

Tax Alert. New VAT rules for Maquiladoras

lunes, 11 de julio de 2011

New VAT rules for Maquiladoras

On June 30, 2011, the Ministry of Finance (“Hacienda”) amended the temporary regulations (“reglas de carácter general en materia de comercio exterior“) to the Customs Law to include a rule that would require the payment (“withholding”) of VAT in case of temporarily imported goods that are transferred to Mexican residents under a virtual export/import mechanism. This would result in the payment of VAT twice on the sale of the goods by the foreign resident to a Mexican resident: first upon the virtual, definite importation of the goods by the Mexican resident and also as a consequence of the VAT withholding by the same Mexican resident.

New VAT rules for Maquiladoras

ByÂ Koen van â€™t Hek

On June 30, 2011, the Ministry of Finance (“Hacienda”) amended the temporary regulations (“reglas de carácter general en materia de comercio exterior“) to the Customs Law to include a rule that would require the payment (“withholding”) of VAT in case of temporarily imported goods that are transferred to Mexican residents under a virtual export/import mechanism. This would result in the payment of VAT twice on the sale of the goods by the foreign resident to a Mexican resident: first upon the virtual, definite importation of the goods by the Mexican resident and also as a consequence of the VAT withholding by the same Mexican resident.

Background

The Maquiladora (and manufacturing/PITEX) customs regime, now called “IMMEX”, was designed to promote exports and job creation. This customs regime allows for the “temporary importation” of goods (machinery and equipment [M&E], tools, raw materials, etc.) which permits these goods to be imported into Mexico with no customs duty¹ or import VAT cost. In general terms, the IMMEX program can be obtained if a tax payer transforms or repairs materials, parts or components into finished goods that are destined for exportation.

Traditionally, the Mexican maquiladora would import most of the materials and export their production, where the inventories and M&E used in their operations would be owned by the foreign related party and provided to the maquiladora on a consignment basis.

The Mexican (and global) economy, however, has evolved in a manner in which numerous maquiladoras have taken on greater production responsibility, have increased sales into the Mexican market, are sourcing more materials and components from local Mexican suppliers and/or have assumed a greater responsibility in developing, sourcing, funding (and owning) the machinery, equipment and know-how required for their production activities.

The Mexican government has - in the past - recognized that the Maquiladora industry became more and more connected with the Mexican economy, and has for that reason broadened the application of the maquiladora program facilitating more local sourcing, allowing for less exports and so on.

One example of this is that a maquiladora is currently required to export only 10% of its production or have minimum annual export sales of \$500,000 US dollars, while there used to be a requirement for a maquila to export 100% of its production.

Another example of facilitating local sourcing and local sales were the introduction of VAT rules that allowed the maquiladora and its foreign principal to trade with Mexican suppliers and customers, without incurring in irrecoverable VAT cost. Some of these rules imply the application of so-called “virtual” imports and exports of goods.

General VAT rules affecting maquiladoras

One of the complicating factors of the Mexican VAT regime is that non-residents can generally not register exclusively for VAT purposes, without also registering for income tax and flat rate business tax (i.e. registering a permanent establishment for all Mexican tax purposes).

In addition, the sale of goods (that are located in Mexico) and the rendering of services is subject to VAT, unless the goods or services are considered to be exported (zero percent VAT).

Therefore, any VAT charged to a foreign resident (without permanent establishment) by Mexican suppliers of goods or services – that are not exported - would constitute an irrecoverable cost.

In a maquiladora/toll manufacturing context, where the foreign resident would generally be the one that contracts with (Mexican) suppliers and customers, the VAT cost would be an impediment to actually buy goods and services from Mexican suppliers and sell goods to Mexican residents. Imagine for example the VAT that is charged to the foreign principal by a Mexican supplier of goods, that are delivered to the manufacturing facilities of the Mexican maquiladora (so not exported). Or the sale of (semi-) finished goods between non-residents through a supply chain that involves various maquiladoras. Or the VAT charged on the toll manufacturing services by the same maquiladora to its foreign principal. The VAT cost on those (gross) flows would in many cases make the maquiladora arrangement commercially not viable.

For this reason, the Mexican government has introduced various rules that facilitate non-residents with maquiladora arrangements to do business with Mexican suppliers and customers.

VAT incentives for maquiladoras

Mexican VAT Law and Temporary Regulations to the Customs Law provide for a complex set of rules with exemptions and zero rated VAT treatment for transactions involving maquiladoras.

