International Bar Association Annual Conference 2024

Recent Developments in International Taxation

Mexico

Roberto Padilla Ordaz

Chevez Ruiz Zamarripa, Mexico City

rpadilla@chevez.com.mx

Mexico tax overview

For Mexico, 2024 will represent a landmark, as its largest election will be held to cast a ballot for local, state, Chamber of Deputies and Senate seats, and the country's next President (expectedly, Mexico will have its first female President).

The new federal administration will certainly face important economic challenges, as the current administration (2018–2024) did not enact any major tax reform and destined most of its revenue to social programmes, infrastructure and transportation projects (Maya Train, Dos Bocas Refinery, Felipe Ángeles Airport and Mexicana de Aviación, a former private airline currently managed by the Federal Government).

On economic aspects, according to the findings of the Organisation for Economic Co-operation and Development (OECD) within its February 2024 Economic Survey on Mexico,[1] the country has the lowest tax-to-gross domestic product (GDP) ratio in the OECD; there is room to raise more revenue from the property tax and environmental taxes, and to make the tax system more effective and progressive by reducing tax expenditure benefitting the more affluent.

Likewise, the OECD considers that Mexico has large potential to attract investment from companies looking to relocate their operations to North America (the so-called 'nearshoring' effect). This is also a significant opportunity to spread the benefits of trade throughout the country, integrate small and medium-sized enterprises more forcefully into trade, and create more and better value chain linkages.

In the tax arena, as mentioned, the current Federal Administration did not enact any major tax reform, and its administrative efforts were directed to its strategy for revenue collection through more aggressive tax audits. The Mexican Tax Administration Service has led audit programmes targeting specific economic sectors, focusing on compliance aspects and strengthening the still very formalistic Mexican tax system.

As addressed in Mexico's 2023 National Report, tax authorities are reluctant to authorise tax refunds, which implies an exhausting verification process with the taxpayer's counterparties, constantly questioning the material elements that surround each economic transaction. In this regard, the Tax Ombudsman's office in Mexico remains as a viable means for mediation in complex cases between taxpayers and the tax authorities.

Tax litigation in Mexico remains active and, in recent years, substance-over-form proceedings have become more active for guaranteeing taxpayers' rights, despite the constant challenges the Judiciary Branch is dealing with, specifically on matters pending to be ruled that are of the utmost interest to the Executive Branch. Recent months have witnessed an intense confrontation between the Executive Branch and the Supreme Court of Justice on different matters.

---

[1] See https://read.oecd-ilibrary.org/economics/oecd-economic-surveys-mexico-2024_b8d974db-en#page1 accessed 12 September 2024.

Protocol to the Mexico–Germany Double Taxation Treaty (DTT)

On 4 August 2023, Mexico's Executive Branch published the 'Decree enacting the Protocol Amending the Agreement dated 9 July 2008, between the United Mexican States and the Federal Republic of Germany for the Avoidance of Double Taxation and Tax Evasion with respect to Taxes on Income and Capital, executed at Mexico City on the eighth day of October, two thousand twenty one' in the *Official Gazette* of the Federation, which entered into force as of 6 August 2023, being applicable since 1 January 2024.

With respect to dividends, tax that may not exceed five per cent of the amount of such income in the state in which the company paying the dividends is resident shall be applicable, provided that the beneficial owner of the dividends is a resident of the other contracting state and a legal person (excluding partnerships) that directly owns at least ten per cent of the capital of the company paying the dividends for a period of 365 days, including the day of payment of the dividends.

Capital gains earned by a resident of a contracting state on the alienation of shares or other comparable participation rights, such as interests in a partnership or trust, may be taxed in the other contracting state if, at any time within 365 days prior to the alienation, more than 50 per cent of the value of such shares or comparable participation rights derives, directly or indirectly, from immovable property situated in that other state.

Energy industry

On 31 January 2024, the Second Chamber of the Mexican Supreme Court of Justice ruled on case number 164/2023, through which it declared several provisions of the 2021 Amendments of the Electrical Industry Law unconstitutional. Such a ruling is based on the reasoning that amendments violate the competition and free market principles that constitutionally govern the electrical sector.

