Mexico:
Guidance issued on payments to tax havens and availability of foreign tax credits

The Mexican tax authorities (SAT) issued guidance on 25 June 2013 clarifying when the 40% withholding tax on payments made to residents of low tax jurisdictions applies and the availability of foreign tax credits.

Payments to residents of preferential tax regimes

Under the Mexican Income Tax Law (MITL), a preferential tax regime or “tax haven” (REFIPRE) is defined as a jurisdiction whose residents are taxed at a rate that is less than 75% of the rate that would be paid under the MITL (i.e. less than 22.5% for 2013).

The REFIPRE concept was included in the MITL when Mexico abandoned a “black list” of low tax jurisdictions (although the list is still in existence) and adopted controlled foreign company (CFC) rules. Provisions related to REFIPRE were included in a section of the law relating to the taxation of Mexican residents (and nonresidents with a permanent establishment (PE) in Mexico) with investments in CFCs. This placement seemingly would indicate that only Mexican residents and PEs that invest in CFCs are subject to the REFIPRE rules. However, a provision relating to tax havens also has been included in the section of the MITL addressing the taxation of nonresident individuals or entities without a PE in Mexico that derive Mexican-source income (article 205); under this rule, such income is subject to a 40% withholding tax rate (instead of the rate that otherwise would apply under domestic law) if the recipient of the income is a resident of a tax haven.

The inclusion of this provision in article 205 created a debate as to whether the provisions concerning REFIPRE applied only to investments by Mexican residents (or PEs) in CFCs, or if the rules also would apply to any nonresident with Mexican-source income that paid taxes at a rate of less than 22.5% in its own country, irrespective of its ownership structure. According to the latter interpretation, a transparent vehicle or entity, such as a disregarded entity or trust that does not pay taxes in its own jurisdiction, would fall within the definition of a nonresident subject to the REFIPRE rules. The new guidance clarifies that the 40% withholding tax applies only to payments made to CFCs that are controlled by Mexican residents or PEs of foreign companies in Mexico; thus, the 40% rate does not apply to payments made to nonresidents that are not considered CFCs from a MITL perspective.

Foreign tax credits

Mexican residents are taxed on worldwide income and are granted unilateral relief from double taxation in the form of a foreign tax credit. Article 6 of the MITL provides that when a Mexican resident pays tax abroad at a rate higher than that provided for in an applicable tax treaty with respect to a specific item of income, the Mexican resident may not claim a foreign tax credit for the excess tax paid until a mutual agreement procedure under the relevant treaty is concluded. According to the new guidance, a foreign tax credit attributable to withholding tax in excess of the relevant rate provided in a treaty may not be claimed until the competent authorities of the treaty partner countries conclude an agreement under the mutual agreement procedure and the Mexican resident has formally accepted the outcome of such procedure.

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