THE TAX DISPUTES AND LITIGATION REVIEW

TENTH EDITION

Editor
David Pickstone

THE LAWREVIEWS

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For further information please contact Nick.Barette@thelawreviews.co.uk

Editor
David Pickstone

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PREFACE

It is increasingly common for tax practitioners to be involved in disputes that span multiple jurisdictions. We operate in a global economy. Supply chains cross continents, and the increasing role of technology accelerates the pace at which economic activity becomes divorced from the structures intended to tax it. The pace of economic and technological change potentially increases the gap between the reality of commerce and that of taxation.

Although supranational agencies, such as the European Commission and the Organisation for Economic Co-operation and Development, work hard to keep pace with change, there is an inevitable lag between intention and action. Of late we have seen individual countries start to take unilateral actions, with digital taxation being a prime example. In coming years, a combination of economic developments and unilateral actions by individual countries is likely further to emphasise the importance of double tax treaties and the OECD multilateral instrument.

As the chapters of this book were being written, there were already important changes taking place in the political landscape in the United States and Europe, and in the global economy, that will affect international cooperation on tax and trade. For example, the past year has seen a ground-breaking deal agreed by 136 countries, accounting for more than 90 per cent of global GDP, to impose a minimum tax rate of 15 per cent on multinational enterprises.

In the light of the economic effects of the global pandemic, tax authorities are under unprecedented pressure to increase tax yield, and this will only increase the pressure on tax authorities to collect what is seen as a fair share of tax from international businesses operating on their shores. For our profession, this means a likely increase in the frequency of tax disputes, an ever-increasing international element to them and the ensuing need to work more closely with international colleagues as complex, multi-jurisdictional issues arise. It comes as no surprise that the authors of many chapters continue to identify international tax issues and offshore structures as areas of key focus for their own domestic tax authorities.

Regardless of whether tax authorities increase in cooperation or increase in competition, one thing is certain: they will not stand still. Tax, and particularly the international approach to tax, is a permanent fixture on the political agenda. The resulting frequent (and sometimes abrupt) changes in key elements of tax law inevitably lead to high value and complex disputes which often take many years to resolve.

The purpose of this book is to provide insight into the issues that give rise to tax disputes in different jurisdictions, the procedures for resolving those disputes and the powers and approach of local tax authorities. It is hoped that it will provide valuable insight into the process, timescale and cost of resolving complex difficulties when they arise across more than one jurisdiction.

We are lucky to have contributions from many leading and impressive tax practitioners across a wide range of jurisdictions. Each provides an up-to-date insight into dealing with contentious tax issues in their jurisdiction. I have enjoyed and learned from reading their contributions and I hope you will do, too.

I would like to thank my colleagues Victor Cramer, Lee Ellis and Cristiana Bulbuc for their valuable assistance in compiling this edition.

David Pickstone
Stewarts
London
February 2022

Chapter 14

MEXICO

Denise Lester, Alejandro Madero and Abraham Rubio[1]

I INTRODUCTION

Under Mexico's constitutional regime, federal and local taxes are levied. Local taxes are further sub-divided into state taxes (such as the payroll tax and, increasingly, green taxes) and municipal taxes which are mainly levied on the transfer or holding of immovable property.

The most common federal taxes comprise income taxes (individuals and corporations, partnerships and certain taxable arrangements), value added tax (VAT) and excise taxes.

Tax authorities have the power to initiate formal tax audits, which must conclude within a 12-month term as a general rule, and are subject to suspensions. There are exceptions: cases related to the financial sector must be concluded within 18 months, and cases related to transfer pricing[2] or in which the tax authorities request information and documentation from abroad must be concluded within two years.

Once the tax authority concludes the audit, it has six months to determine a tax assessment.

Taxpayers can also opt to resolve a case through alternative dispute resolution (ADR), under a conciliation procedure with the tax authorities and the Tax Ombudsman (Prodecon) acting as a mediator. (See Section II.iii.)

Tax authorities still hold a very formalistic approach when carrying out tax audits and resolving tax refund requests, especially after the 2019 Supreme Court Precedent[3] was issued. Under this precedent, taxpayers seem obligated to formalise or register private documents in order for them to have an 'identifiable and valid date' in a tax audit. Taxpayers have used 'substance over form' administrative appeals (see Section VIII.i) and lawsuits to challenge this.

