



# MEXICO



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## INTERNATIONAL DEVELOPMENTS

### 1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

Recently, anti-abuse rules regarding the transfer of tax losses in the context of business restructures have come into force. The approved legislation establishes that where tax losses have been generated pursuant to certain regulated scenarios, and the tax loss generating entity is part of a business restructuring or change of shareholders in such a way that the entity entitled to offset said losses ceases to be part of the original group, then the right to offset such losses may be challenged by the tax authorities absent proof of non-tax related motives. Furthermore, the unlawful transfer of tax losses will be deemed as such when the party that generated the tax losses no longer forms part of the original group after any form of restructuring that causes said entity to exit the group.

Pursuant to Article 25, section I, of the Federal Revenue Law, taxpayers are obligated to disclose certain relevant transaction information and restructurings entered into by the group. This relevant transactions' disclosure return obligates taxpayers to inform the tax authorities on a quarterly basis about related party transactions that exceed the threshold of MXN 60M (approximately US 3.2M) in five appendixes: i) financial derivative transactions, ii) related party transactions, iii) changes in shareholders and tax residence, iv) reorganizations and restructuring within the multinational group and v) other relevant transactions. The information requested in each appendix is aimed to identify harmful tax practices such as abusive financial derivative transactions entered into between related parties, relevant transfer pricing adjustments that may erode the Mexican tax base, direct and indirect changes of shareholding and dual residence, changes in the business model that may imply functions, assets and risks being shifted between jurisdictions, centralization or decentralization of functions, and other practices where the tax authorities may see a risk of tax avoidance such as debt financed dividends or transfer of losses after mergers or spin-offs.

On other fronts, taxpayers entering into outsourcing of payroll within a group must request to the outsourcing proof of tax compliance with its employee related tax obligations in order to make such payments deductible, and VAT creditable.

### 2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

The tax reform introduced in Mexico effective as from 1 January 2014 along with administrative regulations, has led to a comprehensive early adoption of BEPS actions within the Mexican tax regime.

As from 2014, a hybrid mismatch rule was introduced establishing that the deduction of any payments made by Mexican tax residents would be disallowed if the deduction is also picked up at the level of a national or a foreign resident related party (unless such related party considered such payment in its taxable basis). Furthermore, the deduction of interest, royalty and technical service fee payments made to controlling or controlled fiscally transparent entities by Mexican resident corporations would be disallowed unless such payments are taxable at the level of their shareholders or partners, and such payments are at arm's length.

Prior to BEPS, Mexico introduced Controlled Foreign Corporation (CFC) rules applicable to preferential tax regimes where income is obtained through a subsidiary in a low tax jurisdiction or through a transparent entity. Accordingly, Mexican resident entities that carry out activities through preferential tax regimes and transparent entities are taxed on income obtained through a CFC even if there have not been any distributions and they are required to file a disclosure return annually. Recently, the obligation to file such informative return has been extended to taxpayers holding investments in transparent entities or through entities in black listed jurisdictions.



Furthermore, a disclosure return of relevant transactions has been put into place, where it is aimed to identify certain tax planning structures within related parties. Additionally, as a Multilateral Competent Authority Agreement signatory, Mexico has implemented country-by-Country reporting obligations for information pertaining to fiscal year 2016 onwards.

As from 2014, legal requirements to obtain treaty benefits by Mexican residents have been strengthened, prior to BEPS Action 6 (Treaty Abuse). In addition to the requirement that Mexican residents must obtain a certificate of residence of the foreign resident to apply treaty benefits, the Mexican tax authorities may request foreign resident taxpayers to prove the existence of juridical double taxation being relieved under the applicable tax treaty, as well as an explanation of the tax treatment given in the country of residence.

In recent tax treaty negotiations, Mexico has included Principal Purpose Test (PPT) or Limitation of Benefits (LOB) clauses to restrict treaty benefits in abusive situations.

Regarding BEPS Action 15 (Multilateral Instrument), as a historically early adopter of OECD measures and as a member of the ad hoc Group that participated in the negotiations, Mexico has signed the multilateral instrument, which is still pending approval from Congress to become effective. The MLI will be applicable to 61 Covered Tax Agreements (CTA). Mexico's already has in its CTA several provisions in line with the MLI, for which reservations have been issued in connection with transparent entities and dual residence issues, which will need to be analyzed case by case. Furthermore, Mexico has opted for the simplified LOB provision.

