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A LOOK AT MEXICO'S SPECIAL ECONOMIC ZONES

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Mexico's SEZ plan will see different regions of the country offer varied investment incentives (Credit: istock.com/scibak)

As Mexico's first three Special Economic Zones look set to begin operations by the end of the month, local lawyers present an overview of the new rules and potential benefits for companies looking to invest.

Mexico is the 12th-largest economy in the world and second largest in Latin America; however, the country continues to face major regional disparities when it comes to economic development, particularly between the richer and more industrialised north and the rural and poorer southern states.

In an attempt to boost economic growth and enhance public services in the country´s underdeveloped areas and ultimately bridge the gap between the north and south, the Mexican government decided to create Special Economic Zones (SEZs) aimed at promoting local and foreign direct investment in those areas. The government hopes the attraction of investment will to lead to job creation and a growth in production and revenues, improving both the economy and quality of life of the people in those regions.

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Background

SEZs are designated geographical areas in which business and trade regulations differ from those that prevail in the rest of the country. This special type of regime intends to promote direct investment by providing tax benefits, customs and business facilitation measures, and sometimes even financial support to investors. The creation of the first three SEZs was announced by Mexican President Peña Nieto back in September 2015 in the following regions: **Istmo de Tehuantepec Corridor**, located in the states of Veracruz (Coatzacoalcos) and Oaxaca (Salina Cruz); **Chiapas Port**, located in the state of Chiapas; and **Lázaro Cárdenas Port**, located in the states of Michoacán and Guerrero.

However, it was not until the end of September this year that the Mexican government signed the decrees that specified and delineated the areas within the regions that would be the first official SEZs and include:

Puerto Chiapas, located in Tapachula, Chiapas;**Lázaro Cárdenas-La Unión**, located at Lázaro Cárdenas Port, in the State of Michoacán; and **Coatzacoalcos**, located at the metropolitan zone of Coatzacoalcos, in the State of Veracruz).

Investors interested in setting up in the SEZs must first gain authorisation from the Mexican Ministry of Finance, which is expected to issue guidelines on the minimum investment required to operate in the areas as well as the minimum amount of employment opportunities created.

Benefits

Although more SEZs are due to be announced in the near future, the newly designated areas are expected to initiate operations on or before 30 November 2018. The most relevant benefits for Mexican individuals and entities, as well as for foreign entities with a permanent establishment for tax purposes in Mexico (beneficiaries) are as follows:

1. Income Tax: The beneficiaries will obtain a 100% discount of the income tax generated from activities performed within the SEZs for the first 10 years and 50% for the following five years. This benefit needs to be applied on a yearly basis and may not be carried forward.

An additional benefit related to income tax is a further deduction of 25% of the expenses paid for training employees working and located within the SEZ.

It should be noted that to obtain these benefits, the beneficiaries will be bound to maintain at least the same number of employees as originally recorded with the Mexican Social Security Institute (IMSS) when setting up operations in the SEZ.

An additional consideration that may be worth noting is that the beneficiaries operating under an IMMEX or maquiladora programme (ie, temporary duty free imports that are transformed into end products for exportation), will not be able to apply for the safe harbor benefit provided under articles 181 and 182 of the Mexican Income Tax Law, which generally allow companies to avoid having a permanent establishment in Mexico for tax purposes to the extent they comply with the requirements set forth under such provisions. In other words, it is most likely that a company that is resident abroad for tax purposes who is a beneficiary, will be deemed to have a permanent establishment in Mexico for its IMMEX operations.

Despite this, the companies that come under this category will have the income tax discount mentioned above, which should compensate for the lack of access to the current safe harbor benefit at least during the first 10 years of operation within the SEZ.

2. Social Security Tax: Beneficiaries will have a tax benefit consisting of an income tax credit equivalent to 50% of the employers' social security contributions made for health and maternity insurance during the first 10 years of operation and 25% for the following five years.

In those cases where the tax credit mentioned above is greater than the income tax in a given fiscal year, the company will be entitled to the corresponding refund.

3. Value Added Tax (VAT): Individuals and entities that are residents in Mexico for tax purposes, and are located outside of the SEZ, will apply a 0% VAT rate to services provided to companies located within the SEZ or to the sale of goods to companies established therein.

Also, for certain specific cases, companies established within a SEZ that pay VAT for services or the purchase of goods, will generally be able to request a tax refund for said paid VAT, provided that such services or goods are used for the benefit of the activities performed within the SEZ.

Goods transferred from a SEZ to the rest of the Mexican territory will be subject to VAT; however, certain exemptions may apply, for instance, the transfer of machinery and equipment for repair will be exempted from VAT to the extent such machinery and equipment is returned to the SEZ within the same year it was transferred. Also, goods transferred from the SEZ for exportation purposes will not be subject to VAT.

Sales, leases and services provided between and among companies located within a SEZ, or located in other SEZ will not be subject to VAT.

4. SEZ as a customs regime: The government decrees created a special customs regime for foreign or Mexican goods which will be used in authorised activities within the SEZ. These goods may remain within the SEZ for a period of 60 months. The time frame mentioned above will not be applicable to certain goods such as machinery and equipment to be used within a SEZ.

Goods introduced to the SEZ customs regime may be extracted from it to be destined either for import, export, return abroad, re-introduction to the rest of the Mexican territory, or be imported into Mexico on a temporary basis.

Likewise, goods introduced under the SEZ customs regime will neither trigger payment of import duties, nor be subject to non-tariff restrictions and regulations. Certain exemptions will apply, similar to how non-NAFTA materials used in the production of NAFTA-originating goods exported to the USA or Canada are treated, for which introduction importation duties shall be paid.

Extraction of goods from the SEZ customs regime for its introduction into Mexican territory will not be subject to excise tax on products and services (IEPS).

5. Local incentives and administrative facilitation measures: the incentives and facilitating measures to be granted by local governments will have to be enacted on or before 30 November 2017.

It should be noted that specific accounting and compliance control provisions will be applicable to companies located within the SEZ.

Challenges

It is too soon to determine whether SEZ will have a positive impact on the local economies they intend to promote. Although the benefits provided for these areas seem to be extensive, the programmes' success will also be based on the infrastructure accessible to them, the willingness of companies to establish their operations in these areas, as well as with the markets that may be served by the companies established in the SEZ. In addition, SEZs are located in areas with higher concentrations of poor and less educated or trained workforces compared to the national average, and where current conditions are precarious, so policymakers in the country must ensure they design complementary policies that help attract high quality investments and talent and achieve sustainable growth.

Their development will also have to be closely monitored to assess their effectiveness.

Having said the above, the Mexican government has announced the creation of another SEZ (a petroleum corridor) in states near the Gulf of Mexico which include Yucatan, Tabasco and Campeche. Likewise, Puebla and Hidalgo, states in central Mexico, have also expressed their interest in having a SEZ within their borders.