The Second Chamber determined the articles of the 2021 Amendments of the Electrical Industry Law as unconstitutional that intended:

- to establish a fixed order of preference to dispatch electrical energy favouring Comisión Federal de Electricidad;
- to create electrical energy coverage agreements, granting benefits to only some participants of the electrical sector (basic service suppliers) concerning the interconnection to the transmission and distribution networks of energy, as well as on the assignment and dispatch of energy;
- to eliminate the obligation of basic service suppliers to conclude electrical coverage agreements through auctions; and
- to modify the mechanism to grant clean energy certificates to include generators that were not originally contemplated.

Although the Supreme Court ruling only produces effects on companies that submit the constitutional claim, the Second Chamber of the Supreme Court of Justice determined that, in this case, the consequences of the compliance of the ruling will be general to preserve the balance of participants in the electrical sector.

Tax benefits for key sectors of the export industry

On 11 October 2023, the 'Decree granting tax benefits to key sectors of the export industry comprising the immediate deduction of investments in fixed new assets and the additional deduction of staff training expenses' was published in the *Official Gazette* of the Federation, entering into force on 12 October 2023.

The Decree aims to grant two benefits to companies seeking to optimise their operations in Mexico through nearshoring strategies, and to those located in Mexico, belonging to key sectors of the export industry: (1) performing an immediate deduction for investments in new fixed assets; and (2) an additional deduction equal to 25 per cent of the training expenses invested in employees.

Immediate deduction for fixed assets

The immediate deduction for new fixed assets can be applied by Mexican resident corporations or individuals that carry out business activities in Mexico or engage in the production of certain key sectors of the export industry (eg, food products for humans or animals; raw materials for the pharmaceutical industry; electronic components; electronic medical equipment; automotive industry, trucks or aircraft engines; and parts for automobiles, trains, ships and aircraft) that effectively export such products.

The incentive is applicable to investments in new fixed assets acquired from the entry into force date of the Decree to 31 December 2024 that are exclusively used in the activities referred to above, and only to the extent taxpayers estimate that, during 2023 and 2024, the income derived from the export of the goods will account for at least 50 per cent of their total revenue in each tax year.

If the threshold referred to above is not met, the incentive will be terminated and taxpayers will be required to pay the corresponding income tax, adjusted using Mexican inflation and interest.

As a rule, the tax benefit will only be applicable to fixed assets that taxpayers keep using during a period of at least two consecutive years after the year in which the immediate deduction is applied.

Additional deduction for staff training expenses

Furthermore, the taxpayers previously referred to are allowed an additional deduction for tax years 2023, 2024 and 2025, equivalent to 25 per cent of the incremental employee training expenditure. The incremental employee training expenditure is determined as the positive difference between the expense incurred during a given year, and the average expense incurred during 2020, 2021 and 2022.

Only the expenditure on technical and scientific training related to taxpayers' businesses are considered for this benefit, to the extent that the beneficiaries are employees duly registered before the Mexican Social Security Institute. Certain formal obligations are required to apply this benefit.

Inflationary scenario

According to the OECD, within its February 2024 Economic Survey on Mexico, the appreciation of the Mexican peso throughout 2023 contributed to containing and reducing inflationary pressure. Such appreciation can be explained, according to the OECD, by strong macroeconomic fundamentals and an attractive interest rate differential with the United States, as well as ample remittances and the recent rebound of tourism. Annual general inflation in 2023 was 4.66 per cent.

Agenda

Insight into the next Federal Government's administration tax agenda for subsequent years should have become clearer once the elections took place in June 2024. Mexico is expected to increase its foreign investment due to the nearshoring effect; however, much work must be done by the next Federal Administration to attract potential funds to generate a positive impact in Mexico's economy.

The OECD recommendations addressed in its Mexico's February 2024 Economic Survey must not be overlooked; there is great expectation about whether a tax reform will be submitted to Congress in subsequent years or if similar collection policies to those currently in force will remain. The feasibility of a tax reform will depend on the post-election configuration of the Mexican Congress.