An overview of Mexican tax reform in 2022

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The Mexican government made significant changes to its country's tax laws for 2022. Here we examine the reforms expected to have the greatest impact on global enterprises.

Transfer pricing

Limitations for maquiladoras

The 2022 tax reform eliminates the option for maquiladoras—factories owned by foreign corporations—to apply for an advance pricing agreement (APA) with the Mexican tax authority Servicio de Administracion (SAT). Previously maquiladoras could use an APA to comply with Mexican transfer pricing rules regarding the fees they charge to their foreign principals.

The repeal affects the following taxpayers:

- Maquiladoras owned and operated by a foreign principal
- Foreign companies that hire a third-party contractor—a shelter maquiladora—to manufacture or assemble products in Mexico and that must pay the shelter tax to avoid creating a permanent establishment in the country

For years beginning on or after Jan. 1, 2022, only the safe harbor method is available for those taxpayers to meet Mexican transfer pricing requirements. This method requires the taxpayer to report in its Mexican income tax returns net taxable income of at least the higher of the following calculations:

- 6.5% of total costs and expenses (as defined by Mexico's income tax law) incurred by the maquiladora in the manufacturing process
- 6.9% of a theoretical net tax basis (calculated per Mexico's income tax law) of all the maquiladora's assets used to perform the assembly or manufacturing of products, including assets owned by the maquiladora and assets owned by the foreign principal

The elimination of the APA alternative simplifies transfer pricing compliance since maquiladoras now have only the safe harbor method to calculate their net taxable income. However, some maquiladoras will likely see their Mexican income tax liability increase.

Maquiladoras with an APA approved by the SAT for the year ending Dec. 31, 2021, are still able to use that option to determine the net taxable income they report in their 2021 income tax return, due March 31, 2022.

Additional requirements for studies
A mandatory transfer pricing study must now include:

- Transactions between Mexican taxpayers and related parties, whether foreign or domestic and an enterprise or an individual
- Functions, assets and risk analysis for both the taxpayer and the related parties involved in each intercompany transaction
- Limited benchmarking—in most instances, only comparable transactions completed during the study year can be used to benchmark transactions with related parties, and a taxpayer can only use the average of a certain number of prior years to test comparability when the business or product cycle extends longer than a year
- Adjustment of price ranges for intercompany transactions and profit margins using only the interquartile method or another statistical method approved by the SAT through a mutual agreement procedure established by a tax treaty

New due dates for related reporting requirements
For tax years beginning on or after Jan. 1, 2022, the following due dates are established for reporting related to transfer pricing:

Requirement	Due date
Information returns for transactions with related parties (Annex 9)	May 15 of the following calendar year (currently, Annex 9 is filed with the income tax return, with a due date of March 31)
Master file	Dec. 31 of the following calendar year (unchanged from the current due date)
Local country report	May 15 of the following calendar year (changed from the current Dec. 31 due date)
Country-by-country report	Dec. 31 of the following calendar year (unchanged from the current due date)

Temporary provisions for 2021
For the tax year ending Dec. 31, 2021, the following due dates are optional for reporting related to transfer pricing:

Requirement	Original date	Optional due date
Information returns for transactions with related parties (Annex 9) – For taxpayers that opt for the statutory audit for 2021	March 31, 2022 (with the 2021 income tax return)	July 15, 2022
Local country report – For taxpayers that opt for the statutory audit for 2021	Dec. 31, 2022	July 15, 2022
Local country report – For taxpayers that waive the option for the statutory audit for 2021	Dec. 31, 2022	July 15, 2022 (if certain other conditions are met)
Master file	Dec. 31, 2022	Not available
Country-by-country report	Dec. 31, 2022	Not available

Despite the changes in due dates, as part of their transfer pricing study most Mexican taxpayers that carry out transactions with related parties, whether foreign or domestic, are still obligated to produce and maintain contemporaneous documentation to support the prices they use in those transactions.

The transfer pricing study does not have to be filed with the SAT, but it must be kept as part of the taxpayer's tax records and support information disclosed in its filings. Though there is no statutory due date for the study, completion before filing the income tax return for the year covered is highly recommended.

