



Tax incentives granted to taxpayers in northern border region

A presidential decree published in Mexico's government gazette on 31 December 2018 grants a temporary income tax credit and reduced value added tax (VAT) rate to certain taxpayers located in 43 municipalities in the northern border region. The decree applies for a two-year period from 1 January 2019 through 31 December 2020.

The main features of the decree are discussed below.

Definition of northern border region

The northern border region for purposes of the decree includes the following municipalities:

- Ensenada, Playas de Rosarito, Tijuana,

Tecate and Mexicali in the state of Baja California Norte;

- San Luis Río Colorado, Puerto Peñasco, General Plutarco Elías Calles, Caborca, Altar, Sáric, Nogales, Santa Cruz, Cananea, Naco and Agua Prieta in the state of Sonora;
- Janos, Ascensión, Juárez, Praxedis G. Guerrero, Guadalupe, Coyame del Sotol, Ojinaga and Manuel Benavides in the state of Chihuahua;
- Ocampo, Acuña, Zaragoza, Jiménez, Piedras Negras, Nava, Guerrero and Hidalgo in the state of Coahuila de Zaragoza;
- Anáhuac in the state of Nuevo León; and

- Nuevo Laredo, Guerrero, Mier, Miguel Alemán, Camargo, Gustavo Díaz Ordaz, Reynosa, Río Bravo, Valle Hermoso and Matamoros in the state of Tamaulipas.

Income tax credit

The decree allows certain taxpayers that derive income "exclusively" in the northern border region to claim a tax credit of up to one-third of their income tax liability against the tax reported in the annual tax return or in the estimated tax returns.

A taxpayer will be deemed to derive income exclusively in the northern border region where the income represents at least 90% of the taxpayer's total income during the immediately preceding fiscal year, according

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to the Omnibus Tax Bill issued by the Tax Administration Service (SAT) on 7 January 2019 for this purpose, which applies as from 1 January 2019.

Taxpayers are required to prorate the income tax credit based on the percentage of the taxpayer's total income that is derived in the northern border region for

the fiscal year or taxable period. Income from the northern border region excludes income derived from intangible goods or digital commerce, which does not qualify for the tax benefits under the decree.

Qualifying taxpayers include individuals that engage in business activities, Mexican entities, nonresidents with a permanent

establishment (PE) in Mexico and those exercising the income accrual option established for companies incorporated by individual shareholders.

The following example illustrates the calculation of the income tax credit:

2019	Total income and tax calculation	Income from northern border region	Percentage of income obtained in border region
Income	1,000	950	95%
Deductions	900		
Tax losses	0		
Taxable income	100		
Tax incurred	30 (one third:10)		
Tax credit	9.5 (95% of 10)		
Tax payable	20.5		

In this example, the income obtained in the border region represents 95% of the taxpayer's total income, and the taxpayer's effective income tax rate is 20.5%. If the total income obtained in the border region represents 100% of the taxpayer's total income, the tax payable would be 20 (tax incurred of 30 less a credit of 10) and the effective income tax rate would be 20%.

For individuals who pay tax at the maximum 35% rate and derive all of their income in the border region, one-third of the tax (11.67%) is creditable, resulting in an effective income tax rate of 23.3%.

Requirements to claim the credit

To claim the income tax credit, a taxpayer must:

- Request authorization from the SAT to enroll in the "registry of beneficiaries of the northern border region tax incentive" and enroll in the registry;
- Certify that their tax domicile has been

located in the northern border region for at least 18 months before the date of registration; and

- Not benefit from other tax incentives in Mexico as from the date the decree entered into force.

The authorization request must be submitted to the SAT no later than 31 March of the fiscal year for which the tax credit is claimed. The SAT must issue a ruling on the request no later than the month following that in which the request was filed.

Taxpayers that commence operations in a qualifying municipality after 1 January 2019 must request authorization from the SAT during the month following the date of their registration with the Federal Taxpayers Registry (RFC) or the filing of a notice regarding the incorporation of a branch or establishment in the northern border region.

Once granted, the SAT authorization will remain in effect during the fiscal year in which it was issued. Taxpayers wishing to remain in the registry for the next fiscal year must renew their authorization by filing a renewal application with the SAT no later than the date on which the annual tax return is filed for the year immediately preceding the year for which the renewal is requested.

To enroll with the registry, a taxpayer also must fulfill the following requirements:

- Have an advanced electronic signature, along with a positive opinion regarding compliance with its tax obligations under the Federal Tax Code (FTC);
- Have access to the tax mailbox through the SAT website; and
- Collaborate on a semi-annual basis with the SAT by participating in the real-time verification program.

Taxpayers that begin activities in the

northern border region may request registration in the registry before meeting the 18-month requirement, provided they have the economic capacity, assets and facilities necessary to carry out their operations and business activities in the region. In such cases, taxpayers must certify that they use "new" fixed assets to perform their border region activities and estimate that their border region income will represent at least 90% of their total income for the year.

New fixed assets are defined as those that are used for the first time in Mexico. Taxpayers also may utilize fixed assets that already have been used in Mexico provided the assets are not acquired from a related party, according to the Omnibus Tax Bill issued by the SAT on 7 January 2019.

