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TAX REFORM FOR 2022

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On November 12, 2021, the Decree that amends, adds and repeals various tax provisions in Mexico was published in the Official Gazette of the Federation. The following are the amendments and additions that we consider most relevant, which will become effective as of January 1, 2022:

FOREIGN EXCHANGE GAIN

Article 8 of the Mexican Income Tax Law ("MITL") is updated to specify that, to determine the exchange gain that should be treated as interest, taxpayers must consider the exchange rate for settling obligations published by the Mexican Central Bank corresponding to the day in which the gain is realized.

BACK-TO-BACK LOANS

The fact patterns for the existence of back-to-back loans provided for in the MITL are broadened to include financing transactions with related parties that lack a business purpose, provided that the debtor is a Mexican resident entity or a non-resident with a permanent establishment in Mexico.

With the addition of this fact pattern, being able to prove the existence of a business purpose in intercompany loans becomes essential, to avoid interest recharacterization as dividends and non-deductibility of interest for the debtor.

INVESTMENTS

• Accounting-fiscal homologation of tax basis of capital expenses.

Disbursements for the preparation of physical sites, installation, assembly, handling, delivery, and services hired for capital expenses to operate, are included as items that comprise the deductible tax basis (monto original de la inversión or "MOI", per its acronym in Spanish).

USUFRUCT

Several provisions are added to regulate the tax treatment of usufruct, among them, the moment and determination for the recognition of income generated under this legal arrangement; the mechanism to allocate the cost between the bare ownership and the usufruct; and its classification and the rate for its depreciation are modified.

• Recognition of income.

At the consolidation of the bare ownership and the usufruct of an asset the corresponding income must be recognized. For this purpose, the income shall consist of the value of the usufruct rights determined by means of an appraisal performed by an authorized person.

• Reporting obligation for public notaries.

Public notaries, before whom the dismemberment of the property is formalized, must report such transaction to the tax authority within 30 days after its execution.

• Allocation of cost between bare ownership and usufruct.

To determine the gain on dispositions of the bare ownership or usufruct, the proportion of the depreciation tax basis (adjusted as described below) corresponding to the bare ownership or usufruct will be deducted from the consideration received. The depreciation tax basis of the asset would need to be segregated between bare ownership and usufruct according to the percentage obtained, dividing the price received for the asset transferred over the total value of the property. For these purposes, an appraisal must be made by an authorized person.

• Reduction of the maximum depreciation rate.

The amendment states that the right of usufruct constituted on real estate qualifies as a "fixed asset" and not as a "deferred expense"; therefore, the maximum depreciation rate is 5% and not 15%. The rationale behind This is that the owner of the bare property does not have the right to depreciate such bare property, since the owner will not be able to use it.

LIMITATION ON THE DEDUCTION OF EXPENSES FOR TECHNICAL ASSISTANCE, TECHNOLOGY TRANSFER AND ROYALTIES

An exception is added to the requirement to consider technical assistance, royalties or technology transfer as deductible items, which consists of having the services rendered directly and not through third parties. The exception applies to cases where these services qualify as "registered specialized services", in accordance with the subcontracting labor reform. Previously, the exception applied when the services were rendered by a Mexican resident third-party.

COLLECTION EFFORTS IN BAD DEBTS FOR DEDUCTION

Requirements have been added to prove the notorious practical impossibility for collecting a delinquent debt exceeding the amount of 30,000 Mexican investment units (Unidades de Inversión or "UDIs", per its acronym in Spanish), which is necessary to deduct such loss. Note that 30,000 UDIs are equivalent to approximately US$10,658. Prior to the amendment, filing a claim before a judicial court or an arbitration tribunal was sufficient to claim the deduction. Now, as a result of the reform, the taxpayer must obtain a final ruling demonstrating that collection efforts have been exhausted before the competent authority.

Likewise, banks deducting delinquent debts due to the notorious practical impossibility to collect them, must show, in the case of an audit by the tax authority, the information provided to the credit rating agencies.