Enforcement and procedure

Tax residency for individuals

The 2022 reforms indicate Mexican nationals are deemed Mexican tax residents unless they prove otherwise. In addition to passing certain substantiality tests, Mexican nationals who wish to prove they are not residents must file a notice of change in tax residency with the SAT within 15 business days following the date their tax residency ends.

In general, an individual who abandons Mexican tax residency solely to obtain a tax benefit may be deemed not to meet substantiality tests.

Failure to meet substantiality tests and timely file the notice will cause the SAT to treat the departing individual as a resident of Mexico for tax purposes. Because Mexican tax residents are taxed on their worldwide income, delinquent individuals who live in and become tax residents of another country risk a dual-residency situation and double taxation. Since the dual residency would be triggered by failure to file the notice, the SAT might deny application of the residency tiebreaker rules contained in a relevant tax treaty.

Individuals who qualify as Mexican tax residents and plan on moving to another country should keep documentation proving a closer connection to that other country and that the move is not motivated solely for a tax benefit; in addition, they must timely file the notice. The best way to ensure these requirements are properly met is to contact a tax professional with experience in global mobility.

Tax residency for entities

Generally, entities formed in accordance with Mexican laws and establishing their principal center of management in Mexico are considered residents of Mexico for tax purposes.

Like individuals, enterprises that cease to be tax residents of Mexico must substantiate their change in residency. They must also file the notice of change within 15 business days following the date of their departure from Mexico.

In addition, as with individuals, an enterprise that abandons Mexican tax residency solely to obtain a tax benefit may not meet the substantiality test.

Failure to meet the substantiality test or timely file the notice will cause the departing enterprise to be treated as a Mexican tax resident, even if it has moved its operations, legal address or place of management to another country. The departing enterprise will be subject to Mexican tax on its worldwide income as a Mexican tax resident, with potential double taxation—in the country to which it moves, as well as in Mexico.

Tax residency and preferential tax regimes

Individuals and enterprises that become tax residents of a country with a preferential tax regime will still be treated as residents of Mexico for tax purposes during the tax year in which they file the notice, and during the subsequent five tax years.

A preferential tax regime is generally defined as a tax jurisdiction with a tax rate lower than 75% of the Mexican tax rate. For enterprise taxpayers, a tax jurisdiction with an income tax rate lower than 22.5% (30% x 75%) is considered a preferential tax regime. For individuals, the tax rate varies depending on the income bracket to which the individual is subject in Mexico. As an example, for individuals in the highest Mexican income bracket (a 35% tax rate), a tax jurisdiction in which they are subject to a tax rate lower than 26.25% (35% x 75%) will be considered a preferential tax regime.

Mandatory audit for tax purposes

After repeal several years ago, the obligation for certain taxpayers to submit their financial statements and tax return for an audit by an independent certified public accountant registered in Mexico is now reinstated. Taxpayers that acquire either of the following in the prior calendar year are required to complete this statutory audit:

- Gross receipts (as determined under Mexican tax rules of accounting) of 1,650,490,600 Mexican pesos or more
- A public listing of equity on a qualified stock market

For example, a Mexican company that reports gross receipts of 1,650,490,600 pesos or more in its 2021 tax return will be required to submit its financial statements and tax return for the calendar year ending Dec. 31, 2022, to a statutory audit.

By law, the Mexican peso is the reporting currency for tax purposes in Mexico. Enterprises that use a foreign currency must convert transactions to Mexican pesos using the official exchange rate published by Mexico's central bank on the date the transaction takes place. The peso figure that results from the conversion of all foreign currency revenue transactions carried out during the calendar year must be used to determine whether the threshold of 1,650,490,600 pesos is exceeded.

The independent auditor's report must include an opinion on the reasonableness of the financial statements, as well as any findings with respect to the positions that the taxpayer adopted when filing its tax return.

In addition to presenting the audit report to the shareholders meeting or the board of directors of the audited taxpayer, the auditor must electronically file a copy of the report with the SAT, along with several schedules containing detailed information on the tax positions and tax attributes of the audited taxpayer.

The report for the 2022 calendar year must be filed by May 15, 2023. This deadline is subject to automatic extensions, which, if granted, will be officially announced by the SAT in due time.

