



**The position of index regarding the Tax Reform Initiative to modify the Value Added Tax Law in order to tax IMMEX’s temporary imports and the sale of goods between nonresidents.**

The Value Added Tax Law Reform Initiative presented recently by the Federal Executive Branch to the Chamber of Deputies proposes levying Value Added Tax (VAT) on IMMEX’s (maquiladora industry) temporary imports, and subsequently refunding this payment to export companies. It also proposes levying VAT on the sale of goods between nonresidents.

In this respect, the National Council of the Maquiladora and Export Manufacturing Industry (**index**) requests that this VAT Law reform should NOT be approved and proposes establishing instead an effective program to prevent and combat the irregularities that have been committed by just a few companies, in relation to the following statement of reasons.

**I.- VAT ON TEMPORARY IMPORTS**

**1.- Negative economic effect for IMMEX of paying VAT on the temporary importation of merchandise to be exported:**

The statement of reasons of the Federal Executive Branch indicates that the purpose of this reform is to “improve control” and that it is NOT a measure to collect taxes for the Federal Government, since the VAT paid will subsequently be refunded to the taxpayer. However, it must be considered that this reform will have a severe impact on the industry and will generate a loss in competitiveness for the country since it will increase the annual operating costs by 1,150 million USD as can be seen in the following chart:

Annual amount of IMMEX’s temporary imports, based on figures for 2012	\$156 BILLION USD
16% VAT payable (annual):	\$25 BILLION USD
Cash flow required in order to pay VAT, considering a period of six months to obtain a refund as of the payment date.	\$12,500 MILLION USD
Cost of financing for IMMEX:	\$750 MILLION USD (\$9,750 million MXN)
In an optimistic scenario in which the VAT is refunded in 3 months:	Cost of financing \$375 MILLION USD (\$4875 million MXN)
Additional administrative cost to pay and recover:	\$100 MILLION USD (\$1,300 million MXN)
Logistics and operating costs related to the method of	\$300 MILLION USD (\$3,900 million



payment proposed (per vehicle instead of consolidated USA/Mexico import document):	MXN)
Total cost for the industry to pay VAT on temporary imports and subsequently :obtain the refund	\$1,150 MILLION USD (\$14,950 million MXN)

Even if the right to credit and request for a refund were to be subject to monthly payment declarations, which would not solve the control problem set forth in the statement of reasons, the financing term would not be less than three months, implying a cost of financing equivalent to 375 million USD and a total cost of 775 million USD.

In turn, SAT would incur significant additional costs to manage the refund of VAT on temporary imports, which would result in the need to increase its installed capacity substantially in order to refund an unprecedented additional amount: 25 BILLION USD a year (the Reform Initiative does not mention this point nor does it indicate whether a cost-benefit study was conducted). There is no doubt at all that this will have a negative effect on Mexico’s international competitiveness and country cost indicators.

## 2.- The importance of IMMEX whose survival would be at risk:

The effect of the cash flow requirements and the increase in the cost (financial) of its operation in Mexico would make it impossible for our country to compete with the cost of operating a similar program in other countries that either do not levy taxes on imports or only tax definitive imports, and that have also implemented far more efficient systems than ours to facilitate trade and eliminate barriers in supply chains, thus endangering the survival of this industry that currently enjoys the following profile:

- 6,200 companies.
- Generates 2.3 million direct formal jobs (6.8 million indirect formal jobs).
- Salaries above the national average.
- Represents 53.8% of the manufacturing sector’s employment registered in IMSS.
- Represents 65% of Mexico’s non-oil exports.
- Positive trade balance of over 41.2 billion USD.
- Growing national content: 25% halfway through the last decade; 30% at present.
- Maquiladora regime: positioned internationally as the most “attractive” model for FDI: 40% of the total FDI enters Mexico as “maquiladora for export”.
- In border towns and some non-border towns, its economic benefit represents more than 70% of the total economic activity.



### **3.- Considerations regarding the statement of reasons (justification) of the Reform Initiative:**

The statement of reasons of the VAT Law Reform Initiative maintains that SAT has detected the following irregularities in temporary imports:

- The review of the company reveals that the address does not exist and the temporarily imported goods cannot be found (they are diverted to the domestic market without paying VAT).
- The foundation of companies that transfer the merchandise to each other until “at some stage of the process, one of the companies sells the merchandise in Mexico and it disappears without paying VAT”.

