

Legal Alert



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Tax Reform Initiative

On September 8, 2013 the Mexican President, Enrique Peña Nieto submitted to the House of Representatives of the Mexican Congress a bill with a substantial tax reform (Tax Reform)

This Tax Reform proposes, in general terms, the following changes and additions (among many other important topics that will be included in a subsequent alert):

Income Tax

- Incorporates the definition of "maquila operation" for purposes of providing a permanent establishment protection to maquiladora companies, although now requires that such companies must export at least 90% of their total sales.
- Maquiladoras would have to comply with their transfer pricing obligations by following the Safe Harbor provisions or by securing an advanced pricing agreement (other options are no longer applicable for maquiladoras).
- Limits the deduction of exempt salary and wage payments.
- Harmonizes the base to calculate the profit sharing with the taxable base for purposes of the corporate income tax (although the net operating losses of previous years and the paid profit sharing cannot be reduced from the base of the current year for purposes of calculating the profit sharing).
- Eliminates the tax consolidation regime, establishing a transitory regime. A new optional regime would be available with a deferral for a term of three years.
- Creates an additional 10% income tax on the payment of dividends for payments to individuals and non-residents.
- Subjects the capital gains from the stock market to a 10% tax rate.
- Provides a new mechanism to calculate the tax basis of shares to determine the gain on sale of shares in Mexico.
- Eliminates the possibility to elect to consider only the portion of the price that is collected in installment sales as income obtained in said period.
- Corporate income tax on individuals earning more than five hundred thousand pesos will be subject to a tax rate of 32%.
- Prohibits the deduction of payments to related parties

when such payments are not subject to taxation or to a tax lower than 75% of the income tax that would otherwise be paid in Mexico.

- Creates new mechanisms for the crediting of corporate income tax paid in other tax jurisdictions.
- Eliminates the immediate deduction on investments and land acquisition for real estate developers.
- Proposes to eliminate the deduction of estimated expenses on construction activities.
- In the case of the application of a tax treaty benefit, the initiative imposes the right for the Mexican tax administration to request information to the non-Mexican resident if the income payment that is covered by the benefits of the tax treaty will be taxed in the country of the non-Mexican resident.
- Proposes a new article that will rule the Mexican source income received by non-Mexican residents on constructions, installation and maintenance services.
- Eliminates provisions applicable to SIBRAS.

Value Added Tax (VAT)

- There is no VAT on food and medicines.
- Maintains the VAT exemption on medical services and urban transportation.
- The VAT on the border regions is increased from 11% to 16% in order to have the same tax rate nationwide.
- Eliminates the VAT exemption on sales between non-Mexican residents and from a non-Mexican resident to a maquiladora company, a bonded warehouse or a strategic tax precinct.
- Imposes value added tax on temporary imports from maquiladora companies, and from bonded warehouses, tax precincts and strategic tax precincts.
- Eliminates the withholding obligation on sales from domestic suppliers to automobile OEMs and maquiladora companies.
- Eliminates the 0% rate on hospitality services and ancillary services for foreign tourists.
- Eliminates the 0% rate on the sale of: (i) chewing gums, (ii) processed food for pets and, (iii) gold, jewelry, and other products if they are not sold on retail to the general public.
- Subject to value added tax the purchase and sale, as well as on the lease of homes, on interest payments for home mortgages, and of tuition of private schools.
- Subjects to VAT the tickets for public events, although it maintains the VAT exemption for theater and circus presentations.
- Allows the States of Mexico to tax the public events, other than movie theaters. The limit for theater and circus presentation would be 8% of the total income.

Single Rate Tax (IETU) and Cash Deposit Tax

(IDE)

- Repeals the Flat Tax Law (IETU, for its acronym in Spanish), and the Law on Cash Deposits Tax (IDE, for its acronym in Spanish).

Special Production and Services Tax (IEPS)

- Includes the sale of soft drinks as taxable activity.
- Maintains the tax applicable of 26.5% on the sale and on the importation of beer with alcohol up to 14 G.L. Harmonizes to this rate the alcoholic beverages with the same alcoholic grade.
- Imposes the application of the tax on the temporary importation when the taxed goods are utilized by maquiladoras, fiscal deposits and tax precincts.

Green Tax

- Imposes a tax on the sale and importation of fossil fuels, according to their carbon content.
- Imposes a tax on pesticides.

Federal Tax Code

- Includes an anti-abuse clause for tax planning.
- Includes the authority of the Tax Administration to request information through electronic means, during a refund request process or a tax audit, not conducted in the tax domicile.
- Clarifies that the joint responsibility of shareholders and partners will be limited to the level of their participation in the capital stock.
- Includes as joint responsibility on executors or representatives of an inheritance.
- Provides a limitation for the tax authority for provisional seizure of goods (i.e. seizure or freeze of bank accounts).
- Provides new rules to determine a possible tax crime by a legal entity.

The above is a limited list of some of the main issues contained in the reform. In the following days we will be preparing a more detailed list.

Please note that the initiative was sent to the House of Representatives of the Mexican Congress of the Union to be discussed and, as the case may be, sent to the Senators Chamber for subsequent deliberation and approval. If the bill is approved, it shall be sent to the Mexican President for final approval and publication in the Official Gazette.

Although this is only a summary of the bill to be discussed in the House of Representatives, we will organize, throughout our B&M

offices, seminars to highlight the main topics of this bill. Our Firm will keep you duly informed on the development of this relevant matter.

At Baker & McKenzie we are committed to share valuable information with our clients and friends.

Let us know if you should have any questions or comments in connection with the foregoing or if you would like to schedule a conference call or a meeting to discuss a given specific topic or topics of the proposed tax reform.

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