Clients Bulletin

Maquiladora Tax Regime Under the 2014 Tax Reform

On December 11, 2013 a new Income Tax Law (the "New Law") as well as amendments to the Value Added Tax Law and other tax laws were published in the Federal Official Gazette. In addition, a Presidential Decree (the "Presidential Decree") published in the Federal Official Gazette on December 26, 2013 introduced certain incentives for maquiladoras. Further, the administrative Tax Miscellaneous Rules for 2014 (the "Miscellaneous Rules") were published on December 30, 2013 also dealing with some maquiladora issues. Finally, the Sixth Amendment to the General Foreign Trade Rules (the "Foreign Trade Rules") were published on January 1, 2014, dealing with a certain VAT certification.

Most of the amendments came into effect on January 1, 2014.

The new provisions impact the tax treatment of maquila operations in various aspects, including:

- The flat rate tax (IETU) is repealed. As a result, the 2007 IETU incentive for maquiladoras ceases to exist.
- The New Law repeals the 2003 income tax incentive allowing maquiladoras to, in fact, pay income tax on the highest of 3.0% of their costs and expenses or 3.0% of the value of machinery and equipment used in the maquila operation.
- The two preceding repeals mean that maquiladoras will now return to paying income tax as any regular corporate taxpayer rather than paying IETU on reduced taxable income.
- The definition of "maquila operation" continues to require that the foreign principal owns at least 30% of the machinery and equipment. Under certain conditions a 2-year phase in

period is allowed. The new definition now also requires that all income from the maquiladora's productive activity must originate exclusively from the maquila operation. These requirements impact the permanent establishment exemption, the right to apply the safe harbor transfer pricing provisions and the right to an incentive that allows deduction of 100% of exempted fringe benefits.

- Repeal of the first and third transfer pricing methodologies existing for maquiladoras. Only the safe harbor remains as the transfer pricing method for the nonresident principal to avoid permanent establishment status. The General Rules, however, also allow for an APA to be secured to comply with transfer pricing and avoid creating a permanent establishment.

- Non-deductibility of 47% of exempted fringe benefits paid to employees. Maquiladoras may deduct the remaining 53% under certain conditions.

- Repeal of the VAT exemption for sales of the maquila production by nonresidents to maquiladoras. Only sales of the production between nonresidents continue to be exempt. Under certain conditions the Mexican purchasers may be entitled to an immediate credit for the VAT withheld on these transactions.

- As from 2015 VAT will levy temporary imports. This will affect most if not all imports by maquiladoras. A new certification mechanism is, however, introduced to allow for this VAT to be virtual. Alternatively, the importer may post a bond to avoid paying the VAT.

- The reduced 11% VAT rate for the border zones was be repealed. Consequently, the general 16% rate will now apply in the border zones as well.

- Withholding of VAT on sales by maquiladoras to automobile OEMs or to the auto-parts industry is repealed.

- Introduction of a 10% dividends tax.

We discuss these and other changes in the following sections.

BUSINESS FLAT TAX

The tax reform repealed the 17.5% business flat tax ("IETU" for its acronym in Spanish). IETU was an alternative minimum tax where taxpayers paid the lesser of actual income tax or IETU. IETU was levied on a basis that excluded a number of deductions, notably salaries.

This means repeal of the 2007 President Calderón decree that allowed maquiladoras to in fact pay IETU at the general 17.5% rate but on the basis of taxable income computed under the income tax rules (which do allow deduction of salaries) rather than taxable income calculated under the IETU rules.

As a result of the repeal, maquiladoras will now return to paying income tax rather than IETU.

PERMANENT ESTABLISHMENT

Under domestic law and treaty law combined, a permanent establishment arises when a nonresident has a fixed place of business in Mexico through which it carries on commercial activities, in whole or in part. Having a permanent establishment in Mexico subjects the nonresident to taxation in Mexico on income attributable to the permanent establishment.

Maquila operations typically would create a permanent establishment given that the nonresident principals, by having employees of their own permanently present at the maquiladora facilities, have the maquiladora facilities at their disposal on a permanent basis and, thus, they have a fixed place of business in Mexico. Conversely, no permanent establishment would arise where the nonresident principal has no employees in Mexico and it simply has machinery and equipment in Mexico as well as parts and components to be processed by a maquiladora.

Article 2 of the law in effect up to 2013 provided that no permanent establishment would be found to exist in maquila operations where the maquiladora complied with any one of three transfer pricing options set forth in Article 216-Bis. The law also provided that the term "maquila operation" was to be understood as defined in the Maquila Decree (presently known as the IMMEX Decree).

Originally, the IMMEX Decree had only a general definition in Article 2 to the effect that a maquila operation is the industrial or services process destined to manufacture, transform or repair foreign-origin merchandise imported temporarily, for export, as well as the rendering of export services.

In 2006 the decree was amended and a new Article 33 was incorporated, prompted by the tax administration, introducing a sui-generis "maquila operation" definition exclusively for purposes of the penultimate paragraph of Article 2 of the Income Tax Law, that is, exclusively for purposes of avoiding a permanent establishment in Mexico. This stringent unconstitutional provision was aimed at preventing a number of maquiladoras –notably former PITEX as well as entities who were originally regular manufacturers and later transformed into maquiladoras - from qualifying for the permanent establishment exemption as well as for other benefits existing at the time. Article 33 was again amended, effective January 1, 2011, to an even more stern definition of what constitutes a "maquila operation" for purposes of the penultimate paragraph of Article 2 of the Income Tax Law.

The New Law now provides that compliance by maquiladoras of their transfer pricing obligations under the safe harbor discussed in the following section avoids the permanent establishment resulting from "maquila operations". However, with the purported goal of avoiding harmful tax planning under the maquila regime, for purposes of the special safe harbor applicable to maquiladoras, and for purposes of the provisions avoiding creation of a permanent establishment for the foreign principal, the New Law includes a new definition of what constitutes a "maquila operation", following Article 33 but further limiting its scope. Following is the language from both of the above provisions, highlighting the differences:

IMMEX Decree	New Income Tax Law
Article 33. For purposes of the last paragraph of Article 2 of the Income Tax Law, maquila operation is that meeting the following conditions:	Article 181. … For purposes of this article, maquila operation is that meeting the following conditions:
I. The merchandise to which Article 4, Section I of this Decree refers, supplied by a nonresident under a maquila contract pursuant to a Program, which are subjected to a transformation or repair process, must be temporarily imported and returned abroad, including through virtual operations, carried on in accordance with the provisions of the Law or this Decree. For purposes of this section the return abroad of shrinkage and waste is not required.	I. The merchandise supplied by the nonresident under a maquila contract pursuant to a Maquila Program authorized by the Ministry of Economy, which are subjected to a transformation or repair process, must be temporarily imported and returned abroad, including through virtual operations carried on in accordance with the provisions of the Customs Law and the general rules issued for such purpose by the Tax Administration Service. For purposes of this section the return abroad of shrinkage and waste is not required.