For example, the VAT Law establishes, in certain instances, a zero percent VAT rate applicable to the toll manufacturing services charged by the maquiladora to the foreign principal.

In addition, the VAT Law and Temporary Regulations to the Customs Law provide for a special VAT treatment for the sale of goods, in several circumstances. This special treatment provides for a deemed or “virtual” exportation of the sale of goods, even though the goods do not leave Mexican territory.

- For example, a Mexican resident supplier that sells goods to a foreign resident, but with delivery of the goods to a Mexican maquiladora (no physical export) is able to treat the sale as a “virtual” export, subject to zero percent VAT. The maquiladora, that would receive the goods in its production facilities, would virtually import the goods - on a temporary basis – under its IMMEX program. Under this mechanism, there would be no irrecoverable VAT cost for the foreign resident.

- Another example would be the sale by a foreign resident - of goods that are imported on a temporary basis by its maquiladora – to a Mexican resident with IMMEX program. Such a sale by the foreign resident can also be treated as a virtual exportation (zero percent VAT), followed by a virtual (temporary) importation by the Mexican maquiladora that acquired the goods.

- The rule that was amended on June 30 - similar to the rule explained in the previous paragraph - allows for the (virtual export) sale by a foreign resident of temporarily imported goods by its maquiladora, to another Mexican resident, under the application of the virtual export/export mechanism. The difference with the aforementioned rule is that the virtual treatment can be applied irrespective of whether or not the Mexican resident acquiring the goods from the foreign resident, has an IMMEX program. That is, it applies in case the Mexican resident acquiring company is a Mexican end-customer or distributor, etc.

One of the conditions for the application of this rule is that the Mexican maquiladora (that delivers the goods to the Mexican resident that is acquiring the goods), beside the IMMEX program, also has a so-called Certified Importer (“Empresa Certificada”) license. This program can be obtained by companies that have significant amounts of importations per year, and can demonstrate that they have complied with its tax obligations in the past.

Changes effective July 1, 2011

The aforementioned rule, applicable to Certified Importers/IMMEX that deliver goods to Mexican residents, now requires the Mexican resident purchaser of the goods, to pay VAT on behalf of the non-resident seller of the goods. That is, the sale of the temporarily imported goods – physically located in Mexico – is considered as a sale of goods in Mexican territory, subject to VAT.

However, where the previous version of the rule treated the sale by the foreign resident as a virtual exportation (zero percent VAT), the amended rule now treats the sale as a sale as a “normal” sale subject to the general VAT rates (16 percent or 11 percent in the border region). The payment of the VAT on the sale by the foreign resident is done by the Mexican purchaser of the goods on behalf of the foreign resident, based on a kind of self-assessment mechanism (called VAT “withholding”).

The result of this change is that the Mexican purchaser of the goods will have to pay VAT twice. That is, VAT is due on the virtual importation of the goods, as well as based on the VAT “withholding” obligation explained in the

previous paragraph.

It should in principle be possible for the Mexican purchaser of the goods to recover both VAT payments (credit and/or refund). However, there will likely be a cash flow effect (i.e. the need to ask for a cash refund of VAT).

Comments

The amended rule is very unfortunate. It punishes certain tax payers with a double VAT cash flow cost, as well as an increased administrative burden to manage the cash and the compliance with the VAT obligations.

More importantly, it sends a wrong message to foreign investors regarding the investment climate in Mexico, in particular the maquiladora industry.

The rules regarding maquiladoras have suffered several changes during the last couple of years, with the latest controversial change in the IMMEX Decree (making significant income tax amendments) barely 7 months old!

Moreover, it is difficult to understand how a significant change as the one at hand, can be made through an adjustment of Temporary Regulations by the tax authorities, without any involvement of Congress or Senate. In other words, how is it possible that such significant rules are regulated by administrative regulations, instead of by formal laws.

It's time for the Mexican government to make up its mind and establish a coordinated approach for regulating the maquiladora industry, from an income tax, flat rate business tax, VAT and customs duty point of view.

Contacts:

Koen van 't Hek

koen.van-t-hek@mx.ey.com
(55) 1101 64 39

Michael Becka

michael.becka@mx.ey.com
001 (214) 457 5214

Rocio Mejia

rocio.mejia@mx.ey.com
(55) 5283 8672

1 Some exceptions apply: M&E is subject to import duties even under temporary status. Certain raw materials may be subject to duties under specific free trade agreements (e.g. NAFTA and EU-Mexico FTA)