Taxpayers that have their fiscal domicile within the northern border region but have a branch, agency or other establishment outside the region, and taxpayers that have their fiscal domicile outside the region but have a branch agency or other establishment within the region, may apply the tax benefits granted by the decree provided they certify that the fiscal domicile or other establishment has been located in the region for at least 18 months at the date they enroll with the registry. In such cases, the applicable tax benefit will be based on the percentage of income derived within the border region.

Excluded taxpayers

The following taxpayers do not qualify for the income tax credit:

- Credit, insurance and bonding institutions, public bonded warehouses, financial leasing companies and credit unions;
- Taxpayers operating under (i) the optional tax grouping integration regime; (ii) the regime for entities handling fixed assets directly related to the transport of cargo and passengers; (iii) the regime for agricultural, livestock, forestry and fishery activities; or (iv) the tax incorporation regime;
- Individuals resident in Mexico whose income is derived from the provision of

independent professional services;

- Taxpayers engaged in the performance of "maquila" operations;
- Taxpayers that perform activities through trusts engaged in the acquisition or construction of real property for leasing purposes;
- Production cooperatives;
- Taxpayers whose name and federal taxpayer registration number are listed on the SAT website (among others) because they have outstanding tax liabilities, cannot be located, have an unfavorable judgment relating to a tax crime or have had a tax payment forgiven;
- Taxpayers that have issued false electronic invoices for nonexistent transactions or that have a partner or stockholder that has done so. Taxpayers that have entered into transactions with such taxpayers and have not provided proof to the SAT that they effectively acquired the goods or received the services covered by the electronic invoices also will not be allowed to apply the credit.
- Taxpayers found to have transferred unlawful tax losses, as evidenced by their inclusion in the list published in the official gazette and on the SAT website;
- Taxpayers that perform business activities through trusts;
- Taxpayers that supply personnel through labor subcontracting schemes or are considered intermediaries according to the federal labor law;
- Taxpayers that have been subject to an inspection by the tax authorities for any of the five fiscal years preceding the enactment of the decree, where the inspection determined unpaid taxes that have yet to be settled;
- Taxpayers that apply other tax advantages or incentives, including exemptions or subsidies;
- Taxpayers that have commenced the liquidation process at the time authorization is request to apply the tax benefit;
- Entities, the partners or stockholders

of which have individually lost their authorization to apply the tax benefit granted by the decree; and

- State production companies and their subsidiaries, as well as contractors under the Hydrocarbons Law.

Refund requests and offsetting

The income tax credit is not refundable and may not be used to offset other types of taxes.

Reduced VAT rate

The decree also establishes a reduced VAT rate for qualifying taxpayers that engage in activities relating to the sale of goods, the provision of independent services or the granting of the temporary use or enjoyment of goods in premises or establishments located in the northern border region. Such taxpayers are granted a 50% reduction in the 16% standard VAT rate, thus allowing these activities to be taxed at a rate of 8%.

Requirements for reduced VAT rate

Taxpayers that apply the reduced VAT rate must fulfill the following requirements, as well as the requirements under the Omnibus Tax Bill issued by the SAT on 7 January 2019:

- Physically deliver the goods or provide the services in the northern border region; and
- File a notice regarding the application of the tax benefit within 30 calendar days of enactment of the decree, i.e. by 31 January 2019.

Taxpayers that commence activities after 1 January 2019 must file the notice with their RFC (taxpayer identification number) registration application, which must be filed according to the Regulations of the FTC.

Taxpayers may apply the reduced rate only if they file the required notice on time and in the correct form. Failure to file the notice will result in consequences detailed in applicable tax provisions, including disallowance of the reduced rate and possible penalty surcharges. The reduced rate VAT rate does not apply to:

- The sale of real property and intangible

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assets;

- The supply of digital content, such as audio or video, or a combination thereof, through the downloading or temporary receipt of electronic files, among others;
- Taxpayers whose name and federal taxpayer registration number are listed on the SAT website, because they have outstanding tax liabilities, cannot be located, have an unfavorable judgment relating to a tax crime or have had a tax payment forgiven;
- Taxpayers that have issued false electronic invoices for nonexistent transactions or that have a partner or stockholder that has done so. Taxpayers that have entered into transactions with such taxpayers and have not provided proof to the SAT that they effectively acquired the goods or received the services covered by the relevant electronic invoices also will not be allowed to apply the credit; and
- Taxpayers found to have transferred unlawful tax losses as evidenced by their inclusion on the list published in the official gazette and on the SAT website.

Nontaxable income

The tax benefits established by the decree will not be considered taxable income for income tax purposes.

Transition rules

- Taxpayers that are entitled to the income tax credit with respect to income from activities carried out in the northern border region but that receive the income after the date the decree expires may apply the income tax credit with respect to the income provided it is received within 10 calendar days following the date on which the decree expires.
- For the purposes of the VAT credit, when the sale of goods, provision of services or granting of the temporary use or enjoyment of goods took place before the decree expires, the tax benefit will apply provided the relevant payments are made within 10 calendar days following the date on which the decree expires.

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