The merchandise to which this section refers may be owned by a nonresident third-party only when it has a manufacturing business relationship with the nonresident company that in turn has a maquila contract with the company who carries on the maquila operation in Mexico, provided such merchandise is supplied as a result of said commercial relationship.	The merchandise to which this section refers may be owned by a nonresident third-party only when it has a manufacturing business relationship with the nonresident company that in turn has a maquila contract with the company who carries on the maquila operation in Mexico, provided such merchandise is supplied as a result of said commercial relationship.
For purposes of this section, there shall be considered transformation the processes to the merchandise consisting of: dilution in water or other substances; washing or cleaning, including the removal of rust, grease, paint or other coatings; application of preservatives, including lubricants, protective coating or paint for conservation; adjustment, sanding or cutting; dosing; packing, repacking, packaging or repackaging; testing, and marking, labeling or classification as well as product development or improvement in product quality, except in the case of trademarks, commercial advertising and trade names;	For purposes of this section, there shall be considered transformation the processes to the merchandise consisting of: dilution in water or other substances; washing or cleaning, including the removal of rust, grease, paint or other coatings; application of preservatives, including lubricants, protective coating or paint for conservation; adjustment, sanding or cutting; dosing; packing, repacking, packaging or repackaging; testing, and marking, labeling or classification as well as product development, except in the case of trademarks, commercial advertising and trade names.
	II. All income from their productive activity must originate exclusively from their maquila operation.
II. When the companies with a Program who undertake the transformation or repair processes to which the preceding section refers incorporate into their production processes domestic or foreign merchandise that is not	III. When the companies with a Program who undertake the transformation or repair processes to which section I refers incorporate into their production processes domestic or foreign merchandise that is not temporarily

* Béndiksen, Diedrich, Enríquez, Salazar, Santoyo & Yanar, S. C.
Blvd. Tomas Fernández No. 7815, Suite 302
32440 Ciudad Juárez, Chihuahua
Mexico

temporarily imported, it must be exported or returned along with the temporarily imported merchandise;	imported, it must be exported or returned along with the temporarily imported merchandise.
III. The processing or repair processes to which Section I of this article refers, must be carried out with machinery and equipment under subsection a) of Section III of Article 4 of this Decree, owned by the nonresident with whom the companies with a Program have executed the maquila contract, provided that it has not been owned by the company carrying out the maquila operation or by a related Mexican resident company.	IV. The processing or repair processes to which section I of this article refers must be carried out with machinery and equipment owned by the nonresident with whom the companies with a Program have executed the maquila contract, provided that it has not been owned by the company carrying out the maquila operation or by a related Mexican resident company.
To carry out the transformation or repair processes to which Section I of this article refers, the use of machinery and equipment owned by the nonresident may be complemented with machinery and equipment owned by a third-party nonresident who has a manufacturing business relationship with the nonresident company that in turn has a maquila contract with the company carrying out the maquila operation in Mexico, provided that such assets are supplied by reason of said business relationship. The transformation or repair process may also use machinery and equipment owned by the company carrying out the maquila operation or machinery and equipment rented from an unrelated party. In no case under this paragraph may the machinery and equipment have been owned by another Mexican resident company of which the company carrying on the maquila	The transformation and repair process may be complemented with machinery and equipment owned by a third-party nonresident who has a manufacturing business relationship with the nonresident company that in turn has a maquila contract with the company carrying out the maquila operation in Mexico, provided that such assets are supplied by reason of said business relationship, or owned by the company carrying on the maquila operation, or with machinery and equipment rented from an unrelated entity. In no case may the machinery and equipment have been owned by another Mexican resident company of which the company carrying on the maquila operation is a related party.

operation is a related party.	
The provisions of the preceding paragraph shall apply provided that the nonresident with which the maquila contract is executed owns at least 30% of the machinery and equipment used in the maquila operation. The aforesaid percentage shall be calculated in accordance with the general rules issued by the SAT for such purpose.	The provisions in this section shall apply provided that the nonresident with whom the maquila contract is executed owns at least 30% of the machinery and equipment used in the maquila operation. The aforesaid percentage shall be calculated in accordance with the general rules issued by the Tax Administration Service for such purpose.
The provisions of this section shall not apply in the case of companies that as of December 31, 2009 operated under an authorized Program under this Decree and have complied with their income tax obligations pursuant to Article 216-Bis of the Income Tax Law, and	
IV. The companies with a Program that carry on the operations to which this article refers must meet the requirements under the second to last paragraph of Article 2 of the Income Tax Law. For purposes of said paragraph, the processing or repair of merchandise whose sale is made in national territory and is not covered by an export manifest shall not be deemed a maquila operation. Therefore, the provisions of Article 216-Bis of the Income Tax Law shall not apply with respect to said operations.	There shall not be considered maquila operation the transformation or repair of merchandise whose sale is made in national territory and is not covered by an export manifest and therefore the provisions of Article 182 of this law shall not apply.

As can be seen by comparing the above provisions, the New Law:

- Keeps, in substance, the restrictive definition in Section I of Article 33 of the IMMEX decree, thus excluding from the "maquila operation" definition many true maquiladoras who carry on service activities different from those listed.

- Quality improvement of products, included in Article 33, is further excluded from the "maquila operation" definition in the New Law, with the noted result.

- The New Law keeps the requirement under Article 33 of the IMMEX Decree to the effect that 100% of the production must be exported. **This requirement would appear to be contrary to the provisions in the North American Free Trade Agreement and, as such, unconstitutional.**

- The New Law grants upon the tax administration the authority to set the rules for virtual exports qualifying as part of the "maquila operation". A concern is that conceivably this authority could be used to restrict virtual exports under the Customs Law rather than to broaden their scope, which would be unconstitutional as well.

