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Global Tax Alert

News from Americas Tax Center

Mexico issues special tax incentives for businesses in border zone

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On 31 December 2018, Mexico's newly inaugurated President Andrés Manuel López Obrador published a special decree (the Decree) with tax incentives for businesses operating in the northern border zone of Mexico for 2019 and 2020. These incentives include tax credits, which effectively reduce the income tax rate from 30% to 20% for legal entities, and a reduced value added tax (VAT) rate of 8%. The Decree applies to qualified legal entities, individuals and branches of foreign entities, and includes various administrative requirements to take advantage of the incentives.

Overview of incentives

For purposes of the Decree, the border zone is defined to include the following specific municipalities by state: in Baja California - Ensenada, Playas de Rosarito, Tijuana, Tecate and Mexicali; in Sonora - San Luis Rio Colorado, Puerto Penasco, General Plutarco Elias Calles, Caborca, Altar, Saric, Nogales, Santa Cruz, Cananea, Naco and Agua Prieta; in Chihuahua - Janos, Ascension, Juarez, Praxedis G. Guerrero, Guadalupe, Coyame del Sotol, Ojinaga and Manuel Benavides; in Coahuila de Zaragoza - Ocampo, Acuna Zaragoza, Jimenez, Piedras Negras, Nava, Guerrero and Hidalgo; in Nuevo Leon - Anahuac; and in Tamaulipas - Nuevo Laredo, Guerrero, Mier, Miguel Aleman, Camargo, Gustavo Diaz Ordaz, Reynosa, Rio Bravo, Valle Hermoso and Matamoros.

Under the Decree, taxpayers in the border zone are entitled to a credit equal to one-third of the income tax due on their taxable income for the period. The tax credit also applies to monthly estimated tax payments. The current corporate tax rate in Mexico is 30% and, as such, the effective rate would become 20%. For individuals, the tax rates are progressive and max out at 35%, which could result in a reduction to approximately 23%. The reduced income tax rate should be applied to the taxable income derived from the region.

The additional credit for VAT equals 50% due on the transaction and can be taken at the time of the taxable act, which results in a VAT reduction from 16% to 8%. This reduction is allowed for qualified sales of goods, the rendering of services and the provision of the temporary use of assets (leasing) in the region, with certain exceptions.

The Decree also specifically provides rules for denying the incentives and states that the benefit will not be considered taxable income to the taxpayer.

As described later, the overall requirements, obligations and limitations for the income tax and the VAT incentives are distinct and the tax authorities may issue regulations on these requirements. Taxpayers wishing to take advantage of the benefits of the Decree should review the requirements and prepare to request authorization or file the required notice to claim the benefits. Taxpayers also should expect regulations on certain issues surrounding the application of the Decree. Draft regulations were published on the Mexican tax authorities' website on 7 January 2019, in the form of Miscellaneous Resolutions (*Resolución Miscelánea Fiscal*) addressing certain registration and application rules related to the Decree.

Income tax

The income tax incentives included in the Decree generally apply to taxpayers that can show they were resident in the border zone for 18 months before registration and to taxpayers that establish residence and are registered in the newly established Registry for Beneficiaries of the Incentives for the Northern Border (the Registry).

Taxpayers are entitled to the income tax incentives when the income is exclusively from sources within the region. For this purpose, at least 90% of the taxpayer's income must be derived from sources within the region. The tax credit is applied by taking into account a coefficient for the benefit, which is the factor obtained by dividing the revenue received

from qualified border zone sources by the total revenue of the taxpayer; as a result, the incentive only applies to income from activities in the region.

Taxpayers desiring to take advantage of the incentive must be able to prove residence and register in the Registry. The taxpayer must show the economic capacity, assets and facilities to conduct the activities giving rise to income in the qualified area. For taxpayers initiating activities in the region, the taxpayer must show the use of new assets in the region for the qualified activities. There are also rules allowing taxpayers with a branch or office in the region to register for benefits with respect to that branch. Companies resident in the region with branches outside of the region also may register for benefits, with respect to the activity in the region.

The Decree provides a list of taxpayers that may not benefit from the reduced income tax rate, including: financial institutions, special deposit warehouses, taxpayers that file an integrated tax return, qualified real estate trusts, taxpayers in the agricultural and related industries, individuals performing professional services, taxpayers reporting income under benefits from the maquiladora regime, income from intangibles, business trusts, taxpayers receiving other incentives, digital activity, taxpayers identified as issuing invoices without substance, taxpayers under audit or subject to certain action by the tax authorities, and taxpayers that operate under an outsourcing arrangement.

Taxpayers should request registration in the Registry on or before 31 March of the year that the benefit is being sought. In general, to register, taxpayers must: (1) provide evidence of residence in the region for the prior 18 months or support to show new investment; (2) have a registered electronic signature with the tax administration and obtain a certificate of tax compliance; (3) have access to the taxpayers' electronic mailbox; and (4) participate in a semi-annual program of voluntary, real time compliance. It should be noted that items 2 and 3 are required for most taxpayers today.

VAT

The rules related to the VAT incentive are not as detailed as the income tax incentive. The VAT incentives require that the taxpayer file a notice with the tax authorities within 30 days of the Decree going into effect or upon registration with the tax authorities for new businesses or businesses establishing branches in the region.

The VAT incentive only applies to transactions involving the delivery of goods or the rendering of services in the region. Because VAT is paid in Mexico on a cash basis, the Decree provides a transitory rule to address the applicability of the Decree to transactions initiated before the Decree went into effect.

This reduced VAT rate does not apply to sales of real estate, transactions related to digital content and taxpayers under certain audit procedures or challenges by the tax authorities. The list of specific industries and taxpayers excluded from the income tax incentive does not apply to the VAT incentive.

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