

FEDERAL GOVERNMENT REVENUE LAW

DECREES MODIFYING VARIOUS TAX LAWS

As a consequence of the bill submitted by the Executive Branch of the Mexican Government to the Congress, several federal tax laws were amended. The most significant changes are those related to the payment of income tax deferred as a result of the consolidated income tax regime; the elimination of the so called negative credit of the business flat tax against income tax; an increase in the income tax rate from 28% to 30%; an increase in the value added tax rate from 15% to 16%; a broadening of the basis and an increase in the tax on cash deposits from 2% to 3%; and various other amendments that increase the rates applicable to items subject to the special tax on production and services among which stand out the rates applicable to the sale of cigarettes and beer and the rendering of certain telecommunication services.

The comments set forth in these Tópicos Fiscales might not be shared by the tax or judicial authorities. Therefore, they should not be considered as professional advice, since any particular case should be analyzed on its own merits.

As in previous years, we remind our readers that the tax amendments discussed herein and their corresponding supplementary transitional provisions render null and void any administrative provisions, rulings, authorizations or permits, whether of a general or private nature, that contravene the currently amended provisions. In view of this situation, it is advisable to carefully review any private ruling or authorization that companies may have received in order to make sure that they are still in force.

It is noteworthy that the amendments delete any provisions that grant full or partial exemptions, that consider parties exempt from taxes or that establish preferential or differential treatments with respect to revenue or fiscal contributions, other than those established in the Federal Fiscal Code, presidential decrees, international treaties and the laws that impose such fiscal contributions and their corresponding regulations, except where a transitional provision provides otherwise.

In view of the foregoing, we recommend that interested parties review any general or private provision that are favorable to their interests in order to verify the validity thereof.

Below we comment on various aspects of the tax reform that we consider most significant; however, we recommend that a detailed review be made of the amended laws in order to identify any specific issues that may be of interest to our readers or that may apply to specific cases. Our comments are presented in accordance with the following

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INCOME TAX LAW

Tax consolidation regime

The amended provisions restrict to a five-year period the deferred tax benefit arising from the consolidation. It is now required that any tax deferral derived from the consolidation may only be enjoyed during a five-year period; consequently, upon completion of the fifth year, the taxpayer is required to reverse the events that gave rise to the tax deferral generated in the first year of such five-year period. The resulting amount shall be paid jointly with the tax due in the annual consolidated income tax return that should be filed for the fifth year.

Until tax year 2009 the obligation to pay the tax that would be due, such as when the taxpayer had not chosen to file a consolidated income tax return, would be triggered in the following situations:

- a) When a controlled company quits the consolidation (hereinafter referred to as disincorporation), or when the group withdraws from the consolidation (hereinafter referred to as deconsolidation);
- b) When the participation in a controlled company's equity varies;
- c) When the shares of a controlled company are sold or disposed of outside the group;
- d) When a tax loss carryforward of an entity, which was utilized to determine the consolidated tax result or loss is not utilized individually by such entity.

Beginning in 2010, the tax should be paid in advance after five years have elapsed notwithstanding that any of the abovementioned events have materialized. The law identifies the tax effect arising from the consolidation as a "deferred tax", which differs from the accounting definition of deferred items that result from the comparison between temporary and permanent items.

As a result of this new payment obligation, the deferred tax should be remitted to the tax authorities when the situations referred to in a) to d) above materialize, or when five years subsequent to the date on which deferral took place have elapsed, whichever occurs first.

The law contemplates two procedures to determine the deferred tax:

- a) The first consists of the application of the procedure set forth in the law when there is a disincorporation or a deconsolidation; however, this procedure might give rise to various controversies and generate distortions for certain taxpayers that would double or even triple the deferred tax payment. These distortions have been eliminated through rules set forth in the Miscellaneous Tax Resolution (hereinafter referred to as Miscellaneous Resolution); nevertheless, the application thereof as of tax year 2010 for determining the deferred tax is not clear.

- b) The taxpayer may opt for a calculation that eliminates some of the distortions generated by the procedure for disincorporation or deconsolidation previously described because in some manner it includes the provisions set forth in the Miscellaneous Resolution; however, the application thereof might give rise to other distortions in the calculation of the deferred tax.

The deferred tax should be calculated separately and independently from any result or tax loss incurred by the controlling company. For this purpose, taxpayers should recognize separately the items that give rise to the so called deferred tax and are not allowed to consider for purposes of this procedure the consolidated result or tax loss determined in that tax year.

Retroactivity

We consider that the amendments to the consolidation regime clearly violate the guarantee of non-retroactivity of the law because these amendments obligate taxpayers to pay the so called deferred tax despite the fact that the presumptions established for this purpose did not arise at the time the option to consolidate for tax purposes was exercised.

