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Mexican Tax Authority Seeks to Create and Tax Virtual Mexican Branches of Non-Mexican Companies

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EXECUTIVE SUMMARY

Non-Mexican businesses selling products into Mexico, through Mexican-based employees or sales representatives, or selling service contracts through Mexican-based employees or sales representatives could find themselves subject to Mexican taxation because of changes in Mexican tax laws that took effect January 1, 2020. These changes allow Mexican tax authorities to examine non-Mexican books and records and impose tax on profits allocated outside of Mexico. Mexico has become more aggressive in recent years in treating locally operating salespeople as virtual branches, subjecting their non-Mexican employers or primary contractors to Mexican taxation.

For example, a U.S., Japanese or German company (the “Manufacturer”) manufactures machinery or parts outside of Mexico, which it sells to Mexican factories. The Manufacturer has two product representatives in Mexico who work out of their homes or automobiles. These product representatives do not represent any suppliers other than the Manufacturer. Because they depend entirely on the Manufacturer for their income, they are, under Mexican tax treaty parlance, “dependent agents.” These dependent agents make potential customers aware of the Manufacturer, provide information about products, and respond to inquiries. They do not maintain any inventory in Mexico, they do not negotiate pricing, and they do not execute any contracts binding the Manufacturer.

As a second example, assume a U.S., Japanese or German company (the “Professional Services Company”) is based outside of Mexico, but provides engineering and other technical services for Mexican customers. Some of the services are performed inside and outside of Mexico. The Professional Services Company has two representatives in Mexico who work out of their homes or automobiles and are totally dependent on the Professional Services Company for their income. Thus, they also are dependent agents. They make potential customers aware of the Professional Services Company, provide information about the engineering and technical services, and respond to inquiries. They do not perform the services themselves, they do not negotiate pricing, and they do not execute any contracts binding the Professional Services Company.

Prior to the Mexican tax law changes, Mexico would probably not have treated these two sets of dependent agents as a “permanent establishment” of the Manufacturer or Professional Services Company. A “permanent establishment” is the term used in Mexican law and in its sixty income tax treaties to describe a fixed place of business in Mexico through which the business of a non-Mexican enterprise is conducted—in other words, a Mexican branch of non-Mexican business. In prior years, non-Mexican companies could avoid this permanent establishment status by not allowing their Mexican representatives to execute sales or service contracts and by taking other precautionary measures.

The recent changes to Mexican law might, depending on the specific facts, treat the above-described dependent agents as a Mexican permanent establishment of the Manufacturer or Professional Services Company, if (i) they habitually conclude contracts requiring the Manufacturer to sell products, or the Professional Services Company to provide services to Mexican customers; or (ii) they habitually play the principal role leading to the conclusion of such contracts. In other words, even if a dependent agent never executes a contract for the sale of products or provision of services, he or she may still be treated as giving rise to a Mexican permanent establishment depending on the importance of the functions performed in Mexico relative to the entire contracting process of the non-Mexican business.

Non-Mexican businesses selling into Mexico should determine whether their employees or dependent agents play the principal role leading to the conclusion of contracts under which a non-Mexican company commits to sell products to, or provide services for, a Mexican customer. This requires analyzing the contracting process and assessing the relative importance of functions performed within and outside of Mexico. For further information or assistance, please contact your Masuda Funai relationship attorney.