THIN CAPITALIZATION

The calculation to determine the capital of an entity to determine the debt/equity ratio is modified; specifically, the option that allows for taxpayers to consider the sum of the opening and closing balances of their tax attributes (i.e., capital contributions account or CUCA, net-after tax profits account or CUFIN, and reinvested net tax-profit account or CUFINRE) as stockholders' equity for the year to be compared against the level of indebtedness. To determine this equity for tax purposes,

taxpayers will now have to reduce from the sum of the opening and closing balances of such tax attributes, the sum of the beginning and ending balances of the tax loss carryforwards. Further, this option may no longer be exercised when the result exceeds 20% of the stockholders' equity, unless such a difference results from a business purpose that can be proved in the event of an audit by the tax authority, and the corresponding support for the balances of the tax attributes is available.

Regarding the exception to determine thin capitalization in the case of debts incurred for the construction, operation or maintenance of productive infrastructure related to strategic areas for the country or for the generation of electric energy, the reform provides that this exception will only apply to the holder of the document issued by the competent authority, which proves that its holder can carry out those activities on its own account. In other words, the amendment adds another requirement (i.e., to be the holder of the permit, concession) in order to be exempted from thin capitalization rules, in the case of financing for productive infrastructure related to strategic areas in Mexico or for the generation of electric energy.

Also, as a result of the reform, the exception to determine thin capitalization, which currently applies to entities that are part of the financial system, will not be available to unregulated non-bank banks (Sociedades Financieras de Objeto Múltiple Entidades No Reguladas or "SOFOM ENR") that predominantly have activities with related parties. It is important to mention that the tax provisions consider "preponderant activity" to be that economic activity for which, in the fiscal year in question, the taxpayer obtains the greatest part of its income with respect to any of its other activities.

CORPORATE RESTRUCTURINGS BY MEXICAN RESIDENTS

The corresponding regime is amended to indicate that taxpayers must report all relevant transactions related to the restructuring subject to authorization, which have taken place within the five years preceding the filing of the request for the corresponding restructuring authorization. Likewise, when a relevant transaction takes place within the five years that follow the restructuring, the company acquiring the shares must submit the information referred to in article 31-A, first paragraph, section d) of the Mexican Federal Fiscal Code ("FFC", per its acronym in Spanish), in the terms stated in such provision.

In the event that the tax authority, during an audit, detects that the restructuring lacks a business purpose, the authorization will have no effects and the tax corresponding to the sale of shares will have to be paid, considering the value at which such shares would have been sold between independent parties in comparable transactions; or considering the value determined by means of an appraisal performed by a person authorized by the tax authority. The tax determined will be paid by the transferor, updated for inflation from the date on which the transfer was made until the date on which it is paid.

Lastly, article 24 of the MITL is amended to indicate transactions that are considered relevant.

TRANSFER PRICING

In the area of transfer pricing, the amendments are as follows:

- Transfer Pricing Report.

For purposes of the obligation of taxpayers (legal entities) to prepare documentation proving that income and deductions arising from transactions with related parties have been determined in accordance with the arm's length principle, the reference to "nonresident related parties" is eliminated, with the intention of clarifying that the obligation for taxpayers is with respect to all their transactions with related parties, whether they are resident in Mexico or abroad.

- Modification to the filing date for the Local File.

The deadline for taxpayers to file the Local File on transactions with related parties is moved from December 31 of the fiscal year following the one in respect for which the return is filed, to May 15 of such fiscal year.

- Non-residents with Mexican-source income.

An obligation to non-residents is added when they realize Mexican-source income. The obligation consists of determining the income, gains, profits and, if applicable, deductions derived from transactions with related parties, based on the arm's length principle; that is, considering the prices or profit margins that would have been agreed upon by independent parties in comparable transactions.

• Benchmark analysis.