- The New Law includes a new requirement for an activity to be considered as a "maquila operation", namely that all income from the productive activity must originate exclusively from the maquila operation. **In our view, this would not appear to imply that maquiladoras can engage in no other activity, but simply that the only income that can avoid a permanent establishment and qualify for the safe harbor rules is income from the maquila operation.**

  The Miscellaneous Rules consider that income from the productive activity originates exclusively from the maquila operation when the income is received in consideration for maquila services for productive activities rendered to related parties residing outside of Mexico.

  Maquiladoras may also consider as income from productive activities income from acts and activities related to their maquila operation, provided such income and its corresponding costs and expenses are segmented in their books of account. This would appear to be the case, for example, of events where due to downsizing the maquiladora sells part of its facilities.

  The rules add that income will not qualify when it originates from the sale and distribution of finished products for resale, whether it is a buy-sell of products different from those manufactured by the maquiladora or the purchase in Mexico or abroad of the products manufactured by the maquiladora, whether alone or with other products not manufactured by the maquiladora, for their definitive importation and later sale and distribution.

- The new provisions also keep the requirement that the nonresident principal should own at least 30% of the machinery and equipment used in the maquila activities. This machinery and equipment must not have been owned by the maquiladora itself or by any other resident of Mexico who is a related party.

  However, the Presidential Decree grants a two-year phase-in period, up to January 1, 2016, for those maquiladoras who complied with their tax obligations up to December 31, 2009, in accordance with any one of the three transfer-pricing methods in Article 216-Bis of the law in effect up to December 31, 2013. Failure to comply with the phase in will cause the nonresident principals to have a permanent establishment in Mexico not as from the date the New Law came into effect (January 1, 2014), but beginning on January 2, 2016. Thus, in effect more than a phase-in period the Presidential Decree is deferring application and the effects of the 30% requirement for the above maquiladoras.

- The general grandfathering of maquiladoras operating as of December 31, 2009, exempting them from the provisions in Article 33 of the IMMEX Decree, is done away with. **This, again, will affect true pre-existing maquiladoras that do not fall within the ironclad definition and would appear to be unconstitutional as a retroactive application of the law.**

- As mentioned above, the New Law keeps the requirement to the effect that 100% of the production must be exported. The original bill submitted to Congress did not allow virtual exports in order to comply with this requirement. Thanks to the extenuating lobbying efforts of the Maquila National Council ("INDEX") the bill was modified during its passage through Congress with the result that the New Law does allows virtual exports. However, it continues to provide, as did Article 33 of the IMMEX Decree, that exports must be documented with export manifests ("pedimentos"). Consequently, export sales from maquiladoras to Mexican automakers, which are typically documented with "constancias" and not with "pedimentos", would technically not qualify for the permanent establishment exemption or for use of the transfer-pricing safe harbor.

As seen, there a number of hurdles that maquiladoras must overcome in order to avoid a permanent establishment being deemed to exist for their foreign principals. These same hurdles must be overcome for the maquiladora to be entitled to apply the transfer pricing safe harbor discussed below.

Many of the requirements, however, appear to be unconstitutional and could give grounds for individual maquiladoras to file "amparo" actions to have the specific provisions that affect their interest declared unconstitutional and thus not applicable to the maquiladora.

Also, certain of Mexico's tax treaties could grant relief against the new provisions.

Any final conclusion in the above respects requires a facts-and-circumstances analysis. We will gladly discuss your specific situation and what relief your operations may have, at your request.

TRANSFER PRICING

Also in order to avoid creating a permanent establishment for their foreign principals, maquiladoras are required to comply with their transfer pricing obligations by determining their tax profit (income minus allowable deductions and minus employee profit sharing paid during the year, before prior years' net operating losses) under a so-called safe harbor, which is the greater of:

- 6.9% of the assets used in the maquila operation, including assets owned by the nonresident principal or other related parties.
- 6.5% of the costs and expenses of the maquila operation, including those incurred by nonresidents, with certain exceptions.

Therefore, the other two methods that were available to maquiladoras since 2003 as a result of long lobbying efforts have been done away with. These methods were:

- Determining their income as the sum of (i) a transfer pricing study in accordance with the provisions in the law and the OECD guidelines, plus (ii) a 1% return on the machinery and equipment owned by the nonresident principal and used by the maquiladora.

- Determining their income under the transactional net margin method, considering the profitability of the machinery and equipment owned by the nonresident and destined to the maquila operation.

Article 182 of the New Law provides, as did the prior law, that maquiladoras can file for and secure an advance pricing agreement ("APA") to comply with their transfer pricing obligations. Such an APA, however, does not have the virtue, under the law, to avoid permanent establishment status. Again thanks to the efforts of the INDEX, Miscellaneous Rules were issued providing that no permanent establishment will arise when the APA is secured. This is conditioned to the maquiladora complying with the general transfer pricing obligations and further provided the APA request follows a methodology that takes into consideration all assets destined to the maquila operation, including those owned by the nonresident principal. For these purposes it is understood that the assets are destined to the maquila operation when they are located in Mexico and are used, wholly or in part, in the maquila operation. **Maquiladoras making this election must file a notice to that effect before the Tax Administration no later than June 30, 2014.**

Again, principals residing in countries with which Mexico has in place a tax treaty may find treaty relief. We will gladly look into your specific situation upon request.

As a final comment, **it would appear that maquiladoras in general are entitled, if they wish, to apply the safe harbor and the APA, not only maquiladoras qualifying under the "maquila operation" definition discussed above. By the same token, it would appear that maquiladoras who face no permanent establishment exposure could comply with their transfer pricing obligations under any of the general transfer pricing methodologies in Article 180 of the New Law and not necessarily through the safe harbor or the APA.** This, however, might limit their ability to qualify for the fringe-benefit deduction incentive discussed below.

