

## Crowdfunding: the challenge of designing new tax regulation

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**Jorge Correa, partner, and Gerardo Farías, associate, of Creel, García-Cuellar, Aiza y Enríquez provide an overview of crowdfunding activities and related tax issues in Mexico, highlighting recent regulatory changes and setting out their thoughts on how tax matters in this growing sector might be regulated in the future.**



On March 9 2018, the Mexican Congress published the Law to Regulate Financial Technology Entities (*Ley para Regular las Instituciones de Tecnología Financiera*, or the Fintech Law). The Fintech Law provides a legal regime for certain financial technology activities, including crowdfunding (*financiamiento colectivo*).

### Actors

Under the Fintech Law, the main actors in crowdfunding are:

- Crowdfunding institutions: defined as those entities that regularly and professionally bring together individuals or corporations from the public, to obtain or grant financing through electronic applications, interfaces, websites, or any other electronic or digital means of communication (Crowdfunding

Platform);

- Capital investors: defined as those individuals and entities that contribute resources to capital seekers (Investors); and
- Capital seekers: defined as those individuals and entities that have required resources through crowdfunding institutions (Seekers).

Crowdfunding institutions may qualify as Mexican residents since the principal administration of their business is in Mexico, although, Investors and Seekers could be either residents or non-residents of the country.

## Activities

Investors and Seekers may conduct, among each other, the following activities through the crowdfunding platform:

- Debt financing activities, with the aim of Investors granting loans, credits, mutual debts, or any other type of debt to Seekers;
- Equity financing activities, with the purpose of Investors purchasing or acquiring securities representing the capital of Seekers; and
- Profit-sharing financing activities, with the intent of Investors and Seekers entering into a joint venture for Investors to acquire an interest in present or future assets, or in income, profits or losses obtained from the activities or projects of the Seekers.

Crowdfunding activities must be denominated in Mexican pesos; however, crowdfunding institutions are entitled to trade with foreign currencies or 'virtual assets' (Article 30 of the Fintech Law defines 'virtual assets' as value represented in an electronic form used by the public as payment for all type of legal acts, which can only be transferred through electronic means) that are authorised by Mexico's central bank – *Banco de México* (Banxico) – through secondary regulation. At the time of writing, Banxico had not published such regulation.

## Tax implications and practical issues

The broad range of crowdfunding activities combined with the potential diversity of the Investors and Seekers may result in certain tax implications in Mexico. This generates a need, in the short term, to ensure that relevant actors will have the necessary information and documentation to duly comply with their tax obligations; and, in the medium term, to design a sound tax regime for crowdfunding in Mexico.

The tax authorities have not issued a specific tax regulation for crowdfunding activities, so actors in crowdfunding are obliged to apply the general regime set forth in tax law. This would hinge very much on (i) the actors' tax status and residence and (ii) the type of crowdfunding activity that is carried out through the platform. This situation creates several practical issues, as demonstrated in the example below:

A Mexican resident Seeker obtains a loan through a crowdfunding platform to be used for working capital needs and to purchase equipment for a new store in Mexico that will sell furniture (sale of furniture).

### VAT regime

The VAT regime on the payment of interest should be the following:

- Interest paid to a Mexican-resident Investor should be subject to a 16% VAT rate (charged by the Investor);
- Interest paid to a Mexican-resident Investor that is a financial institution should be exempt from VAT; and
- Interest paid to a non-resident Investor should be subject to a 16% VAT rate as an import of services (payable by the Seeker).

If the VAT paid by the Seeker (through the crowdfunding Platform) is fully identifiable as a VAT taxable activity (e.g. sale of furniture), the Seeker may be entitled to credit the full amount of the VAT paid (including the VAT paid on imports), provided that certain requirements are met, for example that the VAT paid:

- Relates to services that are strictly necessary for the performance of activities subject to VAT. For these purposes, 'strictly necessary' is defined as expenditure that is deductible for income tax purposes (Furthermore, Mexican tax law provides, as a requirement, that all deductions are supported by a tax receipt); and
- Has been expressly charged to the taxpayer (i.e., the Seeker) and registered separately on the relevant tax receipt.

## Required information

In this example, if the Seeker aims to claim the VAT credit, it would require:

- An allocation of the amount paid to each Investor through the crowdfunding platform, specifying: (a) the tax status of the Investor, (b) the amount of interest paid, and (c) the amount of VAT paid; and
- A tax receipt issued by each Investor for the interest received through the crowdfunding platform, which should show the VAT expressly charged and which should be compliant with all formal requirements. The tax receipt should include specific information of the Investor and the Seeker, such as their name, tax identification number, and address.

In this regard, if the relevant crowdfunding platform comprises 200 Investors and three Mexican resident Seekers, for each interest payment, there should be a mandatory exchange of 600 tax receipts. To say the least, this implies a substantial administrative burden for actors involved in crowdfunding.

While the example illustrates some practical issues from a VAT perspective, similar problems may arise with respect to income tax, as the Mexican-resident Seeker requires the tax receipt from each Investor to deduct the payment of interest. Furthermore, the Mexican-resident Seeker needs to identify the beneficial owner of the interest to determine if it should withhold income tax on the interest paid to non-resident Investors.

## Some ideas for the new regulation

Considering the above, it is crucial for tax authorities to set forth a tax regime for crowdfunding activities in Mexico. In our view, the new regulation should be designed bearing in mind the prevailing tax regime for financial services, which has been crafted to encompass factors such as (i) the large number of players, (ii) the complex interaction among such players, and (iii) the relevance of financing activities in the economy. In this sense, the new regulation could include the following:

- VAT exemption: exempt most of the activities carried out through crowdfunding platforms from VAT. Historically, financial services have been exempted from indirect taxes to prevent damaging the economy and avoid difficulties with the determination of taxes;
- Withholding tax: establish a general withholding tax (WHT), which could be implemented by the crowdfunding institution and credited by Mexican resident Investors against their annual income tax liability. At present, Mexican tax law establishes a general WHT of 0.46% on the principal amount, with respect to all interest paid by financial institutions, with certain exceptions; and
- Concentration of duties: transfer the obligation of issuing tax receipts and WHT certificates, and of disclosing tax information, to the Crowdfunding Institution through simplified procedures. This type of concentration is commonly seen in the capital markets industry, where brokerage houses are obliged to withhold taxes and prepare necessary tax information and documentation for investors.

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