The reform clarifies that, for comparability purposes, only the information of the comparable transactions or companies corresponding to the fiscal year subject to analysis, must be considered; and that only when the business cycles or commercial acceptance of a taxpayer's product cover more than one fiscal year, the information of comparable transactions corresponding to two or more fiscal years, may be considered.

• Maquiladoras' APAs.

The reform eliminates the possibility for maquiladora companies to obtain from the Tax Administration Service ("SAT") a particular ruling or Advance Pricing Agreement ("APA"), which gave the taxpayer certainty regarding the methodology used to determine the maquila income for a given period. Beginning in fiscal year 2022, maquiladora companies may only be taxed under the regime commonly known as "Safe Harbor", which consists of determining the tax profit as the greater of 6.9% of the total value of the assets used in the maquila operation, and 6.5% of the maquiladora's operating costs and expenses.

OBLIGATION FOR COMPANIES REPORT INFORMATION ON DISPOSITIONS OF THEIR STOCK

Beginning January 1, 2022, corporations will be required to file with the SAT, information regarding each sale of shares issued by them or securities representing their capital stock, carried out between foreign residents, within the month immediately following the date on which the sale occurs. If a legal entity does not submit the referred information, the SAT could (a) impose a fine for each unreported sale; (b) temporarily restrict the use of the digital certificate for the issuance of digital tax receipts through the Internet (i.e., invoices and payroll receipts); and (c) collect income tax on the sale of shares, as joint obligor of the seller.

We understand that, in the case of shares listed in recognized markets or securities representing the ownership thereof, it is impossible for the issuing companies to know if and when such shares are sold, since issuers cannot keep a share registry and brokerage firms cannot provide them with information on such transactions due to stock exchange secrecy; however, issuers that are in this situation are not currently exempted from complying with this new obligation with respect to the stock exchange portion of their shares.

• Recharacterization due to the lack of business purpose.

Currently, the FFC regulates the cases in which a merger or spin-off are not considered to be taxable transaction. As a result of the amendment, a fact-pattern is added under which the tax authorities, during an audit, can determine that the tax effects of a sale should be considered when the merger or spin-off lacks a business purpose. The law itself specifies that the tax authority may consider the relevant transactions related to the merger or spin-off in order to determine the presence or absence of a business purpose.

Article 14-B of the FFC describes the relevant transactions to be considered by the authority; among them are the following: any act by which (i) the ownership of shares or voting rights is transferred; (ii) the right over assets or profits is granted; (iii) the book value of the shares is modified by more than 30%; (iv) the value of the capital stock is modified; and (iv) the tax residence of the partners or shareholders of the companies involved in these transactions is changed.

With respect to mergers or spin-offs that are effective as of 2022, the surviving company or the company designated in the spin-off must report the existence of relevant transactions occurring within five years after the merger or spin-off. Failure to comply with such obligation could result in the merger or spin-off being considered a sale for tax purposes.

• Tax loss carryforwards - spin-off.

With respect to the limitation to transfer tax loss carryforwards in the event of a corporate spin-off, it is stated that they may only be divided between the spin-off and spun-off companies engaged in the same line of business.

• Amortization of tax losses - merger.

With respect to the requirement for the amortization of tax losses of prior years in the context of a change of partners or shareholders, the fact-patterns under which such change is considered to have occurred, have been added. These additions include (a) the change of direct or indirect holders of rights that allow (i) imposing decisions in the general shareholders' meetings, (ii) appointing or dismissing the majority of the directors or (iii) directing the management, strategy or the main policies of the company; additionally (b) when after the merger, the financial statements of the corresponding company and its shareholder are no longer consolidated.

LIMITATIONS TO THE WITHHOLDING RATE OF 4.9% FOR INTEREST PAYMENTS TO NONRESIDENTS

The criterion of the Tax Administration Service is included, establishing that the reduced withholding rates of 10% and 4.9% for interest paid to nonresidents as provided in Sections I and II of Article 166 of the Income Tax Law, are not applicable if (i) the beneficial owners, directly or indirectly through related parties, receive more than 5% of the interest derived from the securities in question and (ii) they are: (a) shareholders of more than 10%, individually or jointly with related parties, of the voting shares of the issuer, or (b) legal entities for which more than 20% of their shares are owned by the issuer individually or jointly with related parties.