Regarding Mexico's PE position, it has notified that its CTA already address the determination of a dependent agent PE's subject to the habitual exercise of an authority to conclude contracts in the name of the enterprise and that an enterprise shall not be deemed to have a PE in a Contracting Jurisdiction in respect of activities undertaken for said enterprise by an agent of an independent status. Furthermore, Mexico has opted to amend the PE provisions contained in the CTA to deal with the artificial avoidance of PE status through specific activity exemptions, but has reserved the right for the provision in connection with splitting up of contracts not to apply to its CTA.

With respect to the arbitration mechanisms contained in the MLI, Mexico has not chosen its application.

## GENERAL

### 3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

#### A) Share deal

##### Tax advantages:

- ❖ Acquisitions of shares of a corporation or partnership interest of a limited liability company are not subject to value added tax (VAT) or stamp tax in Mexico
- ❖ No transfer taxes are triggered during a share acquisition (e.g. real estate transfer tax)
- ❖ The acquisition price will form part of the tax cost basis of shares of the buyer for subsequent sales
- ❖ Tax attributes remain with the acquired entity although limitations may apply for the application of tax losses

##### Tax disadvantages:

- ❖ A loss obtained by a non-resident seller on the sale of an entity may not be offset against future capital gains for Mexican tax purposes
- ❖ The target company's liabilities and possible tax contingencies remain in the target company. The statute of limitations in Mexico is of five years



- ❖ The buyer is generally not allowed to deduct the financing costs of the acquisition against the target's future profits
- ❖ If the buyer is a foreign resident and acquires shares at a value that is at least 10% lower than the appraisal value of the shares, the tax authorities may assess a deemed income to the foreign buyer on the difference between the actual sales price and the appraisal value of the shares. The foreign buyers then must pay a 35% income tax on the difference between the sales price and the appraisal value.

## **B) Asset deal**

### **Tax advantages:**

- ❖ Step-up of the value of the assets for the purchaser
- ❖ The cost of assets purchased may be deducted via depreciation either on the fiscal year that they are put to use or in the following year
- ❖ Seller may be able to offset accumulated tax losses against capital gains derived from the disposition of assets
- ❖ VAT is applicable in a purchase of assets at a general 16% rate. If the buyer were a foreign resident, the VAT would be a final tax payment with no possibility to recover. If the buyer were a Mexican company, VAT paid would generally be creditable against VAT due, and therefore, recoverable
- ❖ The target company's liabilities and possible tax contingencies are not transferred to the buyer unless the transfer is deemed the acquisition of an ongoing concern.

### **Tax disadvantages:**

- ❖ Tax attributes such as accumulated tax losses of the target are not transferred to the buyer
- ❖ Real estate transfer tax is applicable on the transfer of real estate property situated in Mexican territory. This tax is levied at the local level at a rate that may go from 2% to 5% of the value of the property
- ❖ Regardless of the general rule that the target company's liabilities are not transferred to the buyer, Mexican tax provisions establish that, in case of the acquisition of an ongoing concern, the buyer will be jointly and severally liable with the seller for any taxes triggered from the activities carried out by such business.

## **BUY-SIDE**

### **4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?**

Mexican tax law does not contain provisions to allow step up in the value of assets in share deals. For this reason, while assessing a business acquisition, it will be relevant to determine at which level the tax cost basis is required.

### **5. WHAT ARE THE PARTICULAR RULES OF AMORTIZATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS IN YOUR COUNTRY?**

Mexican Income Tax Law (ITL) does not allow for the deduction of goodwill. Goodwill paid as part of the purchase price of shares of a company is part of the tax basis of the shares, which can be deducted from the sales price in a subsequent sale (provided however that the overall original acquisition price was at market value at the time of purchase).