It is considerably important for taxpayers to have in place all accounting and tax information and documentation foreseen in the tax legislation, for a minimum period of five years. As of 2021, keeping bank account statements, if applicable, and certain corporate documents (e.g., minutes whereby equity is increased or decreased by capital redemptions) are not limited to this five-year limit. This same rule also applies to minutes of mergers and spin-offs and dividend distributions.

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1 Denise Lester is a partner, Alejandro Madero is a senior associate, and Abraham Rubio is a junior associate at Galicia Abogados.

2 Before the 2022 tax reform, this term only applied to transfer pricing cases with foreign related parties. As of 2022, it also applies to cases involving national related parties.

3 See court precedent 2ª/J.161/2019 (10a.), published on 6 December 2019.

II COMMENCING DISPUTES

i Tax refunds

Taxpayers have the right to submit a refund request after making an unlawful tax payment (including if a tax is unduly withheld) or when a favourable balance has been determined.

Refund request procedures have a statutory term of 40 business days as of the date of the request, as a general rule. Tax authorities can only lawfully perform up to two requests of information or documentation. Such authorities can open a specific inspection or audit to corroborate the entitlement of the refund request, without being able to determine a tax assessment therein.

ii Federal tax disputes

The federal tax authorities have several powers to prove that taxpayers complied correctly with their tax obligations.

For taxpayers whose financial statements are audited – which is again mandatory as of 2022, provided certain thresholds are met – the tax authorities must initiate a review with an auditor. The authorities can only apply their auditing powers to a taxpayer directly if the auditor fails to submit the required information or the information they submit is inconclusive.

Federal tax disputes generally begin with an assessment of a tax credit after the authority's exercise of a formal audit or by the denial of a refund. Certain precedents also allow a withdrawal of a refund request to be challenged.

Recently, the courts have confirmed that a recipient of a tax invoice (EDO) may challenge an unfavourable resolution issued in a simulation procedure. The simulation procedure, which is set forth under Article 69–B of the Federal Tax Code, provides the recipient of a tax invoice the opportunity to prove that a service detailed in a tax invoice was in fact rendered. The procedure ends with a ruling. Simulation resolutions, as well as tax assessments and unfavourable refund claim resolutions, may be challenged by filing administrative appeals or annulment claims. Taxpayers may file these proceedings under a substance-over-form methodology, provided certain requirements and a *de minimis* threshold are met.

iii Mediation

Once the tax authority issues its observations in a desk or in situ review or an electronic audit, a taxpayer may initiate a settlement agreement procedure before the tax assessment is determined, by means of an ADR process managed by Prodecon (see Sections I, and VI.i).

As of 2021, ADR requests must be filed with Prodecon within 20 working days from the taxpayer being notified of the ruling containing the authority's observations.[4]

4 Specifically, as per Article 69–C of the Federal Tax Code, in case of an *in situ* review, this term is calculated from the issuance of the final inspection minute.

III THE COURTS AND TRIBUNALS

i Administrative appeals

Federal administrative appeals are filed electronically within a 30 business day term of the notification date of the tax resolution. Such appeals are resolved by the authority's legal branch.

In this procedure, taxpayers are relieved from offering a guarantee and are able to submit additional evidence not provided during the tax audit or the refund process. Afterwards, in court, taxpayers are generally barred from offering additional evidence that was not submitted before or during the audit, refund process or administrative appeal procedure.

Taxpayers can opt to file an appeal under the 'substance over form' process, provided certain requirements are met. Under this special procedure, taxpayers are barred from making procedural arguments.

ii Administrative Court

Aside from directly challenging tax assesments and refund resolutions, taxpayers can challenge negative administrative appeal rulings by filing an annulment claim before the Federal Court on Administrative Matters.

The Court is divided into collegiate bodies: the superior chamber and regional chambers. Certain regional chambers focus on specialised areas, such as intellectual property or foreign trade.

With the incorporation of a newly implemented system, taxpayers may now file annulment claims through the traditional method or electronically. Before a recent amendment, all electronic trials were conducted by the specialised chamber for electronic trials based in Mexico City. Now, certain regional chambers have the power to hold electronic trials, but this process is being implemented gradually.

Taxpayers may also file for a trial under the 'substance over form' approach, provided again certain requirements and a *de minimis* threshold are met. Similar to an administrative appeals, taxpayers who opt for this approach are barred from raising any procedural arguments.