The 2022 provisions continue to allow certain enterprise taxpayers to voluntarily audit their financial statements and tax return, even if they do not meet the gross receipts threshold or are not publicly listed. To qualify for a voluntary audit, a taxpayer's tax return for the prior year must meet one of the following thresholds as determined under Mexican tax rules:

- Gross receipts of 122,814,830 pesos or more
- Net tax basis of assets of 97,023,720 pesos or more

Whistleblower rules
An auditor that discovers the taxpayer has failed to pay taxes or is involved in transactions that might lead to tax fraud is required to disclose the finding to the SAT. Additional guidance on whistleblower provisions will be published at a later date by the SAT.

The 2022 provisions impose penalties and fines on independent auditors that fail to adhere to the whistleblower rules. In some cases, the independent auditor may be held jointly liable with the taxpayer with respect to any taxes due, interest penalties, and fines, and may face tax evasion charges if the taxpayer faces those charges and the tax authorities have reason to believe that the independent auditor was a party to the evasion.

If the auditor identifies tax underpayments during the audit, the taxpayer is required to file amended tax returns and pay the deficiency, plus any applicable late-payment interest, within 10 business days following the date the audit report is filed with the SAT.

Corporate reorganizations
The 2022 reforms add stringent requirements for statutory mergers or divestitures involving Mexican legal entities to be considered nontaxable events. The additional requirements include the following:

- That no new assets, properties or obligations are created and recognized in the balance sheet because of the reorganization; they must instead be recognized in the balance sheets of the involved entities prior to the restructuring
- That the merger or divestiture has a business purpose

In mergers and acquisitions involving Mexican legal entities, participants such as private equity funds—whether on the sale side or the buy side of the transaction—should evaluate, with the help of their tax advisors, the effects of these rules on their pre-closing and post-closing reorganization plans.

Additional new provisions characterize a statutory merger or divestiture as a reportable transaction under certain circumstances, subject to disclosure to the SAT.

Royalties
The 2022 changes clarify that a digital image (including a digital asset known as a nonfungible token or NFT) is considered intellectual property for Mexican tax purposes. Accordingly, payments made to a non-Mexican resident for the use of a digital image made by a Mexican tax resident are considered royalties, subject to a tax withholding of 25%. However, under some tax treaties to which Mexico is a party, a royalty sourced in Mexico might be subject to a reduced withholding rate of 10%.

Use of recoverable taxes
Under the new provisions, a taxpayer may use recoverable taxes—value-added tax receivables or income tax overpayments—to pay any assessments that the SAT imposes following an audit. This benefit is subject to certain conditions and limitations and will apply for tax years beginning on or after Jan. 1, 2023.

Tax identification number
Individuals 18 years or older must now obtain a tax identification number—a registro federal de contribuyentes (RFC)—even if they have no activities from which they derive taxable income.

Beneficial controller requirements
In general, a beneficial controller is an individual or entity, foreign or domestic, that meets any of the following conditions:

- Directly or indirectly obtains or is entitled to benefits from an interest (by control or value) in a Mexican legal entity, trust, profit- or cost-sharing agreement, or any other entity formed under Mexican law
- Exercises or has the right to exercise the use, enjoyment, usufruct, exploitation or disposition of property or services in Mexico
- Is directly or indirectly represented by a different person or entity in a transaction
- Directly or indirectly exercises control of a Mexican legal entity, trust, profit- or cost-sharing agreement, or any other entity formed under Mexican law

Mexican enterprise taxpayers—including Mexican legal entities, trusts, parties to profit- or cost-sharing agreements, or any other entity formed under Mexican law—are required to maintain contemporaneous documentation supporting the identity of their ultimate beneficial controllers, and must provide the documentation to the SAT upon request.

Publicly traded companies are also required to disclose the identity of their beneficial controllers.

The 2022 provisions now require a notary public involved in forming a Mexican legal entity to obtain the entity's beneficial controller information at the beginning of the formation process. This requirement extends an already lengthy formation process, and the enterprises involved must plan for additional time and cost.

The SAT has published a set of complex rules regarding the documentation that taxpayers must maintain and provide to support the identity of their beneficial controllers.

Failure to maintain and/or provide contemporaneous documentation supporting the indemnity of the beneficial controllers may expose a delinquent taxpayer to fines of 500,000 pesos to 2 million pesos for each beneficial controller lacking documentation.

Hydrocarbons and other petroleum-derived products
Extensive requirements are imposed on taxpayers that produce, distribute, transport or sell hydrocarbons and other petroleum-derived products. Those taxpayers must establish electronic controls to monitor and calculate income tax, value-added tax and excise taxes derived from the production and flow of the products.

