upon importation, the Proposal clarifies that the customs declaration (*pedimento*) should have the name of the taxpayer who intends to take the related credit. With respect to the VAT credit adjustment mechanism for pre-operating periods, taxpayers would have to inform the Mexican tax authorities on the month in which their activities begin.

The Proposal also proposes to modify the obligations applicable to foreign residents who provide digital services to customers located in Mexico. It also clarifies that the temporary use or enjoyment of goods in Mexican territory has always been subject to VAT, regardless of the location of the physical delivery of the goods.

A 0% VAT would apply to animal food, with certain exceptions such as processed food for dogs, cats and small species used as household pets, which would continue to be taxed at a 16% VAT rate.

Federal Fiscal Code

Regarding corporate mergers and spin-offs, the Proposal includes new assumptions on what would qualify as a sale for tax purposes (e.g., lack of business rationale and review of relevant transactions to carry out the merger/spin-off).

Taxpayers with taxable income in excess of MXN$876,171,996.50 in a tax year would have to prepare audited financial statements, and their public accountant would be obliged to disclose any compliance issues related to tax or customs regulations, as well as any activities that may classify as a criminal activity.

The Proposal includes amendments and additional requirements to several taxpayers' obligations, such as the change of tax residence of individuals and corporations (in order to limit the possibility of migration to low-tax jurisdictions); notifications related to the modification of an entity's partners or shareholders; Federal Taxpayers Registry's (RFC) cancelation notices; tax invoices issued when conducting business activities (additional data would be required, as well as compliance with invoice "complements"); tax invoices on expenses; and the tax invoice cancellation procedure (which should be justified and properly documented).

The Proposal grants new powers to the Mexican tax authorities, including (i) the cancellation or suspension of taxpayers' RFC in specific scenarios (e.g., not conducting any activity during five consecutive years), (ii) updating taxpayers' economic activity and obligations in case of inconsistencies between the business description of their tax invoices and their economic activity as registered in the RFC; (iii) cancellation of taxpayers' digital stamp certificates under specific circumstances; and (iv) declaring, within an audit procedure, the existence of sham transactions between related parties, solely for tax purposes.

Regarding joint and several liability, the Proposal includes specific assumptions under which commercial negotiations should be understood to be transferred; the joint and several liability for representatives of foreign companies; and joint and several responsibility for legal entities that register new shareholders without submitting the corresponding notice of transfer of shares between foreign entities.

The reference to hiring or acquiring volumetric control equipment and systems from, “authorized suppliers”, to their verification and issuance of technical reports, would be eliminated. In addition, the Proposal includes criminal penalties for taxpayers who fail to implement volumetric controls, alter them, use them improperly or destroy them.

The Proposal puts forward new tax auditing procedures, including: (i) the appraisal of taxpayers' investments and (ii) the review of financial institutions; trustees, settlors or beneficiaries in the case of Mexican trusts (*fideicomisos*), and the members of any legal vehicle. The latter seeks to verify compliance with financial institutions' obligations related to account holders' information; as well as with the compliance of reporting obligations applicable to parties to a Mexican trust or any other legal vehicle regarding the “controlling beneficiary” (e.g., whoever exercises effective control in the contract). Such persons should obtain, keep and, if prompted, provide to the Mexican tax authorities all information regarding such “controlling beneficiary”.

The Proposal includes assumptions applicable to the hydrocarbons sector that would enable the Mexican tax authorities to presume profits, as well as the mechanisms and percentages that should be applied in these cases.

Finally, the Proposal adds a provision that provides taxpayers with the possibility to carry out self-corrections by using positive tax balances, starting in 2023.

Excise Tax Law (“IEPS”)

With regards to the IEPS Law, the Proposal contemplates new control mechanisms for the importation of fuels and the sale of alcoholic beverages (including electronic tags, known as *“marbetes electrónicos”*), cigarettes and tobacco products. Additionally, a procedure is established for updating IEPS rates applicable to automotive fuels under Article 2, section I, subsection D), in order to reflect the expected inflation in 2022.

Finally, please note that the 2022 budget did not include any proposal regarding inheritance tax.

Should you require additional information, please contact Oscar López Velarde (olopezvelarde@ritch.com.mx) or Santiago Llano Zapatero (sllano@ritch.com.mx), Ritch Mueller's tax partners.