The Federal Court on Administrative Matters (Specialized Chamber) has ruled that taxpayers may also file for a 'substance over form' trial to challenge a refund denial, provided the tax authority previously exercised its auditing powers to corroborate the refund request.[5]

As a general rule, taxpayers must provide a guarantee when challenging a tax assessment, unless they opt for a 'substance over form' trial. Interpretation has arisen to determine if the relief to guarantee in this special trial is only applicable before the first instance court or until the matter is definitely resolved.

Taxpayers have the right to file a constitutional claim – an *amparo* lawsuit – to challenge an unfavourable resolution.

iii Amparo lawsuits

A taxpayer may file an *amparo* lawsuits within 15 working days of the contested ruling's notification date.

Under this proceeding, aside from 'legality' arguments, taxpayers can also raise constitutionality arguments on the provisions addressed or interpreted in the ruling.

If an *amparo* lawsuit is resolved unfavourably, an appeal can be filed before the Supreme Court of Justice. In this regard, such appeals may only resolve constitutional matters, and

5 See Administrative Court precedent VIII–CASE–REF–15, published in January 2021.

the case must be exceptional from a constitutional or human rights perspective. If the Supreme Court does not find the case to be exceptional, it may reject the appeal. Following a 2021 reform, this rejection may no longer be challenged.

The 2021 reform also amended the court precedent system. Following the reform, rulings by the Supreme Court of Justice (Pleno) approved by eight votes impose mandatory precedents on lower federal and local courts. The factual circumstances of a case that are not necessary to justify the decision do not form part of a precedent.

IV PENALTIES AND REMEDIES

Generally, if taxes are not paid on time the amount due will be updated for inflation (the rate of which is based on Mexico's national price indices) and shall be subject to monthly (in 2022, the rate is 1.47 per cent). The total amount of interest is usually capped at five years.

Criminal penalties are also applicable in cases omitting the payment of taxes, unlawfully benefiting from tax stimuli, and falsely declaring deductions or income for taxable purpose, among others. Under a certain interpretation, the criminal action of tax fraud only arises if a taxpayer showed deceit or took advantage of errors, and payment of taxes is not fulfilled as established in Article 108 of the Federal Tax Code.

A taxpayer may be eligible for reductions or remissions in fines. As of 2022, additional requirements were imposed on eligibility. Furthermore, in certain cases taxpayers can also request a reduction of the late payment interest rate.

V TAX CLAIMS

i Recovering overpaid tax

Since the repealing of the universal offset system in 2019, the only available mechanisms to recover overpaid tax are the 'compensation' of the same tax, when applicable and provided the taxpayer is the debtor and not a withholding agent, and applying for a refund from the tax authorities.

From a Federal Tax Code perspective, Mexican tax residents and non-residents requesting refunds are treated equally. Generally, a non-resident will appoint a Mexican representative to complete this procedure.

The Federal Tax Code foresees interest payments to taxpayers when the refund is performed, disregarding the statutory time terms, referenced above. Additionally, if a refund request is denied and the taxpayer wins an appeal or a trial, interest is payable by the tax authorities.

The calculation depends on the nature of the favourable balance, if it involves taxes unlawfully paid, and whether the taxpayer or the authority determined the tax due.

ii Challenging administrative decisions

Tax authorities provide free guidance to all taxpayers through a special physical segment, through on-site offices and electronic channels. An authority's position described in such guidance cannot be used as an argument during tax disputes, as it is not binding.

Additionally, taxpayers have the right to request an authority to confirm its position on a specific tax item and obtain a ruling containing the authority's interpretation. However, such rulings are not binding and thus cannot be challenged, unless the position is specifically applied in a definitive resolution (e.g., a tax assessment).

iii Claimants and related parties

From a VAT perspective, the acquirer of goods or services may contractually agree with a third party that they bear the consideration and respective VAT. Therefore, Prodecon has recognised that the acquirer has the right to credit such VAT (although borne by a third party) provided it complies with the requirements set forth in Article 5 of the VAT Law.

Additionally, there is no express prohibition to request the tax authorities a VAT unlawfully charged by a supplier. Accordingly, the tax authorities will have the power to collect any underpaid VAT.

VI COSTS

The Federal Court on Administrative Matters and the tax authorities do not require taxpayers to pay any costs for filing tax disputes. The main costs borne by taxpayers are attorney fees, which vary.