Income tax

Application of tax treaties for audited taxpayers
Taxpayers required to submit their financial statements and tax returns to a mandatory statutory audit, or that elect to do so but fail to file the independent auditor's report with the SAT, cannot claim the benefits of the tax treaties to which Mexico is a party.

Interest on back-to-back loans
Mexican income tax law recharacterizes any interest arising on a back-to-back loan as a dividend. The 2022 reforms add that interest arising on an intercompany loan lacking business purpose will also be recharacterized as a dividend.

The recharacterization of interest as a dividend may have adverse tax consequences for the Mexican payer of the interest, including the imposition of a Mexican tax of 43% of the deemed dividend, and depletion of the amount of undistributed earnings already taxed at the corporate level, known as CUFIN. Dividends up to the CUFIN amount are not subject to the 43% tax.

Interest recharacterized as a dividend may also trigger a 10% withholding tax.

Mexican taxpayers with loans from related parties, either foreign or domestic, must assess whether the loans have a business purpose and maintain, as part of their auditable accounting records, documentation supporting this position, or take corrective measures to avoid interest recharacterization and its adverse tax consequences.

Generally, a loan will have a business purpose if the Mexican borrower uses it for appropriate capital expenditures, capacity expansions or working capital during initial or distressed operations.

Business purpose in tax-deferred corporate reorganizations
Mexican income tax law has historically allowed certain legal entities to apply for a private letter ruling with the SAT to defer the tax due on qualifying corporate reorganizations until the Mexican entities involved in the transaction leave the enterprise group. Applicant taxpayers must meet several formal and substantial requirements to be eligible for a tax-deferred corporate reorganization.

Under the 2022 provisions, in addition to the standard requirements, taxpayers must prove that the reorganization has a business purpose. Failure to do so will likely result in the SAT denying deferral of the tax. The provisions also require disclosure of the transaction to the SAT.

Multinational enterprise groups contemplating a reorganization involving Mexican legal entities must determine with the help of their tax advisors if the transaction has a business purpose before applying for a private letter ruling.

Write-off of depreciable property
If a taxpayer wishes to write off the adjusted tax basis of an asset that ceases to be useful, it must file a notice with the SAT. Failure to do so will negate the income tax benefit of the write-off.

Net operating losses in corporate reorganizations
Complex rules are established to allow taxpayers that go through a corporate reorganization (a statutory merger or divestiture) to transfer net operating losses to the companies involved in the restructuring.

Disposition of shares by foreign residents
Mexican legal entities whose shares are disposed of by non-Mexican residents must disclose the transaction to the SAT within the month following the date of disposition.

Foreign entities that sell or dispose of shares of Mexican legal entities must be aware of this requirement and ensure that the Mexican entities timely meet the disclosure requirement. Failure to do so will cause a Mexican legal entity to become jointly liable with respect to any Mexican tax that the transferor is required to pay due to the transaction. This is especially relevant for acquisitive enterprises—such as private equity and investment funds—that regularly acquire shares of Mexican entities.

In addition, a transfer of shares between related parties must occur at arm's length and the professional preparing the filings must submit documentation supporting the transfer price.

Individuals
A new, optional simplified trusted taxpayer regime is established for individuals who in a calendar year obtain 3.5 million Mexican pesos of income exclusively from one or more of the following:

- Business income from self-proprietor activities
- Rendering of personal professional services
- Property rental
- Salaries

Individuals who exceed the 3.5 million pesos of income or have other sources of income, such as dividends, commissions or capital gains, cannot participate in the simplified trusted taxpayer regime.

Qualifying taxpayers pay the tax on a cash flow basis, applying the following monthly tax brackets:

Monthly income in Mexican pesos, up to	Tax rate
25,000	1.00%
50,000	1.10%
83,333	1.50%
208,333	2.00%
3,500,000	2.50%

Taxpayers in the simplified trusted taxpayer regime must meet the following requirements:

- Have a tax identification number
- Maintain an account in the SAT's electronic portal
- File an annual tax return by April 30 of the following calendar year
- Issue electronic documentation—a digital fiscal document through the internet, known as CFDI—to support the income they collect
- Obtain CFDIs to support expenditures associated with the four types of income activities listed above
- Pay profit-sharing and other mandatory benefits to employees

If an individual taxpayer under the simplified trusted taxpayer regime receives payments from an enterprise taxpayer for the income activities listed above, the enterprise taxpayer must withhold and remit the tax at a flat rate of 1.25% on the total payments, without deductions, in lieu of monthly tax based on the above table. Enterprises that fail to withhold and remit the 1.25% tax may not claim any tax benefits from the payment they make to a taxpayer under the regime.