## 6. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

For income tax purposes, interest is deductible when:

- ❖ The capital is invested for the attainment of the purpose of the business
- ❖ If the taxpayer grants loans to third parties, employees or shareholders, only the interest accrued on borrowed capital for up to the amount of the lowest interest rate set forth in the loans to third parties to the taxpayer's employees or to its shareholders on the portion of the loan made to the latter parties will be deductible. These limitations do not apply to banking institutions, regulated multiple purpose financing companies or ancillary credit organisations regarding transactions that are inherent to their activities
- ❖ Interest must be determined at a fair market value. Any excess will be considered non-deductible

Thin capitalization rules disallow the deductions of interest on debt owing to foreign related parties if the total amount of interest bearing debt exceeds a three to one debt equity ratio. Likewise, interest may be re-characterized as a dividend if the loan is considered a back-to-back loan, and non-deductible as such. Although it has been evaluated by the Mexican tax authorities, it is not foreseen whether in the near future the best practice contained in BEPS Action 4 will be implemented to limit interest deductibility based on a net interest/EBITDA ratio.

Although interest expense on a debt subscribed for dividend distribution purposes is not generally prohibited, Mexican tax authorities have the position that interest derived from a loan obtained to pay dividends to shareholders is non-deductible because they consider that such loan is not used for the business purpose of the company. In a similar fashion, the Mexican tax authorities are not fond of debt-pushdowns even if there is no particular provision that prohibits them.

As of fiscal year 2014, anti-abuse provisions to tackle hybrid mismatches and other abusive positions have been introduced in Mexico's ITL. Any interest or royalty payments made to foreign resident controlled or controlling fiscally transparent entities is non-deductible unless the corresponding income is picked up and taxed at the level of the shareholders or partners. This rule aims to deny the deductibility for Mexican tax purposes of interest, royalty and technical assistance payments which are not subject to tax in another jurisdiction, either in the jurisdiction of the entity receiving the payment or of its shareholders.

## 7. WHAT ARE COMMON STRATEGIES TO PUSH-DOWN DEBT ON ACQUISITIONS?

The usual strategy to push-down debt on an acquisition is to incorporate a Mexican acquisition company to borrow the purchase funds. Following the purchase, the acquisition company is merged into the target company so it pays debt and interest from operating cash flows. The merger may qualify as a tax neutral transfer of assets subject to the fulfilment of certain requirements. Nevertheless the Mexican tax authorities may challenge the deduction of the interest considering that such interest is not strictly necessary for the purposes of the surviving company.

Tax consolidation was used to optimize a group's tax burden utilizing the deduction of acquisition debt interest (with the associated recapture of losses if the holding company did not individually generate sufficient profits to amortize the loss derived from financing). However, as from fiscal year 2014, the tax consolidation regime was substituted by a fiscal unity regime which only allows the deferral of taxes for a three-year period.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Under Mexican ITL there is no deemed interest deduction for equity contributions or deductibility of paid in capital. However, capital reimbursements that do not exceed the paid in capital, subject to certain computations set forth in the ITL, are considered tax free distributions. There are however anti-abuse provisions set forth to avoid the result of a transfer of shares through capital increases and future capital redemptions by another shareholder.



## **9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTIONS ON THE USE OF SUCH LOSSES?**

The target company may carry forward the net operating losses for a period of 10 years after they were incurred. The target company may offset such tax losses against the profits corresponding to the same business lines as those in which the losses were incurred if the purchaser acquired more than 50% of the shares of the target. Mexico does not allow carryback of losses.

Tax losses cannot be transferred in the case of a merger. Similarly, as in the case of change of control of an entity, the tax losses incurred by the surviving entity may only be offset against profits derived from the same business activities that generated such losses. In the case of spin-offs, tax losses are divided between the spun-off entities in the same ratio in which inventory and receivables are assigned in the case of trading companies, and in the same ratio as fixed assets in the case of other companies. If the taxpayer changes its business activity, this will not result in forfeiting the possibility to offset tax losses generated in the conduction of a different business line against profits obtained from the new business since the restriction shall only apply to the abovementioned cases.

Furthermore, certain rules to disallow the transfer of tax losses that permit the Mexican tax authorities to disregard the offset of such losses in case of abusive situations have been recently enacted. Generally, where the entity that generated tax losses is part of a corporate restructure or change in shareholders, and as a result the entity that may offset such tax losses leaves the group, the Mexican tax authorities may presume it is an abusive situation and may challenge the transaction absent proof of non-tax related motives.