EXEMPTED FRINGE BENEFITS

The New Law limits deduction of exempted fringe benefits paid to employees to 53%. If the amount of exempted fringe benefits paid to employees is reduced with respect to the amount paid in the previous year, then the deductible amount is of 47% only. Needless to say, this rule would have a huge negative effect on maquiladoras, given that their largest deduction, by far, is salaries and that they pay a large amount of exempted fringe benefits to their employees. This change was prompted by the repeal of the flat business tax. **In our opinion, this limitation, too, is unconstitutional.**

The INDEX again was successful in persuading the Ministry of the Treasury of the imperative need for maquiladoras to be granted relief in this respect. The Presidential Decree was thus issued, allowing maquiladoras to take the additional 47% deduction of these fringe benefits. The incentive is available only to maquiladoras who determine their transfer pricing under the safe harbor or the APA discussed above.

In that it would appear that maquiladoras who have no permanent establishment exposure may comply with their transfer pricing obligations under the general rules, not necessarily under the safe harbor or the APA, **it would also appear that the limitation on the beneficiaries of the incentive, based on adoption of the safe harbor or APA, is unconstitutional** and could warrant a Constitutional injunction relief ("amparo"). **That is, maquiladoras who apply the general transfer pricing methodologies should also be entitled to this incentive**.

Maquiladoras who apply this incentive must keep separate records of account to segregate the maquila operation from other operations and the exempted fringe benefits paid to employees in respect of the maquila operation. These maquiladoras should also file an information return in March of each year informing that the incentive was taken and how it was calculated.

2003 INCOME TAX DECREE

The 2003 President Fox decree allowed maquiladoras to reduce their tax profit (income minus allowable deductions before net operating losses and employee profit sharing paid) to 3.0% of assets used in the maquila activity or of costs and expenses of the maquila operation. This incentive appears to have been repealed by the New Law and was further expressly repealed by the Presidential Decree.

WITHHOLDING OF VAT BY OEMS

As another success of the INDEX, the amendments to the Value Added Tax Law eliminate withholding of value added tax ("VAT") by automakers on purchases from maquiladoras. This issue was all but clear. OEMs had been interpreting the law in the sense that withholding applied. Our opinion, from inception, was that no withholding should apply.

DROP SHIPMENTS

The amendments repeal the existing provision exempting sales from nonresidents to maquiladoras of goods exported or which remain in Mexico under temporary importation or fiscal deposit. The original bill also proposed repeal of the exemption of sales between nonresidents. The efforts of the INDEX in this respect bore fruit. The amendments passed by Congress do continue to exempt sales of the maquiladora production between nonresidents.

The reason for the repeal, mentioned in the bill submitted to Congress, was that the exemption was justified when it arose because maquiladoras returned 100% of their production abroad, but that at present they are required (under the IMMEX Decree) to return only 10% of their total invoicing.

This is absolutely incorrect. The exemption came about for the express purpose of eliminating the need to physically export goods and then import them again in transfers between companies operating under the temporary importation and fiscal deposit regimes, which had an unfavorable effect in generating production chains in Mexico.

The bill adds that the exemption discriminates against customs regimes other than temporary imports and strategic fiscal warehouses. It also discriminates, says the bill, against sales between residents of Mexico. Thus, by eliminating the exemption, an equal treatment is afforded with national manufacturers making sales in Mexico, who do pay VAT on their sales, adds the bill.

This purported argument, too, is completely incorrect. Rather than being a preferential regime, what the repealed provision did, when enacted, was to give export sales by nonresidents a treatment similar to that afforded in the law to export sales by residents, levied at a 0% rate.

In that sales of the above products to maquiladoras will now be subject to VAT, from a formal standpoint the nonresident sellers would have to comply with the following Mexico VAT obligations:

- To register for VAT purposes.
- To issue Mexican invoices in prescribed form, itemizing the corresponding VAT.
- To file monthly VAT returns.
- To carry Mexican books of account for VAT purposes.

Regarding the obligation to issue invoices, the Miscellaneous Resolution allows for simplified invoices to be issued instead, meeting only the following requirements, when the seller is a nonresident with no permanent establishment in Mexico:

- Name, address and foreign taxpayer identification number or equivalent of the entity issuing the invoice.
- Place and date of issue.
- Mexican taxpayer identification number ("RFC") of the buyer or, in absence thereof, name of the buyer.
- Amount, measure unit and type of the goods sold.
- Value per unit in numbers and total value in numbers or letters.
- The amount of value-added tax shifted and withheld, itemized where different tax rates apply.

Notice that the simplified invoice calls for the foreign identification number of the seller and not for the Mexican taxpayer identification number ("RFC"). This suggests that sellers using the simplified invoices need not register for tax purposes. If this interpretation is correct, then it would appear that they should not be required to file monthly VAT returns either, as the VAT is withheld and paid in by the Mexican buyer and as there would be no RFC in the tax returns to track the sellers down, which would make the returns useless. It would thus appear that only the obligation to carry Mexican books of account for VAT purposes would remain. Yet, this appears to make no sense either given that tax compliance is assured by causing the buyer to withhold and pay in the VAT corresponding to these sales.

Under general VAT principles, the buyers will be entitled to recover the VAT paid by crediting it against VAT collected from their customers, offsetting it against their income tax liability or by filing for refunds, complying with certain requirements.

The buyers, in turn, must comply with the following obligations:

- To issue to the sellers certifications on the VAT withheld.

- To file information returns on the 17th of every month regarding the persons to whom VAT was withheld during the previous month.

Note that sales made in 2013 but paid in 2014 are subject to VAT. An exception was made for those events where payment was made during the first 10 days of January 2014, but this exception did not apply to transactions between related parties, which made it academic for most maquiladoras.

Again, treaty relief against VAT on these sales may be available in certain events.

As a final note on this topic, the Presidential Decree allows an immediate credit for the VAT withheld on purchases from nonresidents with no permanent establishment in Mexico in the same VAT return where the withholding is reported. This results in a mere bookkeeping entry, with no cash-flow impact. This is also an achievement by the INDEX. The benefit applies provided that the goods being imported were exported or that they were imported into Mexico under a maquila program. A further requirement is that the goods purchased must be part of a supply chain of goods destined to be exported and that the imports are documented with virtual "pedimentos" in accordance with the customs provisions.

These purchasers are required to carry inventory controls and accounting records clearly itemizing purchases that are exported and those destined to the Mexican market.

TEMPORARY IMPORTS

Temporary imports have been traditionally exempted from VAT. The reason is that VAT is a consumption tax, to be paid by the final consumer, and temporary imports are, by definition, not intended for consumption in Mexico. If maquiladora temporary imports remain in Mexico, then VAT will be triggered when the customs regime is changed from temporary to definitive importation, because at such point they are clearly destined to consumption in Mexico.

