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NEW CFC RULES
IN MEXICO

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Agenda

- Review of Old CFC Rules
- 2020 Tax Reform on CFC Rules
 - Eliminate “Transparent Entities and Figures”
 - Overhaul of Control Exception
- New Separate Regime for “Transparent Entities and Figures” (Art. 4B)
- Information Reporting
- As of 2021 New Separate Anti-Transparency Rule (Art. 4A)



Old CFC Rules

- 1998 “Black List” (Tax Havens)
 - Anti-deferral
 - Information Reporting
- 2005 “Preferential Tax Regimes”
 - Income obtained indirectly subject to less than 75% of the applicable Mexican income tax; and
 - Income obtained through fiscally transparent entities
 - Exception for lack of control, defined as the ability to determine the timing of income distributions
 - Exception for active business income (80% of total income)
 - Information Reporting



New CFC Rules

- Income obtained through transparent entities and transparent figures is not income subject to a PTR
 - If a structure involves several entities and at least one of them is not transparent, it remains subject to the PTR regime
- Control is now defined as:
 - More than 50% of voting rights or of equity, or
 - Rights to more than 50% of assets or profits in a capital redemption or liquidation, or
 - Any combination of the above two resulting in more than 50%
 - There is a presumption of control
- Attribution Rules for Control
 - Related Parties: when a party participates, directly or indirectly, in the management, control, or capital of the other, or when another party participates directly or indirectly, in the management, control, or capital of the other two
 - Linked Parties: when one party participates in the management of the other party's business; when they are legally recognized as business associates; spouses or concubines (domestic partners); and, blood relatives up to the 4th degree
 - Attribution goes both ways, and all parties are subject to complying with the rules
- Income is recognized in the percentage of direct and indirect participation in the underlying entity, as determined by applying the control rules
 - FX gain may be deferred if the foreign entity maintains books and records in its functional currency
 - FTC is allowed



Transparent Entities and Figures (Art. 4B)

- Mexican taxpayers are subject to tax on income obtained through:
 - Transparent foreign entities (foreign entities with a distinct legal personality)
 - Transparent foreign figures (foreign trusts, associations, investment funds, and other similar figures without a distinct legal personality)
- Transparency
 - Not considered residents for income tax purposes in their country of formation or effective management, and
 - Attribute their income to their members, partners, shareholders, or beneficiaries
- Income is accrued by the taxpayer when generated by the transparent entity or figure
 - FTC allowed
- No exceptions for:
 - Lack of control
 - Active business income
- FX phantom gains are recognized and taxed



CFC Information Reporting

- The following taxpayers are required to file an information return in February (extended to May by regulations):
 - Those obtaining income subject to PTR
 - Those obtaining income from blacklisted jurisdictions (even if such income is not considered subject to a PTR)
 - Those performing operations through transparent foreign legal entities or figures (4B)
- Failure to file the return may result in:
 - Criminal penalties
 - Being subject to tax on gross income (all deductions are disallowed)



Anti-Transparency Rule (Art. 4A)

- For purposes of the Mexican Income Tax Law, any transparent foreign entities or figures are considered separate legal entities
 - Even if the members, partners, shareholders, or beneficiaries are subject to tax in their country of residence
- Consequences:
 - If their place of effective management is in Mexico, they are considered residents in Mexico
 - If they have a place of business in Mexico through which their business activities are performed, they have a PE in Mexico
 - If they receive Mexican source income, they are subject to withholding
- This rule does not apply where a double tax treaty applies
 - Note US-Mexico Protocol relating to LLCs



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