In order to be able to challenge a tax assessment during a trial, taxpayers will have to provide a guarantee through one of the options established in the Federal Tax Code. The cost of some of these guarantees (e.g., surety bonds) vary from approximately 2 per cent to 5 per cent of the secured amount.

As of 2021, it is unclear whether an enterprise – and its proceeds – can be subject of a guarantee. We believe this is viable under the Federal Tax Code.

VII ALTERNATIVE DISPUTE RESOLUTION

i Prodecon

As stated in Section II.iii, taxpayers can file a conclusive agreement procedure before Prodecon, after the notification of the observations or findings by the tax authority following a tax audit and before the determination of a formal tax assessment. The procedure is flexible. Prodecon acts as a mediator, with the principle purpose of facilitating an agreement between the taxpayer and the tax authorities.

As of 2022, the maximum duration of this procedure is one year, which applies to ongoing procedures and new ones.

The filing of this procedure suspends certain statutory time terms, including the 20-day term to rebut the observations or findings in a desk review.[6]

Working or technical sessions can be carried out to resolve specific matters where consensus is not reached initially.

This procedure represents a great tool for the taxpayer, as additional and new evidence may be submitted on a selective basis. Also, taxpayers that are signing their first conclusive agreement are entitled to a 100 per cent fine reduction.

6 See internal Prodecon criterion 5/2015/CTN/CS-SG approved in ordinary session on 24 April 2015.

ii Mutual agreement procedures

The mutual agreement procedure (MAP) is another form of ADR provided in double taxation treaties. This procedure exclusively concerns cases of double taxation, in which the competent authorities involved try to provide remedies or a solution, when a case is upheld.

This form of ADR is not used frequently in Mexico, compared to other countries. For example, for the year 2020, only 31 cases were initiated,[7] whereas other countries, such as the United States, initiated 295 cases.[8]

Part of the 2022 reforms requires a taxpayer requesting a MAP to provide a guarantee, if they have not previously filed an administrative appeal.

VIII ANTI-AVOIDANCE

Mexico has adopted a general anti-avioidance rule (GAAR) and several specific anti-avoidance rules (SAARs) in its tax legislation.

i Substance over form

In 2020, a general 'substance over form' rule entered into force. This rule allows tax authorities to re-characterise legal transactions that lack business reasons during tax audits.

Under the rebutabble presumptions of the rule, a presumable lack of business reason shall exists, when upon performing a series of transactions:

a the reasonably expected economic benefit is lower than the tax benefit; and

b the reasonably expected economic benefit could have been obtained through fewer transactions, and the tax effect would have resulted in a higher tax burden.

In 2021, the above-referred provision was amended to remove a section that prevented authorities from using the business reason information as evidence in a criminal prosecution.

ii Back-to-back loans

As of the 2022 reform, an anti-abuse provision related to 'back-to-back' loans was also amended.

Section V, Article 11 of the Income Tax Law was amended so that financing operations through which interest is payable by Mexican legal entities or permanent establishments of foreign entities are now considered to be back-to-back loans, if said operations lack a business purpose.

Due to the ambiguity in this provision, it could be argued that if the rule is interpreted literally, its scope could apply to interest payments made to unrelated parties. However, this interpretation does not align with the origin of this rule.

7 www.oecd.org/tax/dispute/2020-map-statistics-mexico.pdf.

8 www.oecd.org/tax/dispute/2020-map-statistics-united-states.pdf.

iii Corporate restructurings

Another 2022 reform allows tax authorities to challenge the business purpose of certain transactions during a tax audit. Specifically, if a corporate restructuring, merger or spin-off is found to lack a business purpose or fails to comply with certain statutory requirements, it will constitute a taxable event.

iv Base erosion and profit shifting

On several occasions, Mexico has supported measures related to base erosion and profit shifting (BEPS), such as the 2020 anti-anti abuse provision that is based on the OECD's BEPS Action 4 Limitation on Interest Deductions.[9]

In general terms, the rule aims to limit base erosion through the use of interest expenses to achieve excessive interest deductions or to finance the production of exempt or deferred income. Under this rule, the deduction limitation is set at 30 per cent of the taxpayer's adjusted taxable profit.

A *de minimis* rule is in place, whereby the limitation only applies to accruable interest exceeding 20,000,000 Mexican pesos (computable by taxpayer or proportionally).