Effective January 1, 2015, temporary imports by maquiladoras under their maquila program will be subject to VAT.

The base on which VAT is to be applied is the customs value increased by the duties and other levies that would apply if the importation were definitive. Payment is to be made when the temporary import "pedimento" is submitted to the customs house.

Evidently, in these events no further VAT will apply when the customs regime of the goods in question is changed to definitive importations by the importing maquiladora, as was the case up to 2013 and will continue to be during 2014.

The bill submitted to Congress justified this dramatic change on the fact that when the maquila rules were primarily enacted maquiladoras were required to export 100% of their production while nowadays they can sell 90% into the domestic market. This, coupled with the fact that the temporary importation regime is extremely flexible and allows a number of tax-free transfers to other maquiladoras or OEMs, which makes follow-up and control extremely difficult and has lead to abuses, explains the bill. Merger of the maquiladora decree and the PITEX decree is also mentioned as an event that further complicated control of temporary imports, as did the possibility of making virtual exports and virtual temporary imports. The bill adds that the VAT exemption for these importations has curbed purchases of domestic products to be incorporated into the maquiladora production because domestic purchases would attract VAT and would cause the maquiladoras to seek refunds regularly while exempted temporary imports did not. Discrimination is also argued by the bill, mentioning that maquiladoras were required to pay VAT on products destined to the domestic market only when they changed the customs regime from temporary to definitive importation, while other importers pay VAT from inception, upon importation.

Under the general VAT rule, the VAT paid upon temporary importation will be recoverable, as maquiladoras will be able to offset it against output VAT, to offset it against income tax or to file for refunds. The law further clarifies that this VAT will also be creditable where the products manufactured with the imported goods are not sold into Mexico but simply returned abroad to the maquiladora's principal.

VAT on temporary importations was one of the points which the INDEX lobbied the most, tirelessly. As a result, the amendments passed by Congress create a credit of the full VAT to be paid on the temporary importations, to be applied against the temporary importations themselves, such that this VAT will be virtual, a mere bookkeeping entry.

In order to qualify for the credit, maquiladoras must be certified by the tax administration. To this end, maquiladoras must evidence that they meet the requirements allowing for an adequate control of the operations carried on under the maquila program. On January 1, 2014, the tax administration published an amendment to the Foreign Trade Rules with the rules for the certification, enclosed as Attachment 1. The certification may be type A, AA, or AAA and will be valid for up to three years year, depending on the classification. The certification may be renewed within thirty days before expiration provided the maquiladora in question continues to satisfy the requirements for the certification. Complimentary rules should be issued within 40 days from January 1st.

Evidently, where the VAT is paid virtually with the above credit, no VAT will have been actually paid on the temporary import. Thus, here VAT will apply on the change of customs regime from temporary to definitive importation.

Maquiladoras who do not secure the certification may nonetheless avoid payment of VAT on the temporary importations provided they post a bond from a Mexican insurance company to cover the VAT contingency.

SPECIAL PRODUCTION AND SERVICES TAX

The tax reform also levies with the special production and services tax the temporary importation into Mexico of goods subject to such tax. These goods are alcoholic beverages; alcohol, denaturalized alcohol and non-crystalized honey; worked tobacco; gasoline; diesel; and energizing drinks as well as concentrates, powder and syrups to prepare energizing drinks.

Later definitive importation of these goods would, of course, not be further subject to this tax.

On the other hand, maquiladoras will be entitled to a refund of this tax when the goods on which the import tax was paid are exported.

DIVIDENDS TAX

A new dividends tax came into effect on dividends distributions paid by Mexican legal entities to individuals and to nonresidents. The tax is 10% and will be withheld by maquiladoras when distributing profits. Reduced rates may apply under Mexico's tax treaties

No tax applies on distributions to Mexican legal entities, but this is rarely the case for maquiladora structures.

SHELTER MAQUILADORAS

The permanent establishment protection that operating through a shelter maquiladora offers to nonresident manufacturers will be limited to four years upon compliance with certain requirements.

ELIMINATION OF THE 11% VAT RATE FOR THE BORDER ZONE

The tax reform modified the VAT rate applicable in the border zones. The VAT rate was 11%. and was increased to 16%, the same rate applicable in the rest of the country. This change may result in a financial costs for maquiladoras, who will be required to pay an additional 5% VAT to their suppliers in the border zone and then file for refund of this additional VAT, together will all other VAT paid. It will also increase the cost of living for maquiladora employees who will have to pay the additional 5% VAT on their purchases of goods, rentals and services but will not be able to recover it because they are not regular VAT taxpayers.

CONTACT INFORMATION

For further information and questions, please feel free to contact us.

Jaime G Bendiksen	jbendiksen@bendiksenlaw.com
Alejandro Enríquez-Mariscal	aenriquez@bendiksenlaw.com
Max Salazar-Quintana	msalazar@bendiksenlaw.com
David Santoyo-Amador	dsantoyo@bendiksenlaw.com
Víctor Yanar-Ríos	vyanar@bendiksenlaw.com
Daniel Rangel-Flores	drangel@bendiksenlaw.com
Sergio Ortuño	sortuno@bendiksenlaw.com

RECOGNITIONS AND AWARDS

Lawyers World Magazine Law Awards 2013 Mexico - Boutique Tax Law Firm of The Year

ACQ Law Awards for 2013. Mexico - Full Service Law Firm Of The Year

Corporate INTL 2013 Legal Awards Boutique Tax Law Firm of the Year in Mexico

Chambers and Partners Latin America Guide 2014
Tax: Jaime G. Béndiksen
Mexico Lawyers Band 1
Tax: Mexico firm Band 4

2013 DealMakers Monthly Global Awards Mexico - Boutique Tax Law Firm of The Year

InterContinental Finance Magazine
Jaime G. Béndiksen

2013 International Global Law Experts Awards
Boutique – Tax Law Firm of the Year in Mexico

Acquisition International
2013 M&A Awards
VAT Advisory Firm of the Year – Mexico

Attachment 1

CERTIFICATION TO AVOID VAT ON TEMPORARY IMPORTS

5.2.13. For purposes of Articles 28-A first paragraph of the Value Added Tax Law and 15-A first paragraph of the Special Production and Services Tax Law, companies that are current in their tax and customs compliance may obtain the VAT and SPST certification to which the aforesaid articles refer, under types A, AA and AAA, provided that they:

I. Enter and complete, in the Digital Window, the "Request for Certification for VAT and SPST Purposes" at the website www.ventanillaunica.gob.mx, in accordance with the instructions to register certified companies for VAT and SPST purposes.