Through this amendment, it is established that the limitation is applicable to other cases and not only in the context of the issuance of securities; therefore, banks and non-bank banks (SOFOM) that receive loans from their nonresident related parties, may not apply the withholding rate of 4.9% provided by the MITL for the interest resulting from such financing. Depending on the creditor's tax residency, a reduced withholding rate may be applied in accordance with the applicable treaty for the avoidance of double taxation, provided that the corresponding requirements of the treaty are met.

OBLIGATION FOR THE SELLERS OF MEXICAN REAL ESTATE PROPERTY

The MITL provides that in cases in which the tax authority performs the appraisal for the sale of Mexican real estate property that derives in Mexican-source income and the acquisition price is more than 10% lower than the appraised value, the difference will be considered as bargain sale income for the non-resident. In connection with this provision, transferors (if they are a resident in Mexico or a non-resident with a permanent establishment in Mexico) will now have the obligation to pay such tax; and only if the transferor does not pay it, the non-resident acquirer will pay such tax through a tax return, 15 days after being notified by the tax authority. The reform further adds that the transferor will substitute the taxpayer (acquirer) in its obligation to pay the tax if the transferor pays the tax.

VOLUNTARY JOINT AND SEVERAL LIABILITY FOR THE LEGAL REPRESENTATIVES OF NON-RESIDENTS

In addition to the obligations already provided for in the MITL for the legal representatives of non-residents, two additional obligations are imposed on them: (i) to assume joint and several liability for the amount of the taxes triggered by the non-resident and (ii) to have sufficient assets to act, as joint and several obligors, for the taxes triggered by the principal non-residents.

No general rules have yet been issued to establish the guidelines for the application of this new obligation, which could be of great relevance to determine its scope and effect.

CORPORATE RESTRUCTURING BY NON- RESIDENTS

In connection with corporate restructurings where a non-resident was authorized to defer the payment of tax on the sale of shares issued by a Mexican resident entity, the shares sold shall be deemed to have left the corporate group when the target company and the acquiring company cease to consolidate their financial statements in accordance with the provisions that regulate the taxpayer in accounting and financial matters; or those that it is obligated to apply.

Likewise, the MITL is amended to provide that, the tax authority will have the power to detect while performing an audit that a restructuring lacked business purpose. The tax authority can analyze the relevant transactions related to such restructuring that were carried out within the preceding five years, together with those carried out within the five years immediately following the granting of the authorization in question, or that the exchange of shares generated income subject to a preferential tax regime (i.e., low-tax jurisdiction), the authorization issued in connection with the restructuring will be null and void.

Lastly, the reform provides that when, within five years following the restructuring, a relevant transaction is executed (understood in reference to the amendment to article 24 of the law itself), the company acquiring the shares must submit the information referred to in article 31-A, first paragraph, section d) of the FFC, in the terms established in said provision. It should be noted that, as provided for in a transitory provision, this obligation applies to restructurings that are already in effect as of the effective date of the reform.

MINING SECTOR

Article 32 of the Income Tax Law is amended to incorporate a criterion followed by the tax authority in audits, consisting of considering that expenditures made for the acquisition of mining concession titles should not be considered as expenditures made in pre-operating periods. This type of expenditures will be considered as deferred expenses, and therefore, the maximum depreciation rate applicable will be the percentage obtained by dividing the unit by the number of years for which the concession was granted.

Article 34, section I, paragraph b) is also amended to establish that the annual depreciation rate of 5% is applicable for those installations, additions, repairs, improvements, adaptations, and in general any type of construction carried out in mining lots.