## **10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?**

The statute of limitations in Mexico is of 5 years, with the possibility to be extended to 10 years in cases where the taxpayer is not registered, does not comply with book-keeping obligations or fails to file tax returns being obligated to do so. When performing a due diligence it is important to review the tax attributes such as the Contributed Capital Account (CUCA), the Net After Tax Profits Account (CUFIN), the Net After Tax Reinvested Profits Account (CUFINRE) and the expiration of tax losses.

The CUCA is an account kept for tax purposes whereby paid in capital is registered for future tax free distributions. The CUFIN account is formed from profits that have been taxed at a corporate level. Dividends distributed up to the amount of the CUFIN are free from corporate taxation. Dividends distributed from CUFIN balances generated prior to 31 December 2013 are not subject to the additional 10% withholding tax levied on dividends distributed to foreign residents and Mexican individuals. The CUFINRE is a balance conformed by reinvested untaxed profits for the deferral of taxation, which tax is triggered upon distribution of such reinvested profits.

## **11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?**

Mexico has no indirect taxes (VAT, stamp duty, transfer tax, etc.) on transfer of shares.

## **12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?**

The acquisition costs of shares can only be offset against the profits derived from a following sale of such shares. The tax basis is adjusted subject to a particular procedure set forth in the ITL to reach the adjusted cost basis, which takes into account tax losses incurred by the company and retained profits during the shareholding period, capital reimbursements and previous losses offset against profits obtained during the shareholding period.

The acquisition cost of assets used in the taxpayer's business activities can be deducted by means of depreciation subject to the maximum yearly rates set forth in the ITL, depending on the type of business asset or the sector in which it is used. In some cases, the amount that can be deducted in the acquisition of an asset is



limited. The ITL also provides for immediate depreciation (full deduction of the acquisition cost in the first year) in particular industries (e.g. generation of renewable energy) or for small to medium taxpayers.

### **13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?**

VAT is triggered in the case of the purchase of business assets but not in the case of the purchase of shares. VAT paid in the purchase of business assets can be offset against VAT triggered during the business activities of the taxpayer insofar as certain requirements are fulfilled. Additional requirements have been established for the recovery of VAT incurred during a pre-operative period as from 2017. Any VAT that is paid and that cannot be offset against to VAT triggered (given certain limitations for offsetting contained in the VAT law) is deductible for income tax purposes.

### **14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?**

Foreign residents who acquire the interest of Mexican target companies for a sales price that deviates in more than 10% from the appraisal value determined by the Mexican tax authorities are subject to income tax at a rate of 35% with no deduction on the difference between the appraisal value and the sales price effectively paid. Such difference will increase the tax basis of the purchaser for purposes of a subsequent sale. Furthermore, in case of a transfer of share where by no consideration is established, the tax will be determined at a 25% rate with no deduction on the appraisal value performed by an authorized party.

In general, Mexican resident target companies are jointly liable for the taxes due by the former shareholders in a share deal if the target company proceeds with the registration of the acquiring shareholder in its shareholder registry and does not receive from the acquiring shareholder proof of compliance with its income tax withholding obligations or proof of tax compliance of the seller's obligations derived from the sale. Thus, it is important to ensure that when a foreign company is the purchaser, the seller duly complies with its income tax payment obligations. Furthermore, the tax unity regime is allowed only for companies which are resident in Mexico for tax purposes. As a consequence there is no possibility to consolidate a foreign company with a Mexican company for tax purposes. Furthermore, tax free reorganizations are not allowed between foreign entities and Mexican entities, for example, the merger of a Mexican entity with a foreign resident entity cannot apply for a tax-free transfer of assets.

### **15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL MANNER THROUGH MERGERS OR A TAX GROUPING?**

Mexican law provides for a tax neutral regime applicable to some qualifying corporate restructurings, such as mergers, spin-offs, contributions-in-kind and exchanges of shares.

Subject to certain requirements, companies can achieve tax-free mergers and spin-offs whereby any transfer of assets is not considered as such for income tax and VAT purposes. In the case of mergers and spin-offs resulting from a corporate restructure, the requirements set forth in the ITL described in the following paragraph must be additionally met. Tax free mergers and spin-offs can only be achieved where the entities entering into the merger, or resulting from the spin-off are Mexican resident for tax purposes.