II. Have the inventory control pursuant to the provisions prescribed by the SAT.

III. Submit the positive opinion on the filer's tax compliance set forth in Article 32-D of the Code and the Miscellaneous Tax Rules, issued within 30 days prior to the filing date of the request, as well as that of the partners, shareholders, legal representative, sole administrator or members of the board of management, as the case may be.

IV. Are not listed, upon filing the request, on the list of companies published by the SAT pursuant to Articles 69 and 69-B, third paragraph of the Code, except as provided in section VI of said Article 69.

V. Have current digital stamp certificates and have not been shown to have violated any of the provisions of Article 17-H, section X of the Code during the last 12 months.

VI. Submit the records for all personnel registered with the Mexican Social Security Institute (IMSS) and provide the supporting documentation of the payment of employer-employee contributions to the IMSS for at least 10 employees, using the input code for the last two-month period of the immediately preceding tax year, with the payment receipt issued by the referenced deposit system (SIPARE); and in the case of subcontracted workers under Article 15-A of the Federal Labor Law, they must evidence that the companies have the positive opinion of tax compliance under Article 32-D of the Code and the Miscellaneous Tax Rules, issued within 30 days prior to the filing date of the request, and evidence that they fulfill the obligation to withhold and submit the employees; income tax.

VII. Enclose, as indicated in the instructions, documents evidencing the investment in national territory.

VIII. Report on the "Request for Certification for VAT and SPST Purposes" the name and address of foreign clients and suppliers with which they carried out foreign trade operations in the immediately preceding tax year.

IX. Allow personnel of the General Foreign Trade Audit Administration (AGACE) access at all times to conduct the initial inspection visit, the compliance verification visits, and to comply with the parameters of the customs regime in which foreign trade operations are carried out.

The following must be observed, in addition to the foregoing requirements:

I. For purposes of taxpayers operating under the temporary import regime with an IMMEX program authorized by the Ministry of Economy (SE), the following requirements must also be met:

a) To have a current program as of the date of the request.

b) To have registered with the SAT all domiciles or establishments in which activities associated with the maquila or export program are carried out.

c) To have the necessary infrastructure to carry out IMMEX program operations, the industrial process or service according to the program type, for which the customs authority may conduct inspections at any time at the domiciles or establishments where operations are undertaken.

d) To evidence that, during the last 12 months, the value of merchandise processed and returned during such period represents at least 60% of the value of temporary imports of components during the same period.

e) To evidence that the company is legally entitled to use or enjoy the site or sites where the production processes or performance of services is carried out, as applicable, for a term of at least one year from the filing date of the request.

f) To describe the activities relating to the production processes or performance of services according to the program type, describing the process from arrival of the merchandise, storage, the production process and return, attaching photographs, according to the instructions of this rule.

g) To evidence that the company has a maquila contract, purchase agreement, purchase or service order, or currently firm orders evidencing the continuity of the export project.

For companies that request an IMMEX program from the SE for the first time, or that have been operating for less than one year, the program shall not be subject to the requirements set forth in subsection d), except in the case of the companies indicated in the following paragraph.

In addition, companies that temporarily import and return merchandise under the tariff sections listed in Annex I TER of the IMMEX Decree, or under the tariff sections listed in Annex 28 of these Rules, when allocated to the manufacturing of goods in the garment sector classified under Chapters 61 and 63 and tariff section 9404.90.99 of the General Import Tax Tariff Schedule (TIGIE), or allocated to the manufacturing of goods in the footwear sector under Chapter 64 of the TIGIE, must comply with the following requirements and enclose the supporting documentation:

a) To have undertaken operations under the IMMEX program for at least 12 months prior to the request.

b) To evidence that during the last 12 months, the value of merchandise processed and returned during such period represents at least 80% of the value of temporary imports of components during the same period.

c) Submit the records for all personnel registered with the IMSS and provide the supporting documentation of the payment of employer-employee contributions to the IMSS, using the input code for three two-month periods of the immediately preceding tax year, with the payment receipt issued by SIPARE for at least 20 employee, in addition to those set forth in section VI of the general requirements.

d) The partners and shareholders, legal representative, sole administrator or members of the board of management of the company must evidence that on their annual returns for the two tax years prior to the request they reported taxable income for the tax authority for income tax purposes.

e) To list the carriers and bonded warehouses, if any, with which foreign trade operations are carried out.

f) To have minimum fixed capital stock, or as applicable machinery and equipment, of at least 4 million pesos.

II. Taxpayers operating in the tax deposit regime for vehicle assembly and manufacturing must also:

a) Have a current authorization and not be subject to a cancellation procedure.

b) Adequately meet the requirements of Rule 4.5.30.

III. Taxpayers operating under the regime for the manufacturing, processing or repair in a bonded warehouse or strategic bonded warehouse must:

a) Have a current authorization and not be subject to a cancellation procedure.

b) Comply with the guidelines determined by the customs authorities for the control, oversight and security of the warehouse and the foreign trade merchandise.

Taxpayers that meet the aforesaid requirements shall be registered and active under type A, while those seeking the benefits established for types AA or AAA must evidence the following requirements on the form prescribed for such purpose:

Under the AA type, companies that also evidence the following may be certified:

I. At least 40% of the value of their operations undertaken in national territory, with respect to their primary activity in the immediately preceding tax year, were with suppliers that as of the filing date of the request have the positive opinion on tax compliance provided in Article 32-D of the Code and the Miscellaneous Tax Rules, issued within 30 days prior to the filing date of the request, and as of the request filing date they are not listed in the publications referenced in Articles 17-H, section X, 69 except for section VI, and 69-B, third paragraph of the Code.

II. During the last five years or more, they have carried out operations under the regime for which the VAT and SPST certification is sought, or during the immediately preceding tax year they had an average of 1,000 employees registered with the IMSS, or their machinery and equipment is above 50,000,000 pesos.

