



# **Tax incentives Decree for the Mexican Northern Border Region**

On December 31st, 2018, a Decree granting tax incentives to taxpayers in the Mexican Northern Border Region (the “Decree”) was published on the Official Gazette. The Decree is meant to restore the investment and business productivity in the Mexican Northern Border Region (the “Border Region”) and improve the competitive conditions against the commercial market of the United States of America. Such Decree entered into force on January 1st, 2019 and will remain in force during 2019 and 2020.

The Decree includes a tax incentive that allows Mexican taxpayers (both individuals and legal entities), and foreign residents with a permanent establishment in Mexico to pay two thirds of the income tax (“IT”) applicable to the income obtained from activities carried out in the Border Region. Regarding value added tax (“VAT”), the Decree provides a tax incentive applicable to Mexican taxpayers that consists on granting a tax credit equivalent to a 50% of the VAT rate, so that the applicable rate to such taxpayers would be 8%.

Taxpayers that plan to benefit from the tax incentives for IT and VAT shall comply with a series of requirements contained in the Decree and in the rules that the Tax Administration Service (“SAT” as per its initials in Spanish) will publish (such rules have been released preliminarily in the draft of the Sixth Resolution of Modifications to the Tax Miscellaneous Resolution for 2018). It is worth mentioning that the requirements applicable to the IT incentive differ from the requirements applicable to the VAT incentive, in a way that there will be taxpayers who will be able to apply the IT incentive but not the VAT incentive, and vice versa.

The IT incentive established in the present Decree cannot be applied together with other tax treatments or incentives that grant tax benefits, including exemptions and subsidies.

On the other hand, it should be noted that the taxpayers that apply the tax incentives of this Decree would not be obliged to file the tax incentive crediting notice referred to in article 25 of Federal Fiscal Code (“FFC”).

## **IT INCENTIVE**

A tax incentive is granted to Mexican taxpayers (both individuals and legal entities), and foreign residents with a permanent establishment in Mexico who obtain income exclusively in the Border Region which consists on applying a tax credit equivalent to one third of the IT payable (both monthly and annually) in the proportion in which such taxpayer earns income from such region. In other words, taxpayers that benefit from this incentive would only pay two thirds of the IT payable derived from the income obtained from activities carried out in the Border Region, while the income obtained from activities carried out in the rest of the country will be subject to IT determined pursuant to the IT Law. For these purposes, the Decree considers that a taxpayer obtains income exclusively in the Border Region when the income obtained in such region represents at least 90% from the total income obtained during the fiscal year.

In the case of individuals, the incentive is only applicable to income obtained from business activities carried out in the Border Region; therefore, income obtained in such region from professional activities or any other non-business activity will be subject to IT determined pursuant to the terms established in the IT Law, without applying the incentive.

To enjoy the tax benefits established by the Decree, taxpayers must submit the application to register in the “Registry of the beneficiaries of the northern border region incentive” (the “Beneficiaries Registry”) and obtain from the SAT a registry authorization. For these purposes, the following requirements must be met:

- File the application to register on the Beneficiaries Registry before March 31st of the fiscal year on which the tax incentive is going to be applied. Taxpayers that enroll to the Taxpayers Federal Registry (“RFC” as per its initials in Spanish) with a tax address in the Border Region or that open an establishment on said region on a date later than the entry into force of the Decree, shall file the application to register on the Beneficiaries registry within a month after enrolling to the RFC or filing the establishment opening notice.
- Prove that the tax address or establishment has been on the Border Region for at least eighteen months prior to filing the application to register on the Beneficiaries Registry. Taxpayers that have been on the Border Region for less than eighteen months prior to filing the application, shall prove to the Mexican tax authorities that they are capable of carry out operations in such region.
- Collaborate twice a year with the SAT by cooperating with the real time verification program.
- Have access to the tax mailbox (buzón tributario) on the SAT webpage, an advanced electronic signature (e.firma), and a positive opinion of compliance of federal tax obligations.

The SAT shall issue a resolution authorizing the taxpayers’ enrollment to the Beneficiaries registry within a month following the filing of the application to such registry. Taxpayers shall begin applying the incentive’s benefits immediately after being notified that they have obtained the corresponding authorization. If the tax authorities detect that a taxpayer does not comply with one of the requirements, the SAT will notify such taxpayer so the taxpayer can amend the situation and file the application again.

The authorization shall be valid for the fiscal year in which it was obtained. If the taxpayers intend to continue enjoying the incentive’s benefits, they must request a renewal of authorization to remain in the Beneficiaries registry no later than by March 31st of the fiscal year for which the renewal is requested.

The following taxpayers would not be able to apply to the Beneficiaries registry:

- Banking, insurance, and bonding institutions; general bonded warehouses; financial leasing companies; and credit unions.
- Taxpayers that apply the optional regime for groups of companies.
- Taxpayers who carry out business activities through trusts.
- Taxpayers that supply personnel through labor subcontracting or are considered as intermediaries in terms of the Federal Labor Law.
- Taxpayers that have been assessed omitted contributions and that have not corrected their tax situation.

- Contractors, as defined in the Hydrocarbons Law.
- Taxpayers who (i) meet any of the assumptions established in the last but one paragraph of article 69 of the FFC, (ii) carry out allegedly non-existent transactions in accordance with article 69-B of the FFC or who have carried out transactions with taxpayers who fall under the same presumption, or (iii) taxpayers who have improperly transferred their tax losses in accordance with article 69-B Bis of the FFC.

Finally, taxpayers who have not applied the tax credit referred to in this incentive, having been able to do so, will lose the right to apply it in the corresponding year and up to the amount that could have been applied. When the tax credit is not applied in a monthly payment, the right to apply the tax credit to the corresponding monthly payment, as well as to any of the subsequent monthly payments and to the annual tax return of the year, will be lost.

## **VAT INCENTIVE**

A VAT incentive is granted to taxpayers residing in Mexico for tax purposes (both individuals and entities) who, within the northern border region, sell goods, provide services or grant the temporary use or enjoyment of goods located in the aforementioned region, consisting of a tax credit equivalent to 50% of the VAT rate, so that the applicable rate will be 8%.

To be able to obtain the benefits of the VAT incentive, a notice of application of the tax incentive must be submitted no later than February 7, 2019. Taxpayers may begin to apply the incentive as of January 1st, 2019, provided that they obtain the acknowledgement of receipt of the aforementioned notice. In the case of taxpayers who begin operations after the entry into force of the Decree and have not registered with the RFC, they must submit the aforementioned notice together with the application for registration in the RFC. Unlike the IT incentive, no authorization is required by the tax authorities to apply the VAT incentive.

Additionally, in the case of the selling of goods and the provision of independent services, the material delivery of the goods or the rendering of services must be carried out in the northern border region.

The VAT incentive cannot be applied in the cases of import of goods, sales of immovable property and intangible assets, or the supply of digital content.

As in the case of the IT incentive, taxpayers who fall under any of the assumptions established in the last but one paragraph of article 69 of the FFC, the assumptions established in article 69-B or in article 69-B Bis of the FFC, cannot apply the VAT incentive.

## **Taxand's Take**

Even though the incentives discussed above seem attractive, it is necessary to review their application for each case to validate that the requirements contained therein are complied with, as well as to review that a taxpayer does not fall under any of the exception assumptions. If applicable, they could prove beneficial to eligible companies albeit just for a short period of time since these benefits will only apply during 2019 and 2020.

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