In the case of corporate restructures concerning Mexican resident legal entities, the Mexican tax authorities may authorize a transfer of shares at cost basis within entities forming the same corporate group. Subject to other requirements, the shares received and the shares transferred by each entity must remain directly held by the acquirer and within the group for a period of at least two years following the date of authorization of the restructure, and the shares received by the taxpayer must represent the same percentage that such shares represent in the paid in capital of the entity whose shares are received, as the percentage that the shares being transferred in turn would represent, prior to the transfer, in the consolidated capital of both entities.



Regarding the contributions-in-kind and exchange of shares, the Mexican tax authorities have to authorize the corporate restructuring before it is executed and the benefit of the authorization is a deferral in the payment of the tax that would have been triggered without the reorganization authorization. The transfer value to be considered for purposes of the deferral is the tax basis of the shares. In any case, several formalities and requirements must be fulfilled to qualify for the tax neutral regime. Among others, the related parties must not be resident in a preferential tax regime.

Mexico also has some tax treaties in place which allow for tax free or tax deferral reorganizations (eg United States, the Netherlands, Luxembourg, Hong Kong and Spain, among others).

**16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN THE CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?**

Income derived from the transfer of shares or securities that represent the ownership of assets will be considered Mexican-source income when the entity who issues the shares or securities is a Mexican resident or when more than 50% of the book value of said shares or securities derives, directly or indirectly, from real estate property located in Mexico.

In this sense, if a foreign resident indirectly sells the shares of a Mexican company whose value is represented substantially by Mexican real estate, such a transaction would be taxable in Mexico. Tax treaties entered into by Mexico may contain an indirect ownership rule in order for Mexico to be able to consider that the sale is Mexican sourced and therefore taxed in Mexico.

**17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?**

Tax integration (consolidation) is available under Mexican ITL, which allows for the deferral of income tax for a period of three years. The application of the integration regime requires the holding and the subsidiaries to be Mexican residents and the holding company must have above 80% ownership in all integrated subsidiaries, directly or indirectly. Furthermore, the holding company must be owned in more than 80% by Mexican resident shareholders or foreign resident shareholders resident in a country who has entered into a broad exchange of information agreement with Mexico.

Each entity of the integrated group would determine an individual taxable income or operating losses, as the case may be, and in the annual return the losses belonging to group members may be offset pursuant to a specific mechanic. The difference between the integrated taxable income and the taxable income that would have been realized had there been no integration will be deferred for three years and covered updated by inflation.

**18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS A PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?**

There is no special tax status applicable in Mexico such as a patent box or intangible holding company regime.

**19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?**

There are no specific limitations pertaining to the transfer of ownership of intangibles out of Mexico, however, this type of transaction must be reported as part of the taxpayers' obligation to disclose certain relevant transaction information and restructures entered into by the group. Derived from the foregoing, the Mexican tax authorities may identify and challenge the transaction from a transfer pricing perspective or deny the deductibility of royalty payments abroad where it is not demonstrated that the foreign resident has the technical capacity to provide the services related. In this respect, the Mexican tax authorities have issued a non-binding criterion by means of which



certain situations where the transfer of intangibles originated in Mexico to foreign related parties, or the payment of royalties thereof, are regarded as a harmful tax practice where the transaction does not have a valid business reason or is not set at arm's length.

## SELL-SIDE

### 20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

Mexican tax provisions provide that income obtained by a foreign resident derived from the sale of shares will be considered Mexican source income if:

- ❖ The issuer of the shares is a Mexican entity
- ❖ The value of shares is represented directly or indirectly by more than 50% of real estate property located in Mexico

The ITL provides the following options to compute income tax arising from the sale of shares:

- ❖ 25% on the gross amount of the transaction (sales price) with no deductions allowed
- ❖ 35% on the gains (sales price deducted by the tax cost basis) provided that several formalities are fulfilled, such as the appointment of a legal representative in Mexico for purposes of the sale and the filing before the Mexican tax authorities of a tax report of the transaction issued by a registered public accountant

Taxation on the capital gain pursuant to the foregoing is only allowed to the extent that the foreign resident is not subject to a preferential tax regime or to a territorial tax system. A 40% withholding rate may apply to sales of shares made by residents of a preferential tax regime in related party transactions.

Capital gains derived from the sale of shares of listed Mexican companies in a recognized stock exchange and shares issued by variable yield investment funds are subject to a 10% tax rate on the gains.