III. No deficiency has been determined by the SAT in the last 24 months before the filing date of the request or they evidence being subject to the proceeding set forth in the third to last paragraph of this rule, or the payment has been made, as the case may be.

IV. No ruling denying a VAT refund request has been issued in the last 12 months from the filing date of the corresponding certification request.

Under type AAA, companies that evidence, in addition to those provided for the type A certification, that:

I. At least 70% of the value of their operations undertaken in national territory, with respect to their primary activity in the immediately preceding tax year, were with suppliers that as of the filing date of the request have the positive opinion on tax compliance provided in Article 32-D of the Code and the Miscellaneous Tax Rules, issued within 30 days prior to the filing date of the request, and as of the request filing date they are not listed in the publications referenced in Articles 17-H, section X, 69 except for section VI, and 69-B, third paragraph of the Code.

II. During the last seven years or more, they have carried out operations under the regime for which the VAT and SPST certification is sought, or during the immediately preceding tax year they had an average of 2,500 employees registered with the IMSS, or their machinery and equipment is above 100,000,000 pesos.

III. No deficiency has been determined by the SAT in the last 24 months before the filing date of the request or they evidence being subject to the proceeding set forth in the third to last paragraph of this rule, or the payment has been made, as the case may be.

IV. No ruling denying a VAT refund request has been issued in the last 12 months from the filing date of the corresponding certification request.

Companies that intend to file for types AA and AAA and that have tax deficiencies pending payment may seek the certification provided that they request the deferred installment payment authorization for unpaid taxes and additions to tax, without the term exceeding 12 months from the authorization granted by the SAT.

The Central Foreign Trade Legal Affairs Administration (ACALCE) shall rule on the certification request in a period of 40 days from the day following the date entered on the acknowledgement generated by the electronic customs system. In the case that the customs authority finds that any requirement is missing, it shall electronically request the filer, one time only, to provide the missing information or documentation, for which the taxpayer shall have a period of 15 days to attend to the requirement; otherwise, the request shall be deemed withdrawn.

The 40-day period shall be computed from the time that all of the aforesaid requirements are met. After such period, if no ruling is entered, the ruling shall be deemed unfavorable. If an inspection finds that the taxpayer does not have the necessary controls to carry out its production processes or services, a new request cannot be sought during six months after the respective ruling is issued.

5.2.14. Companies that obtain the certification for VAT and SPST purposes, type A, shall have the following benefits:

I. Tax credit in operations allocated to the customs regime for temporary importation for manufacturing, processing or repair in maquila or export programs; tax deposit for vehicle assembly and manufacturing; manufacturing, processing or repair in bonded warehouses and strategic bonded warehouses, pursuant to Annex 22.

II. VAT refund in a period not to exceed 20 days from the day following the filing date of the respective request, pursuant to Article 22 of the Code.

III. The term of the certification shall be for 1 year.

Moreover, persons who obtain the certification for VAT and SPST purposes, type AA, in addition to the benefits of type A, shall have the following benefits:

I. VAT refund in a period of not more than 15 days from the day following the filing date of the respective request, pursuant to Article 22 of the Code.

II. If, before the authority exercises its inspection powers, the taxpayer appears before the ACALCE and files a statement describing the irregularities found, determining any unpaid taxes or fees, the authority shall grant a period of 30 days to correct its situation pursuant to the legal provisions, in accordance with Article 73 of the Code. After said period, if the taxpayer has not exercised this right, the authority shall proceed with its inspection powers.

III. When the customs authority, before exercising its inspection powers, detects an alleged failure to pay taxes and fees on foreign trade operations, it shall notify the taxpayer through an invitation letter. If the taxpayer does not attend to the invitation or does not remedy all irregularities indicated in the term granted by the authority, it may begin to exercise its inspection powers at any time.

IV. In the case that the customs authority learns that the causes for suspension in the roster of specific importers and exporters set forth in Rule 1.3.3 of this Ruling have occurred, it shall follow the respective procedure, regardless of the section at issue.

V. The term of the certification shall be two years, which shall be renewed automatically, provided that a renewal notice is filed within 30 days before the term expires and the taxpayer continues to comply with the registration requirements and obligations set forth in Rule 5.2.16.

Companies obtaining the certification under type AAA shall have the following benefits:

I. Tax credit in operations allocated to the customs regime for temporary importation for manufacturing, processing or repair in maquila or export programs; tax deposit for vehicle assembly and manufacturing; manufacturing, processing or repair in bonded warehouses and strategic bonded warehouses, pursuant to Annex 22.

II. VAT refund in a period of not more than 10 days from the day following the filing date of the respective request, pursuant to Article 22 of the Code.

III. If, before the authority exercises its inspection powers, the taxpayer appears before the ACALCE and files a statement describing the irregularities found, determining any unpaid taxes or fees, the authority shall grant a period of 60 days to correct its situation pursuant to the legal provisions, in accordance with Article 73 of the Code. After said period, if the taxpayer has not exercised this right, the authority shall proceed with its inspection powers.

IV. When the customs authority, before exercising its inspection powers, detects an alleged failure to pay taxes and fees on foreign trade operations, it shall notify the taxpayer through an invitation letter. If the taxpayer does not attend to the invitation or does not remedy all irregularities indicated in the term granted by the authority, it may begin to exercise its inspection powers at any time.

V. In the case that the customs authority learns that the causes for suspension in the roster of specific importers and exporters set forth in Rule 1.3.3 of this Ruling have occurred, it shall follow the respective procedure, regardless of the section at issue.

VI. Monthly consolidated declarations may be filed.

VII. With respect to Articles 59, section I, 185-A and 185-B of the Law, Rule 4.3.2 and Annex 24, they may evidence compliance with such obligation provided that they have an inventory control reflecting the allocation, applications and balances of raw materials, to be sent as prescribed by the SAT.

VIII. They may undertake the customs clearance of merchandise for temporary importation, without declaring or sending the serial numbers on the declaration, electronic document, invoice, shipping document or attached list, provided that they keep an updated record of such information in the inventory control system that generates the automatic reports requested b y the authority.

IX. They may elect the customs clearance for export at their domiciles, provided that they meet the guidelines issued for such purpose by the General Customs Administration (AGA), as published at the website www.aduanas.gob.mx.