A carry-forward rule has also been established, similar to the rules applicable to Mexico's net operating losses in the Income Tax Law. There have been several interpretations on how this will impact VAT and other income tax provisions.

Mexico also adopted another 2020 anti-anti abuse provision based on the OECD's BEPS Action 2. Although the referred Action targets hybrid mismatches, Mexico extended this rule to payments made subject to the preferential tax regime as defined under Mexican legislation.

The non-deductibility effect applies to payments made to related parties or through structured agreements, where the recipient's income is subject to a preferential tax regime. It also applies to 'triangular cases' under certain conditions.

An exception to the non-deductibility rule applies if payments are subject to a preferential tax regime deriving from the recipient's entrepreneurial activity, provided the recipient holds the necessary 'personnel and assets'. We consider this will likely be subject to interpretation by the tax authorities.

v Value added tax

The Superior Chamber of the Federal Court on Administrative Matters has confirmed an interpretation that Article 19 of the VAT Law contains a 'substance over form' anti-abuse provision.[10]

The case ruled that granting an usufruct and paying a consideration for immovable property under the form of capital contributions to an entity, should be considered as a lease and not as a sale of property, as the usufruct was time-limited and a consideration was paid.

IX DOUBLE TAXATION TREATIES

Mexico currently has a vast tax treaty network and has concluded various Protocols. A recent example is the October 2021 Protocol between Mexico and Germany, in which new BEPS-related measures and a Limitation on Benefits (LOB) rule were adopted.

9 www.oecd.org/tax/beps/beps-actions/action4.

10 See Administrative Court precedent VIII–P–2aS–728 published in July 2021.

Currently, adoption of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS is still pending ratification by the Senate.

X AREAS OF FOCUS

i Tax authorities' 'invitations'

Increasingly, the tax authorities are issuing taxpayers unofficial 'invitations'. These are powers that differ from excercising a formal tax audit and do not involve the level of costs of a formal audit.

Although these invitations may not be challenged before the courts, the consequences of a taxpayer not replying or clarifying the situation being queried (e.g., invoices issued by the taxpayer not matching their accruable income or deductions declared) can lead to a temporary or definitive restriction of the digital certificate to invoice.

Both federal and local state tax authorities are using this practice more frequently. However, the latter's power to issue 'invitations' is questionable under the Administrative Collaboration Agreement for Federal Tax Matters in place with Mexico City.

ii Simulated transactions

Actions to challenge non-existent or simulated transactions continue to hinder the tax authorities.

The Federal Tax Code provides for a procedure for a recipient of an invoice to prove the invoiced service or transaction was effectively carried out. This decision may be challenged in court or through a federal administrative appeal, as confirmed by the Supreme Court of Justice.[11]

However, during such a trial or administrative procedure, and under an interpretation of the applicable provisions, the taxpayer may be subject to several contingencies and consequences, such as a temporary or definitive restriction of the digital certificate to invoice, joint tax liability for partners and shareholders (if the invoices exceed a specific amount) and fines.

Even criminal sanctions could be applicable under certain criteria in this circumstance.

Finally, a tenth Paragraph was added to Article 69–B of the Federal Tax Code, which came into force as of 2022. The provision assumes that transactions are non-existent if a taxpayer has been issuing tax invoices regarding transactions carried out by another taxpayer whose digital certificate for invoicing has been restricted. This assumption also applies to tax invoices involving assets, personnel and infrastructure of other such taxpayers.

iii Tax refunds

Requesting tax refunds is an extremely burdensome process for most taxpayers, especially after the elimination of the 'universal offset' of tax balances in 2019 (see Section V.i).

iv Digital taxes

Mexico adopted new income tax and VAT rules on digital services and transactions performed through technological platforms, which entered into effect in June 2020.

11 See court precedent 2a. /J. 48/2020 (10a.) published on 23 October 2020.

Digital services providers are no longer obliged to comply with a set of complex tax compliance obligations in Mexico if their services are delivered through intermediaries that withhold the VAT due.

The current income tax rules place tax burdens on Mexican individuals, upon the transfer of goods or the provision of certain services through the internet, digital platforms, applications or similar mechanisms. Such rules establish that Mexican legal entities, foreign entities or legal arrangements that directly or indirectly provide the technological platforms or applications shall be considered withholding agents. The rate of the tax burden varies, depending on the activity performed and the taxpayer's monthly income.