There is no participation exemption regime or a similar concept under Mexican tax law, however, as mentioned earlier, Mexican ITL allows for a deferral regime for qualifying corporate restructurings. Further, the tax rate on capital gains may be reduced or even eliminated by means of a tax treaty.

For Mexican resident companies, capital gains are taxed as ordinary income with no special capital gains treatment. Hence, such capital gains would be subject to the 30% corporate income tax rate. A loss in the sale of shares may be offset against future capital gains subject to the fulfillment of certain requirements.

### 21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES OR ASSETS ARE REINVESTED?

There is no particular advantage or deferral benefit for reinvesting proceeds from the sale of shares or assets.

### 22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

There are no local substance requirements for foreign holding companies, nor any further rules are envisaged after BEPS.



## 23. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Any transfer of assets derived from a merger or a spin-off is in principle considered as a sale of such assets and triggers income tax, VAT, and in the case of real estate, is subject to real estate transfer tax. However, in the case of the transfer of assets derived from a merger or a spin-off involving Mexican resident entities, the transfer can be disregarded as a sale for income tax and VAT purposes (not for real estate transfer tax), thus not triggering these taxes. To qualify for this treatment, the following requirements must be met:

- ❖ Tax free merger: Filing of a merger notice before the Mexican tax authorities (and of the merged entity's final annual tax return by the merging entity) and after the merger, the surviving entity continues to carry out the activities that it and the merged company had conducted before the merger, for a minimum period of one year immediately following the date on which the merger becomes effective. This last requirement will not be applicable if the following requirements are met: (i) The income from the principal activity of the merged company for the fiscal year immediately preceding the merger derived from the leasing of assets used in the same activity as that carried out by the merging company; and (ii) In the fiscal year immediately preceding the merger, the merged company has received more than 50% of its income from the surviving company, or the latter has received more than 50% of its income from the merged company
- ❖ Tax free spin-off: The shareholders owning at least 51% of the voting shares of the spun off entities are the same for a period of one year before and two years after the spin-off takes place, and must maintain the same level of participation in both resulting entities for such period. When an entity ceases to exist following a spin-off, such entity must designate a legal representative to comply with its outstanding tax obligations, such as the filing of the pending annual tax return

Further, to achieve a tax-free merger within five years following a previous merger or spin-off, authorization from the Mexican tax authorities is required prior to carrying out the merger.

Real estate transfer tax is levied at State level and is triggered at a rate that may vary from 2% to 5% on the cadastral value, sales price or appraisal value (whichever is higher), depending on the State in which such real property is situated. This tax is generally collected by the notary public.

Finally, there are rules in place that allow the deferral of taxation derived from the transfer of shares in the restructuring of certain investment vehicles that hold immovable property and energy related assets, subject to the fulfillment of certain requirements.

## MANAGEMENT INCENTIVES

### 24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

Income earned by individuals from the exercise of stock options granted by the employer or a related party thereof are treated as employment income for Mexican tax purposes. The option will be taxed upon exercise on the difference between the market price of the stock at the moment of exercise and the value set at the moment of vesting of said stock. Furthermore, the price considered for the determination of the aforementioned taxable income will be the tax basis of the employee in a subsequent sale of the stock. In case of Mexican resident individuals, the stock option income will be subject to a progressive rate with a maximum tax rate of 35%.

Where foreign resident individuals perform management services, such services will be sourced in Mexico when they are performed within Mexican territory. In this regard, stock options income sourced in Mexico and earned by a foreign resident will be subject to (i) exemption for the first MXN 125,900 (approximately US 6,700), (ii) a 15% rate with no deductions between MXN 1M (approximately US 53,000) and the previously mentioned threshold, and (iii) a 30% rate with no deduction thereafter.



Payments made by foreign residents without a permanent establishment in Mexico or with a permanent establishment to which such services are not connected will be exempt from taxation in Mexico if the services rendered do not exceed 183 days in any 12-month period. Conversely, where the payments are made by a Mexican resident or a foreign resident with an establishment in Mexico (not necessarily a permanent establishment) to which such services are connected, or where there are complimentary payments made by a foreign resident to payments made by Mexican residents or permanent establishments in Mexico to which such services are connected, such services will be taxable in Mexico.

There are no special tax considerations in Mexico for management incentives, such as sweet equity or manager remunerations.

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