In this regard, the common factors of which **index** has been made aware in diverse meetings held in the past with the SAT tax authorities are as follows:

The infractions are committed by companies that:

- Temporarily import relatively significant amounts and then disappear without re-exporting the merchandise.
- Are fairly new (they are often companies under one year old).
- Have few assets. When the authorities look for them it turns out that the location is empty or the value of the assets found there is very low. They never own property or machinery and equipment of a significant value.
- They have only a few workers or no employees at all.
- They often import merchandise that is subject to the general import tax (IGI) or compensatory duty. They seek a greater economic benefit by avoiding not only VAT, but also IGI and/or compensatory duties. Illicit firms occur more often in the textile and apparel or steel sectors, among others. The incidence is even higher in sectors that do not pay IGI, such as the electronic, automotive and auto-part, and aeronautics sectors.

However, in the VAT Law Reform Initiative, we did not find any measures that focused specifically on preventing or combatting the aforementioned irregularities, but instead it simply makes the payment of VAT compulsory for every IMMEX company alike, thus affecting a large number of importers that do not fit the profile of the companies that committed the infractions detected by SAT.

The statement of reasons of the VAT Law Reform Initiative suggests that control will be based on the fact that all the IMMEX companies should pay VAT at the time of the temporary import, and the amount paid will be refunded only to the companies that re-exported the merchandise.



Nevertheless, this control based simply on granting or denying VAT refunds will be highly complex, with limited probabilities of succeeding and a high risk of affecting companies that are not involved in unlawful acts, and therefore:

### **1.- Complex environment for ruling on or granting refunds.**

- The number of refund requests the SAT will receive and the amount of these refund requests would increase exponentially, because every month all the IMMEX companies would request refunds of the VAT paid on temporary imports (at least 6,000 requests) amounting approximately to \$2,000 MILLION USD every month.
- The number of requests in addition to those currently processed by SAT and the elevated amount of the same will surpass from the very first month SAT's installed capacity for processing them, and would generate pressure on the part of the companies (that would quite rightly need the VAT refund in the shortest time possible) as well as the inner functions of the authority, which would undoubtedly endeavor to inspect each request meticulously.
- This situation will cause tension in SAT, which would have to decide between:
  - a).- Applying more flexible criteria for granting refunds, in which case the VAT might be refunded to the companies that are precisely set up with the specific objective of evading paying VAT, or
  - b).- Implementing a more stringent procedure for granting refunds, in which case the term for granting the refund to all the companies in general (which are not involved in any of the aforesaid irregularities) would inevitably be longer, thus increasing the cost of financing for IMMEX as a whole.

### **2.- The legal text proposed allows companies to obtain the refund without exporting.**

The statement of reasons of the Initiative suggests that all the IMMEX companies should pay VAT at the time of the temporary importation and the VAT would be refunded after the merchandise has been exported. However, the text of the Law (even after the proposed reform) allows companies that pay VAT on temporary imports to determine credit balances in the month following the imports and to request the VAT refund without necessarily having re-exported the imported merchandise.

This is because the general structure of VAT and the design of crediting is based on determining the credit balance (where appropriate) on the basis of the company's monthly operations. In fact, this is expressly affirmed in the statement of reasons of the Initiative in the following paragraph:



*It must be noted that the measure does not affect companies' revenues as long as the VAT paid on introducing the goods into the diverse programs can be credited in the monthly payment declaration; the refund in all cases can be requested when the company has credit balances.*

Therefore, the reform allows companies to request a refund of the VAT paid in the month following the payment without necessarily having to prove that the merchandise was re-exported.

This circumstance shows that the Initiative DOES NOT GUARANTEE THAT CONTROL WILL BE STRENGTHENED, but simply the cost of all of IMMEX's operations will increase horizontally, without preventing or combating the abuse mentioned in the Initiative.

It must be noted that **index** IN NO WAY AT ALL PROPOSES that the refund request should not be presented until the merchandise has been re-exported, because this circumstance would generate an exception and discriminatory treatment in relation to the general rules applicable to crediting in the VAT Law. It would also harm each and every IMMEX company even more, since it would take even longer for them to obtain the VAT refund. The VAT Law Reform Initiative is unlikely to solve the corresponding control issue.

Paradoxically, the legal modification proposed does not guarantee that control will be improved, since it does not include specific, focused preventive or corrective measures for the profile of the irregularities detected by the tax authorities and, therefore, it is highly unlikely that the aim of improving control will be successful.

## **II.- VAT ON THE SALE OF GOODS BETWEEN NONRESIDENTS AND BETWEEN A NONRESIDENT AND A MAQUILADORA**

The Reform Initiative proposes eliminating the exemption set forth in article 9, section IX of the VAT Law, in which the sale of goods between nonresidents or by a nonresident to companies that participate in an IMMEX program is exempt from paying VAT, as long as the goods have been introduced into Mexico under an IMMEX program and the goods remain in the temporary import regime.

Allowing taxation within the framework of the proposed reform would practically imply a double taxation and an automatic 16% increase on the cost of the goods since the VAT would not be creditable and, therefore, would be nonrefundable.



