ACA proposed regulations on minimum value, premium tax credits help employers with health plan duties for 2014

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In brief

Yesterday the Executive Branch of the Mexican government presented its 2014 Tax Reform package to Congress. The package's most significant proposals would eliminate the tax consolidation regime, eliminate the Flat Tax (IETU), provide a more limited maquiladora regime, retain the 30% income tax rate without reduction, introduce a new corporate-level tax on dividends, limit the deduction of certain related party payments, and eliminate the statutory audit (*dictamen fiscal*) requirement.

In detail

The following summarizes the package's most salient aspects:

Income tax law

- A new income tax law would: (1) eliminate tax consolidation, special regimes applying to instalment sales, and tax benefits applicable to Real Estate Investment Entities (SIBRAS); (2) impose an additional corporate-level tax on dividends paid by Mexican entities to resident individuals or foreign residents (including foreign corporations) at a rate of 10%; (3) impose a 10% income tax on capital gains realized in connection with the sale of shares listed on the Mexican stock exchange (which are currently exempt); and (4) maintain the current 30% corporate income tax rate by repealing the scheduled reduction to 28%.

- No deduction would be allowed for related party payments abroad that are subject to an effective tax rate that is less than 75% of the Mexican corporate income tax rate.

- Deductions for accrued pension costs would be deferred until paid.

- Deductions for donations to the government would be available up to 4% of the prior year taxable income, and other donations remain limited to 7% of prior year taxable income.

- Deductions for tax-exempt salaries and benefits would be limited to 41% of such tax-exempt amounts.

- The employee share of social security contributions (funded by the employer) would not be deductible.

- The deduction for business automobile purchases would be limited to $130,000 pesos without VAT and, for rental cars, the deduction would be limited to $200 pesos per day.

- Meals/restaurant expenses (other than for travel meals) would not be deductible.

- Itemized deductions for individuals would be limited to the lower of 10% of the gross income or an amount equal to two times the annual minimum salary.

Tax consolidation regime

- The existing tax consolidation regime would be repealed effective January 1, 2014.
- The proposed law provides two options to calculate the deferred tax benefit that the deconsolidation would trigger, and the income tax associated with the triggering of such deferred items would be payable over a five-year period (from 2014 to 2018).
- Taxpayers may elect to apply for a new simplified tax consolidation regime as a substitute for the existing regime. The new regime would allow a three-year income tax deferral period.

Maquiladora regime

- A new more limited definition of "maquila operation" would be introduced. The new rule would require 90% of total revenues to be derived from exports in order for existing permanent establish protection and other favorable tax rules to apply. This would impose several restrictions on maquiladora structures that have significant domestic sales.
- Foreign residents with “shelter maquiladora” operations in Mexico would continue to have permanent establishment protection for three years. This regime would be reviewed at the end of such period.
- Maquiladora entities would not qualify for the new simplified consolidation taxation regime.
- Temporary imports under IMMEX and other similar programs would be taxed at the 16% VAT rate. A new financing program would be developed to aid maquiladoras facing cash-flow challenges.
- Sales of goods located in Mexico, between foreign residents or between a foreign resident and a maquiladora, would be taxed at the regular 16% VAT rate (currently zero rated).
- Maquiladoras would no longer withhold VAT on domestic suppliers, which could have a negative impact on their cash flow.

Flat tax and tax on cash deposits

- The flat tax and the tax on cash deposits would be repealed.

VAT and excise tax provisions

- The current 11% VAT rate applicable in the border area would increase to 16%.
- Mortgage interest, the sale of personal residences, tuition, chewing gum and pet food would now be subject to the general 16% rate.
- Medical services and city transportation would continue to be exempt from VAT.
- Excise tax would apply to fuels and pesticides.
- To discourage obesity, a specific excise tax of one Mexican peso per liter would apply to soft drinks.

Universal retirement pension law

- A new Universal Retirement Pension Law proposal would provide a monthly pension of $1,092 pesos, fully financed by the Federal government. This pension would be available for Mexican residents upon reaching 65 years of age beginning in 2014 (non-residents would qualify if they are Mexican residents for at least 25 years). Such residents would qualify for the pension when they are registered in the National Population Registry and when they receive monthly income of less than fifteen times the minimum wage (approximately $900 pesos).
- In addition, the Social Security Institute and the Social Security for State Workers Institute would administer and operate the unemployment insurance. This benefit would be granted for a five-year period. The unemployment insurance would be funded by a government subsidy and a mandatory employer contribution equal to 3% of salary and benefits.

Federal tax code

- The Mexican tax authority would receive additional audit powers.
- The proposed law would repeal the obligation to prepare statutory tax audit reports (dictamenes fiscales).
- A new rule would impose monthly accounting reporting obligations.
- The law would require an annual tax status report for corporate taxpayers, the rules for which would be established by the tax authority. This new status report would be due by June 30 after the calendar year end, and failure to file or late filing of such report would result in penalties.
- The tax reform would incorporate a procedure for the Mexican tax authority to impute taxable income and/or re-characterize transactions in certain cases.
- The tax authorities would have expanded powers for situations in which the taxpayer does not establish business purpose where Mexican taxes have been avoided – specifically when there is insufficient business purpose to justify a quantifiable economic benefit for the taxpayer.

Mining royalty

A fee for mining rights would be charged at the rate of 7.5% of net profits.

Legislative process

The provisions of the Tax Reform package will be debated by the Mexican Congress during September and October, and the reform is expected to be approved (either in its current form or with amendments) by October 31, 2013. The effective date of a final tax reform law (if passed and published in the Official Gazette) would be January 1, 2014.

The takeaway

There are several significant proposals in the 2014 Tax Reform package. As such, multinationals with affiliates or other investments in Mexico should consider and model the potential tax impact of the proposed provisions on their businesses. Those multinationals that file on a consolidated basis in Mexico should immediately model the impact of a potentially imminent deconsolidation event, and should evaluate approaches to potentially mitigate any such effects prior to December 31, 2013. In addition, multinationals that are currently utilizing the maquiladora regime should assess the impact of a more limited regime on their value chain structures. Finally, companies should assess the potential impact of the new 10% dividend tax from a tax accounting and foreign tax credit perspective.

Let's talk

To discuss how these issues might affect your business, please contact:

Mauricio Hurtado
Tax and Legal Services Leader PwC México
mauricio.hurtado@mx.pwc.com
+52 (55) 5263 6000

Mexico City
Jose Alfredo Hernandez
jose.alfredo.hernandez@mx.pwc.com
+52 (55) 5263 6060

Southwest
(Cancun, Merida, Puebla, Veracruz, Villahermosa)
Pedro Carreon
pedro.carreon@mx.pwc.com
+52 (55) 5263 6068

Northeast
(Monterrey, Tampico, Torreon)
Fausto Cantu
fausto.cantu@mx.pwc.com
+52 (81) 8152 2000

West and Bajio
(Chihuahua, Ciudad Juarez, Guadalajara, San Luis Potosi, Hermosillo, Leon, Los Cabos, Mexicali, Queretaro, Tijuana)
Raul Sicilia
raul.angel.sicilia@mx.pwc.com
+52 (33) 3648 1000

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