In August 2021, Prodecon, the tax authorities and a non-resident formalised the first conclusive agreement concerning VAT in digital services, which resulted in the collection of VAT of 183,000,000 Mexican pesos.[12]

v 2022 reforms

Several landmark amendments have been adopted in the tax legislation for 2022. Specifically, the regime of fiscal incorporation (RIF) was repealed and a new Simplified Trust Regime, applicable to individuals and entities under certain requirements, entered into effect.

The new regime seeks to facilitate payments for individuals carrying out business or professional activities, or who grant the temporary use or enjoyment of goods, whose income earned in the previous fiscal year does not exceed 3,500,000 Mexican pesos. The monthly and annual income tax rates range from 1 per cent to 2.5 per cent, which are applied progressively on the basis of income obtained. Taxpaying individuals are not allowed to apply deductions under this regime, as the Simplified Trust Regime's tax rates take these into account.

Mexican legal entities that are only incorporated by individuals, and that have a total income of less than 35,000,000 Mexican pesos,[13] can also use this regime. Entities under this regime can calculate their income tax liabilities on a cashflow basis.

XI OUTLOOK AND CONCLUSIONS

Although not all matters qualify for the 'substance over form' procedures (see Section VIII.i), we consider certain precedents have been issued related to these procedures. One aims to provide clear guidelines on the elements that must be taken into account to resolve upon a 'substance over form' trial, to avoid excessive or disproportionate effects on the taxpayers' non-compliance of formal requirements.

Finally, a VAT trend we have identified since the 2014 reform, to which we have perceived authorities show an unyielding position, relates to a 'potential double VAT' upon the sale in Mexico of imported goods that have been subject to transformation or maquila processes abroad. The authorities have, under a literal interpretation of Article 1 of the VAT Law, stated that the sale of and importation of the goods are separate acts, and both subject to VAT. However, we believe this does not take into account Article 1–A, Paragraph 2 of the VAT Law nor the General Foreign Trade Rules that establish a legal fiction that the

12 See Prodecon Bulletin 009/2021 dated 25 August 2021.

13 Newly incorporated entities can make an estimate to determine their income does not exceed the referred threshold.

sale of goods previously imported on a temporary basis by a company utilising an IMMEX programme are considered to have been sold abroad. Therefore, the sale of such goods should fall outside the scope of Mexican VAT.[14]

14 See Rule 5.2.5 of the 2020 General Foreign Trade Rules. This Rule was repealed in the 2022 version of the Rules.

Appendix 1

ABOUT THE AUTHORS

DENISE LESTER

Galicia Abogados

Denise has over 20 years of experience specialising in tax litigation, honing her skills as an expert in complex proceedings before the tax authorities and Mexico's Tax Ombudsman Agency (Prodecon). In her practice she has been able to reverse criteria that had already shaped jurisprudence. She has analysed issues ranging from procedures carried out by the tax authorities, such as the temporary restriction of digital seals, to the filing of means of defence through which precedents have been established that have served as guidelines for the resolution of new cases, as well as for the interpretation and application of tax provisions and international treaties.

ALEJANDRO MADERO

Galicia Abogados

Alejandro has more than 14 years of experience, and specialises in strategic advisory on tax audits and procedures before the tax authorities, as well as in alternative dispute resolution procedures in tax matters before the Mexico's Tax Ombudsman Agency (Prodecon). He also specialises in tax controversy procedures regarding federal and local taxes. He acted as lead counsel in a landmark case won upon challenging the payroll tax in San Luis Potosí several years ago, which resulted in a substantial tax refund. In 2019, he was appointed as a part-time professor of the Monterrey Institute of Technology and Higher Education's bachelor programme, instructing in tax matters.

ABRAHAM RUBIO

Galicia Abogados

Abraham Rubio joined firm in 2020. He is currently a junior associate in the tax litigation practice area. He studied law at Mexico's Panamerican University in 2019 and specialised in Companies Law at the same university in 2021.

GALICIA ABOGADOS

Blvd. Manuel Ávila Camacho 24, FL 7
Lomas de Chapultepec
11000
Mexico City
Mexico
Tel: +52 55 5540 9200
dlester@galicia.com.mx
amadero@galicia.com.mx
arubio@galicia.com.mx
www.galicia.com.mx

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