SIMPLIFIED REGIME OF TRUST FOR INDIVIDUALS

A new tax regime is introduced for individuals, "Simplified Trust Regime for Individuals". This new optional regime provides a simpler method to comply with tax obligations, for taxpayers with business or professional activities or who grant the temporary use or enjoyment of goods, provided that their total income does not exceed three million five hundred thousand pesos. Likewise, the main benefit of this regime is its progressive tax rates of up to 2.5%. With this new regime the Régimen de Incorporación Fiscal (Tax Incorporation Regime) is eliminated.

TAX CERTIFICATE FOR FINANCIAL STATEMENTS

The following fact-patterns are included, under which corporate taxpayers must audit their financial statements for tax purposes: when (i) in the immediately preceding fiscal year they have reported taxable income exceeding $1,650,490,600 MXN (approximately US$82,524,530); or when (ii) they have shares placed among the general investor public in a stock exchange at the close of the immediately preceding fiscal year.

In terms of the FFC, the procedural rules in force at the time the obligations must be complied with, are applicable. Therefore, we consider that this new obligation is applicable to the 2021 tax year, unless the tax authority indicates otherwise by means of general rules.

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CONTROLLING BENEFICIARY

As part of the commitments adopted by Mexico as a member of the OECD Global Forum, and particularly for the purpose of complying with the proper adoption of the standard for the exchange of information upon request, a new obligation is introduced related to the identification of the controlling beneficiaries of the entities and legal arrangements.

Specifically, legal entities, trustees, settlors or beneficiaries, contracting parties or members of the legal entities, as well as financial entities and members of the financial system ("Legal Entities") and any other person involved in their formation or execution (including notaries and brokers) will have the obligation to obtain, keep and provide to the SAT, when required, information regarding the controlling beneficiaries of such Legal Entities.

The controlling beneficiary shall be understood as the person or group of individuals who, directly or indirectly, (i) obtain an economic benefit from the legal entity or (ii) exercise control of the legal entity (e.g., have the power to appoint or remove members of the board of directors or have voting rights with respect to more than 15% of the capital stock), even on a contingent basis. In the case of trusts, controlling beneficiaries include (iii) the parties to the trust (e.g., trustees, settlors and beneficiaries).

Penalties for non-compliance with the referred obligations may range from $500,000 to $2,000,000 MXN (US$25,000 to US$100,000) for each controlling beneficiary that is part of the legal entity.

VAT NON-OBJECT ACTIVITIES

In accordance with the criteria of the tax authority, the concept of value added tax "Non-Object Activities" is introduced in the Value Added Tax Law ("VAT Law").

Article 4-A is added to establish the concept of activities not subject to VAT. In summary, this new provision states that "non-object acts" are (i) those that are not carried out in Mexican territory, (ii) as well as those carried out in Mexican territory that are different from the sale of goods, rendering of independent services, granting of temporary use or enjoyment of goods or importation of goods or services, for which the taxpayer obtains income for which it makes expenses and investments in which VAT was transferred or VAT would have been paid upon importation.

As a result, taxpayers that carry out activities that are not subject to the VAT Law will not be able to credit the VAT paid to suppliers or on the importation of goods when they are related to such activities. Likewise, for purposes of calculating the credit factor with respect to expenses and investments that are used indistinctly to generate taxable, exempt, or non-taxable activities, the activities indicated in items (i) and (ii) in the preceding paragraph, must be considered in order to compute such factor.

CANCELLATION OF DIGITAL TAX INVOICES ("CFDI", PER ITS ACRONYM IN SPANISH) DURING THE FISCAL YEAR IN WHICH THEY WERE ISSUED

With the reform, the cancellation of a CFDI is limited to the fiscal year in which it was issued, unless earlier terms are provided for in the law. In addition, in any case, the cancellation must be accepted by the recipient of the CFDI.

The tax authority must issue rules to regulate the manner in which the cancellation of CFDIs is accepted. The amendment establishes that, if the cancellation refers to income CFDIs, the reason for such cancellation must be justified and supported by documentation; and, in any case, this may be verified by the tax authorities during an audit.

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