X. The term of the certification shall be 3 years, which may be renewed automatically, provided that a renewal notice is filed within 30 days before the term expires and the taxpayer continues to comply with the registration requirements and obligations set forth in Rule 5.2.16.

5.2.15. Companies that have obtained the certification pursuant to Rule 5.2.13 may request the renewal within 30 days prior to the expiration of the term, provided that they evidence that they continue to meet the registration requirements for the type in question and the obligations set forth in Rule 5.2.16. They must enter the "Request for Renewal of the Certification for VAT and SPST Purposes" at the Digital Window, and the ACALCE shall rule on the renewal request in a period of 20 days from the day following the date entered on the acknowledgment generated by the electronic customs system. The notice shall be subject to the provisions of the electronic notice chapter of the Law. After such period, if not ruling is entered, the respective ruling shall be deemed favorable.

In the case that the customs authority detects the failure to meet any requirement, it shall request the missing information or documentation one time only, which the filer shall have a period of 15 days to address; otherwise, the request shall be deemed withdrawn.

The 20-day term for the ACALCE to rule on the request shall be computed from the date on which all of the aforesaid requirements are met. The term to which this rule refers shall not apply in the case of the automatic renewal to which Rule 5.2.14 refers.

5.2.16. Entities that obtain the certification to which Rule 5.2.13 refers shall be subject to ongoing compliance with the following obligations:

I. Permanent compliance with the certification requirements, with the corresponding type.

II. To notify the General Taxpayer Services Administration (AGSC), in a period of not more than 5 days, of any change in company name, tax domicile, or the domicile or domiciles where the production process is to be performed, or changes in partners, shareholders or members, sole administrator or board of management and legal representatives.

III. To update the data on the Request for Certification for VAT and SPST Purposes, in the case of the change or modification of carriers, bonded warehouses and the list of domestic and foreign clients and suppliers linked to the production process, no later than 30 days after the change or addition is made.

IV. To undertake foreign trade operations with carriers with the harmonized alphanumeric carrier code (CAAT) registration.

V. When two or more entities with certification for VAT and SPST purposes, in any of the types provided in Rule 5.2.13, are merged, and one of them survives the merger, the ACALCE must be notified 10 days in advance of the effective date of the merger, and the surviving company shall not be eligible for the benefit of automatic renewal and must request renewal under the corresponding type

VI. When a new company results from the merger or division of companies having the certification for VAT and SPST purposes, and one or more companies with a current certification for VAT and SPST purposes disappear, the company resulting from the merger or division must file a new request for VAT and SPST purposes with the ACALCE, in accordance with Rule 5.2.13 of this Ruling.

VII. Taxpayers with IMMEX programs must electronically register the companies with which they enter into virtual transfer declarations, as well as the taxpayer registration (RFC) data on the companies with which they engage in sub-maquila processes, according to the rules published by the SAT for such purposes.

VIII. Companies operating under the tax deposit regime for vehicle assembly and manufacturing must electronically register the companies with which they undertake transfer records.

IX. To allow the customs authorities to physically inspect plants to verify compliance with the certification requirements.

X. To be in ongoing compliance with the payment of employer-employee contributions with the IMSS and that they are paid using the input code in the SIPARE system.

5.2.17. The ACALCE may cancel the certification granted pursuant to Rule 5.2.13 of this Ruling, for any of the following causes:

I. When failure to comply with any of the registration requirements under the applicable type is evidenced.

II. When customs authority personnel are denied access to the initial inspection and compliance verification inspections.

III. When the proceeding to suspend registration in the roster of specific importers or exporters is concluded, the irregularity cannot be disproved.

IV. Failure to evidence during inspections that the company has the necessary infrastructure to undertake the manufacturing or maquila process, industrial process or service pursuant to the program type.

V. When the obligations set forth in Rule 5.2.16 are not met.

VI. When it is not evidenced that the temporarily imported merchandise was returned abroad, transferred or allocated to another customs regime.

VII. When the customs authorities find that the merchandise temporarily imported under the IMMEX program is not at the authorized domiciles.

VIII. When the legal presence of foreign trade merchandise of more than 100,000 pesos is not evidenced, and the tax deficiency determined by the SAT is not paid.

IX. When the terms authorized by the SAT to pay outstanding tax deficiencies are not met, pursuant to the third to last paragraph of Rule 5.2.13.

X. When a proceeding is begun to cancel the authorization to operate under the customs regimes subject to certification.

For these purposes, the customs authority shall give electronic notice of the start of the proceeding, stating the causes therefor, order the suspension of the effects of the certification granted under Rule 5.2.13, grant a period of 10 days to offer the evidence and arguments the company deems appropriate. The customs authorities must enter the corresponding ruling in a period of not more than four months following notice of the start of the proceeding.

Taxpayers whose certification has been canceled cannot seek it again until 24 months have passed from the effective date of the cancellation ruling.

Two. Companies wishing to request certification for VAT and SPST purposes during 2014, pursuant to Rule 5.2.13, must request certification according to the following timetable, corresponding to their tax domicile and considering the jurisdiction of the Regional Foreign Trade Audit Administration (ARACE):

ARACE	Period
Certified companies under Rule 3.8.1, part L and companies operating under the tax deposit regime for vehicle assembly and manufacturing	April 1 – 30
North Pacific	April 15 – May 15
Northeast	June 3 – July 3
North Central	July 7 – August 7
Central	August 7 – September 8
West and South	September 22 – October 22

Entities that have the authorization to manufacture, process and repair merchandise in customs warehouses and strategic customs warehouses may file their request in any of the 6 periods.

If the request is not filed in the period corresponding to the tax domicile, it may be filed in other periods. However, the computation of the 40 days to issue the ruling shall start October 22, 2014, unless filed at a later date, in which case it shall begin as from the filing date.

Companies with the authorization in the registry of certified companies pursuant to Rule 3.8.1, part L and companies operating under the tax deposit regime for vehicle assembly and manufacturing, that do not file their request in the established period , may request it in the corresponding period according to the tax domicile.

The registration instructions for certified companies for VAT and SPST purposes shall be published in not more than 40 days after these rules are published.

* Béndiksen, Diedrich, Enríquez, Salazar, Santoyo & Yanar, S. C.
Blvd. Tomas Fernández No. 7815, Suite 302
32440 Ciudad Juárez, Chihuahua
Mexico