With an estimated 25 BILLION USD in transfers with virtual operations, the added cost would be 4 BILLION USD that would NOT be a tax on consumption, since the merchandise has to be exported and in the event that a percentage is allocated to the domestic market, for example 10%, VAT would be paid on the definitive importation, thus constituting a double taxation.

In this regard, we request that this reform be reconsidered and **that the exemption should not be eliminated** since this continues to be justified as it targets temporary imports that have to be re-exported and, if they are distributed to the domestic market, then the VAT would have to be paid when changing the regime or processing their definitive importation contemplated in a virtual import operation.

The aim of the virtual import and export operations is to foment supply chains at lower costs in Mexico and thus achieve a greater Mexican added value on the products that are exported. The companies that receive merchandise through virtual imports still have the obligation to export their products or, otherwise, change them to the definitive import regime in the event that the goods were to remain in Mexico.

**index** agrees that better control and taxation measures need to be formalized and, therefore, the proposal should restrict the right to these transfers for the companies that have been fully identified and exclude highly sensitive products.

### **CONCLUSION:**

**Index** considers that imposing the obligation of paying VAT on temporary imports will NOT produce positive results regarding control and will generate significant costs for both IMMEX and for the authorities themselves.

Moreover, the exemption stipulated in article 9, section IX of the Value Added Tax Law should NOT be eliminated. This article provides that the sale of goods between nonresidents or by a nonresident to companies that participate in an IMMEX program is exempt from paying VAT.

**Consequently, index considers that the reform in question should NOT be implemented since, in addition, it does not guarantee that control will be improved.**

In order to solve the tax evasion and avoidance issues described in the statement of reasons of the Reform Initiative, **index** recommends implementing a monitoring and control program for IMMEX's temporary imports, with the participation of SHCP-SAT, SE (Ministry of the Economy) and **index**.



The core of this program must be the collaboration of the IMMEX private sector and its representative organization, **index**, with the SHCP-SAT authority, who should perform an objective analysis regarding irregularities related to temporary imports in order to implement more assertive preventive and corrective measures to significantly reduce any abuse in this matter and, finally, formally and periodically supervise and report on the indicators that show the results irregularity issues and improvement in the level of compliance.

This collaboration between the authorities and the private sector, in order to find genuine solutions that foster compliance in temporary imports, are also contained in one of the key pillars of OMA's SAFE framework for the Authorized Economic Operator scheme, or NEEC scheme, in Mexico: Customs to Business partnerships.

**index**, which groups together the largest number of Mexico's NEEC businesses, has the best of intentions and is more than willing to collaborate with the SHCP-SAT authorities to foster the construction of compliance patterns in companies in the use of the SE's Export Development Programs, such as the successful IMMEX program.

Taking into account all of the above, **index** requests the modification of the Initiative of the Decree that reforms, appends and repeals diverse provisions of the Value Added Tax Law, eliminating from the proposal the content of the texts that are crossed out of the Initiative presented and appending to the same the text that is in bold, so that it would be as follows:

## **VALUE ADDED TAX LAW**

**ARTICLE I.** The following articles will be **REFORMED** 1.-A, fourth paragraph; 1.-C, sections IV, V, first paragraph and VI, first paragraph; 2.-A, section I, subsection a), first paragraph, and last paragraph; 5, sections I, first paragraph, II and IV; 5.-C, section II and last paragraph; 5.-D, first paragraph; 7., last paragraph; **9, section IX**; 15, sections V, X, subsection b), first and second paragraphs and XIII; 18-A, first paragraph; ~~25, section I, second paragraph; 26, section I; 27, first paragraph;~~ 29, section VI; 32, sections I, III and V, first paragraph; 33; 41, sections I, first paragraph and II, and 43, section I, second paragraph and third from last paragraph; the articles to be **APPENDED** are 2.-A, section I, subsection b), with numerals 5 and 6; 5.-E; 7, with a second paragraph, the current second and third paragraphs would become the third and fourth paragraphs, respectively; 11, with a last paragraph; 17, with a last paragraph; ~~24, section I, with a second and third paragraphs; 25, with a section IX; 27, with a second paragraph, the current second and third paragraphs would become the third and fourth paragraphs, respectively; 28, with a second paragraph, the current second, third and fourth paragraphs would become the third, fourth and fifth paragraphs, respectively, and 30, with a second paragraph, the current second paragraph would become the third paragraph;~~ and the articles to be **REPEALED** are 1.-A, section IV; 2; 2.-A, section I, subsection h); 2.-C; 5, last paragraph; 9, sections II and ~~IX~~ and the last paragraph; 15,



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sections I, IV and X, subsection d); 20, section II; 29, section VII; 41, section V, and 43, section IV, fourth paragraph, of the Value Added Tax Law.