Mexico’s President issues Decree granting tax incentives to maquiladoras

Executive summary

As a follow up to the Mexican tax reform package that was enacted on 11 December 2013, President Pena Nieto issued a Presidential Decree granting certain new tax benefits to the maquiladora industry. Likewise, the Mexican tax authorities issued Miscellaneous Resolution rules that provide clarifying rules related to the treatment of certain items included in the aforementioned tax reform. The published guidance does not address all issues on key provisions; however, the rules are generally taxpayer favorable and can be considered as an indication of the intent of both the tax authorities and the executive branch to work together with the maquiladora industry to maintain its global competitiveness.

Specifically, on 26 December 2013, Mexico’s President Pena Nieto published a Decree granting tax incentives to the manufacturing, maquiladora and export services industry in the Official Gazette (the Decree). On 30 December 2013, Miscellaneous Resolutions for 2014 were published.

The Decree provides some guidance and relief to taxpayers with respect to changes in the laws that will go into effect on 1 January 2014. As part of the tax reform for 2014, new rules were included in Articles 181 and 182 of the Income Tax Law for maquiladoras. Compliance with these rules is necessary for the foreign partner of a maquiladora to benefit from a statutory exemption from creating a permanent establishment in Mexico. Without this exemption, the foreign partners for the maquiladoras must look to facts and circumstances under the applicable treaty to evaluate whether or not a permanent establishment exists.

Below is a summary of some of the benefits of the Decree.
Detailed discussion

Decree

Additional deduction for certain employee wages and benefits

An additional tax deduction is granted to maquiladoras that comply with the requirements for maquiladoras as established under the terms of Articles 181 and 182 of the Income Tax Law. The amount of this additional deduction is equal to the amount of the non-deductible salaries and wages established in the Income Tax Law beginning 1 January 2014. As part of the tax reform, 47% percent of the tax exempt benefits paid to employees are non-deductible (53% are non-deductible, if there is a reduction in the amount of the benefits paid over the prior year). This additional tax deduction equals 47% of the total amount of exempt compensation and benefits paid to employees that are related to the maquiladora operation. In order to apply this additional tax deduction, maquiladoras must:

- Maintain financial information segmented between maquiladora and non-maquiladora activities, as well as exempt compensation payments made to employees that are related to the maquiladora operation.
- Inform the Mexican tax authorities in the month of March following the end of each year about the amount of tax incentive that was applied.

Transition period for foreign owned machinery and equipment

A two-year transition period will be granted to certain maquiladoras to allow them time to comply with the new requirement that at least 30% of the machinery and equipment used in the maquiladora process be owned by the foreign resident and not previously owned by the Mexican entity or a resident related party. This benefit is available to maquiladoras that as of 31 December 2009, met the transfer pricing rules for maquiladoras as established in Article 216-Bis of the Income Tax Law in force through 31 December 2013.

If the 30% threshold is not met by the end of the two-year term, the foreign resident contracting with the maquiladora will not be allowed to apply the permanent establishment exemption as of the third year.

The wording of this benefit does not clearly address the issue of using machinery and equipment that has previously been owned by the maquiladora or a Mexican related party, even when the 30% threshold is otherwise met. This issue will be subject to interpretation and may require further clarification from the Mexican tax authorities.

VAT credits

An immediate credit is allowed for qualified VAT withheld by companies operating under qualified export programs, such as IMMEX or similar programs, as well as companies of the automotive industry. Sales of goods by a nonresident to a Mexican resident is generally subject to a VAT withholding mechanism, which, under general rules, would create a credit in the month following the withholding and payment of the tax. Under the Decree, this credit is allowed on the same tax return, thus, avoiding an actual cash payment of the tax. This immediate credit is allowed on qualified transactions with foreign residents for the purchase of products that are under the temporary importation regime, a similar regime or under fiscal deposit. The immediate VAT credit will be applicable in the following cases:

- During 2014, the credit is allowed as long as the goods are transferred as part of a supply chain of products destined for export and are documented through virtual export documents or transfer certificates. For these purposes, an inventory control system and accounting controls must be maintained in order to allow for the segmentation of the purchases of goods that are destined for export and the ones destined for the Mexican market.

- In 2015, the credit is allowed as long as the company that makes the withholding (the purchaser of the goods) becomes certified by the Mexican tax administration as part of the process that will be established by that time for temporary imports.

Specific repeal of prior Presidential Decree

The income tax benefit granted under the Presidential Decree of 30 October 2003 (commonly known as the Fox Decree), that provided a special income tax reduction for maquiladoras, is repealed. It was not clear that the 2003 decree was applicable going forward and this Decree specifically eliminates the ability to reduce income tax for these amounts.
Miscellaneous Tax Resolution for 2014
In addition to the Decree, on 30 December 2013, the Mexican tax authorities published Miscellaneous Resolution (RM) rules related to the 2014 tax reform package. The following rules relate to the maquiladora industry.

Transition rule for meeting the productive activity test
Under the tax reform for 2014, 100% of the “productive activity” of a maquiladora must be from maquiladora activities in order to qualify for the maquiladora benefits under the income tax rules.

The RM provides that an entity’s productive activity will be deemed to be from maquila activities, if the income is for providing services to nonresident related parties under a maquila agreement, and also clarifies that other income related to the maquila operations may qualify as income from maquila activities. In this regard, the RM provides that for the period between 1 January and 30 June 2014, all revenue of maquiladora companies will qualify as maquiladora revenues arising from productive activity. For this benefit, the maquiladora’s financial records must properly segment the revenues, costs and expenses related to each activity. This transition period of six months should allow companies to analyze the new provisions and restructure their operations as needed.

Advanced Pricing Agreements
The RM clarifies that a foreign principal operating through a maquiladora that elects an Advanced Pricing Agreement (APA) will be deemed to meet the transfer pricing rules that are required for the statutory exemption from a permanent establishment in Mexico with respect to the maquiladora operations. The APA must determine the profitability of the maquiladora using a methodology that includes all of the assets used in the maquiladora operation (including foreign owned assets).

To make the APA election, taxpayers must notify the tax authorities by no later than 30 June 2014.
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