Preferential tax regimes

According to Mexican income tax law, a preferential tax regime exists when an item of income is not subject to tax in a foreign jurisdiction or when the foreign effective tax rate is lower than 75% of the effective tax rate to which that item would be subject in Mexico.

Under the 2022 provisions, determination of the effective tax rate to which the income would be subject under Mexican law requires exclusion of gains and losses due to inflation or the currency exchange. This change seeks to avoid distortions in the effective tax rate derived from these unique Mexican tax concepts that may not be present in the foreign tax jurisdiction.

Starting calendar year 2022, Mexican taxpayers who earn income from foreign sources must calculate the effective tax rate by excluding inflationary and currency gains and losses. If the foreign-sourced income is subject to a preferential tax regime, taxpayers may have to recognize the income in their Mexican tax return. In some cases, though, the exclusions may bring the Mexican effective tax rate closer to the foreign effective tax rate—benefiting the taxpayer, who then avoids preferential tax regime treatment.

Small-entity regime

A new mandatory regime for small entities is included in the 2022 reforms. Small entities subject to this regime include those used by a group of individuals to carry out business activity that in the prior calendar year obtained gross receipts of 35 million pesos or less. A typical example is a cooperative.

For the most part, this regime follows the same rules as the ordinary regime for enterprise taxpayers and has the same statutory tax rate of 30%. However, it features certain additional tax benefits, such as the following:

- Cash basis taxation, in which income is recognized when payment is received and deductions are recognized when income is disbursed
- Higher depreciation rates for qualifying depreciable assets

Value-added tax (VAT)

0% rate on medicine and certain foods

The 2022 provisions clarify that a 0% VAT rate applies to drugs and products destined for human as well as animal consumption.

Transactions not subject to VAT

An added provision stipulates exemptions from the VAT apply only to the following transactions:

- Conducted outside of Mexican territory
- If conducted in Mexico, are not for the passage of property title, the lease of property, the performance of independent services, or the importation into Mexico of property and goods

This clarification becomes relevant for taxpayers that carry out a mix of transactions subject and not subject to VAT. The higher the number of non-VAT transactions, the less creditable input VAT the taxpayer will have.

Of note, this limitation does not affect Mexican taxpayers that export goods or services, which are taxed at a 0% VAT rate rather than being exempt from the tax.

Import declarations

For taxpayers importing tangible property into Mexico to consider the VAT they pay as recoverable, they must appear as the importers of record in the corresponding import declarations.

Taxpayers that actively import tangible property into Mexico and use a third-party agent or commissioner as the importer of record should consider becoming the importer of record themselves to ensure they can recover the VAT.

E-commerce

Until Dec. 31, 2021, foreign taxpayers offering goods and services through a digital platform were required to file quarterly SAT information returns on the transactions they carried out with Mexican users. Under the 2022 reforms, effective Jan. 1, 2022, these information returns must be filed monthly, by the 17th day of the following month.

Failure to file the information returns may trigger a fine ranging from 1,560 pesos to 38,700 pesos per each unreported transaction. In addition, the SAT may request a block of the offending taxpayer's portal until the fines are paid and the delinquent filings are made.

The first required monthly information return is for January 2022, with a due date of Feb. 17, 2022.

What should companies do?

Key takeaways from the 2022 provisions include potential disallowance of tax benefits from transactions that lack business purpose. In addition, the implementation of stricter transfer pricing rules, especially for maquiladoras that had been paying Mexican income tax under an APA, will likely increase the tax liability of Mexican enterprises that carry out transactions with related parties.

To prepare for or avoid potential new tax exposures, internationally active companies with a footprint in Mexico should evaluate whether they can satisfy that country's business purpose test and should assess the impact of the significant new provisions regarding transfer pricing and other compliance requirements as soon as possible.

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