

## MEXICO

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## Impact of Mexico's 'controlling beneficiary' rules

**Santiago Llano and Eduardo García of Ritch Mueller analyse the impact and relevance of the Mexico's 'controlling beneficiary' rules, including several issues arising due to their poor implementation.**

From 2022, taxpayers are obligated to obtain, keep and provide to the Mexican tax authorities when so requested, information of individuals who are considered to be the 'controlling beneficiaries' of legal entities, trusts and other legal vehicles, such as name, date of birth, gender, nationality, tax residence, tax ID number and marital status.

The new tax provisions incorporated in the Federal Fiscal Code are based on the recommendations issued by the Financial Action Task Force (FATF), which encourage countries to take measures aimed to prevent the misuse of legal persons and legal arrangements for money laundering or terrorist financing.

Under the referred FATF recommendations, the intention is to identify the individuals having a certain level of control, significant participation or otherwise being responsible of the management decisions in an investment structure. However, this objective is not necessarily met when applying the set of rules that were approved as part of the Mexican 2022 tax reform.

In terms of the Federal Fiscal Code, a 'controlling beneficiary' (which is the term used in the Federal Fiscal Code, and is the equivalent to the term 'beneficial owner' used in the FATF recommendations) is the individual or group of individuals who:

- i) Directly or through other individuals, obtains the benefit derived from its participation in a legal entity, trust or any other legal vehicle, or who ultimately exercises the rights of use, enjoyment, exploitation or disposal of a good or service.
- ii) Directly or indirectly, exercises control of the legal entity, trust or any other legal vehicle, which exists when:
  - a) Decisions in the general meetings of shareholders, partners or equivalent bodies can be imposed, or the majority of the directors, administra-

tors or their equivalent can be appointed or removed;

- b) Voting with respect to more than 15% of the capital can be exercised; or
- c) The administration, strategy or main policies can be directed.

In the case of trusts, the settlor, the trustee, the beneficiaries and any other person that ultimately exercises effective control in the agreement, shall be considered as 'controlling beneficiaries'.

Based on administrative rules, when doing the identification of controlling beneficiaries, legal entities must apply sections (i) and (ii), subparagraphs (a), (b) and (c) in a successive order, so that when no controlling beneficiary was identified under (i), section (ii) and its subparagraphs shall be applied. If still no individual is identified, members of the board of directors or equivalent body, shall be considered the controlling beneficiaries.

The Mexican tax provisions have significant differences when compared to the FATF recommendations.

Under the Mexican tax provisions, it is understood that assumptions under sections (i) and (ii) above should be read independently and in that order, meaning that any individual that has a direct or indirect benefit shall be understood as a controlling beneficiary, regardless of such individual having or not a significant level of control or participation.

The above implies that practically any individual linked to a structure, even if its participation is minimal, shall be considered as controlling beneficiary, causing the second test established under section (ii) to become irrelevant, when it would have made much more sense to apply sections (i) and (ii) together.

Even when the Federal Fiscal Code expressly allows the application of the FATF recommendations for purpose of interpreting who shall be considered as controlling beneficiaries in terms of the Code (when their application is not contrary to the own nature of Mexican tax provisions), arguing that sections (i) and (ii) should be applied jointly would clearly go against the position established via administrative rules, which require to apply sections (i) and (ii) in a successive order.

When referring to a 'group of individuals', the Federal Fiscal Code does not require that the relevant individuals be somehow related or linked, as it happens under stock exchange laws (e.g. that they are members of the same family, that they have pre-arrangements to vote in the same way, etc.). This could lead the tax authorities to interpret that any group of individuals (including minority investors with no

connection whatsoever between them) can actually be considered to surpass the 15% participation threshold, automatically becoming controlling beneficiaries all of them.

As these provisions are intended to apply to individuals, in the case of trustees (e.g. Mexican banks and brokerage houses), in principle this would imply trying to identify their ultimate owners.

On the other hand, there are other issues when applying these new rules, related with who are obligated to obtain and keep information of controlling beneficiaries.

Since notaries/brokers and trustees intervening in the incorporation of legal entities and the formation of trusts are obligated to obtain information to identify controlling beneficiaries, this is causing a lot of delays in such processes, given the lack of clarity on how to properly comply with such obligations and potential fines and sanctions of not doing so (e.g. fines ranging from MXN 500,000 to MXN 2 million (approx. \$25,000 to \$100,000), for each unidentified controlling beneficiary, and other sanctions, such as not being allowed to enter into contracts with the government).

The obligation to obtain and keep this information also applies to any other person who intervenes in the incorporation of legal entities and formation of trusts, which implies that legal advisors appearing before a notary public to notarise the related documents, may also be considered as obligated to comply with this obligation.

Financial institutions, with respect to the information related to bank accounts, are also obligated to obtain the information to identify controlling beneficiaries. Even when such institutions are allowed to comply with this new obligations through CRS and FATCA procedures, there are still some concerns on who should be considered as 'financial institutions' under the new rules.

In the case of trusts, the obligation to obtain and keep the information is being imposed on all parties involved in such trusts, rather than only on the trustee, which would have been the logical approach. On the other hand, trustees are becoming stricter on their KYC procedures.

Under administrative rules, it is established that the Mexican tax authorities will not resolve 'controlling beneficiaries' queries that are filed by collective groups, including employer associations and commerce chambers. This is no surprise, as regrettably this has been a common trend whenever a particular subject gives rise to lot of questions from taxpayers.

Nevertheless, efforts are still being made with the Ministry of Finance and with the Mexican tax authorities to get clarifications on all these concerns and others, but it is unclear whether such clarifications will actually be issued.

Hopefully, the authorities will be sensitive to the importance of this; otherwise, taxpayers will need to get used to applying the current rules and will be forced to start adopting positions with all associated risks, which unfortunately has become the standard in recent years.

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