Eventhough in the legislative proceedings it was argued that the reforms are constitutional on grounds that the optional regimes, such as the tax consolidation, are not susceptible to challenge, we consider that such argument is not sufficient to justify the violation previously mentioned, since the amendments affect situations that evidently occurred before the amendments entered into effect.

Additionally, we consider that the procedures established for determining the supposedly deferred tax give rise to various distortions that might violate the constitutional guarantees of proportionality and equity in taxation.

With respect to the optional procedures set forth in the law for calculating the deferred tax, it is worth pointing out, before choosing any method, that the taxpayer should analyze the legal consequences arising thereof such as, among others, the inclusion of items that, in principle, it is not necessary to consider.

In many instances, the change in the regime will also cause the appearance of liabilities in the financial statements of the controlling companies, including tax year 2009, thus modifying the relationship of the financial ratios and equity with the resulting legal and financial repercussions, particularly in the case of public companies.

Deferred tax since 2005

The amended provisions require payment of the deferred tax by the controlling company in each tax year of the deferred tax period that corresponds to the sixth preceding year, not paid as of December 31 of the tax year immediately preceding that in which such payment should be made.

The amended provisions establish that the deferred tax payable should be calculated in accordance with the procedure set forth in the law for determining the effects of a disincorporation or deconsolidation, or the sum of those resulting in accordance with the new procedure; the option chosen should be applied for a minimum period of five tax years.

The deferred tax should be paid in five tax years as follows: 25% in the first and second years, 20% in the third year and 15% in the fourth and fifth years.

The deferred tax payable should be restated for inflation from the month in which it would have been paid if there have been no consolidation to the date the return for the fifth year should have been filed. In the case of the tax payable from the second to the fifth tax year, the tax should be restated for inflation from the month in which the first payment was made to the month immediately preceding that in which the corresponding partial payment should be made.

Deferred tax as of December 31, 2004

In tax year 2010, there is the obligation to calculate and pay the tax deferred as of December 31, 2004 not paid on December 31, 2009. The procedure for calculation thereof is set forth in the transitional provisions of the law.

The deferred tax must be determined in a cumulative manner from the date a group began to consolidate for tax purposes up to December 31, 2004.

The deferred tax shall be paid as follows: 25% in June 2010, 25% in April 2012; 20% in April 2013 and 15% in April 2014 and April 2015.

For determining the deferred tax at December 31, 2004 taxpayers should apply the procedure set forth in the law for the case of a disincorporation or deconsolidation, or optionally apply the procedure established in the transitional provisions.

In the event taxpayers apply the procedure set forth in the law, as commented with respect to the determination of the deferred tax as of tax year 2005, it would be advisable for the tax authorities to confirm whether taxpayers may apply the procedure set forth in the Miscellaneous Resolution for the case of a disincorporation or deconsolidation, thus avoiding doubling the calculation of the deferred tax.

Taxation of interest

The amended provisions establish a new procedure for the taxation of interest earned by Mexican residents that will take effect in 2011. For purposes of calculating the tax, it is necessary to determine an amount of "positive real accrued interest" by considering all accounts and financial assets maintained by the taxpayer in financial institutions (entities that make up the financial system). The financial institutions will be required to calculate and withhold this tax from Mexican residents.

Resident individuals are required to calculate and pay this tax when they have deposits abroad or are the beneficial owners of interest on loans granted to non-residents.

This new procedure is also applicable to resident individuals that have interest-bearing accounts or investments with companies that are not part of the financial system or that earn interest from not-publicly traded credit instruments (unlisted instruments). In this case, individuals are required to calculate the tax and make monthly payments, which are final.

Residents abroad

The tax reform establishes a new procedure for interest received by residents abroad that invest in shares of debt instrument or in variable income investment companies whereby gains realized on the sale of these shares are determined after considering only the proportion of the investment portfolio consisting of taxable debt instruments. For this purpose, a comparison should be made of the sale price of the shares in question with the weighted average cost of acquisition thereof.

Under the new procedure, it is necessary to determine a weighted average cost of acquisition that must be recalculated on the date the resident abroad acquires shares. This weighted average cost of acquisition is not subject to restatement for inflation. This means that non-residents will be taxed on nominal interest received.

Tax rate schedule

Provisions temporarily in force establish that in tax years 2010 to 2012 the tax rate applicable to resident legal persons shall be 30%; however, they indicate that in tax year 2013 the tax rate shall be 29% and will be brought back to 28% in 2014. These same rates will apply in these years at the top bracket of the tax rate schedule for resident individuals.

Residents abroad

In the case of income from a Mexican source obtained by residents abroad, the law establishes several presumptions so that when the taxpayer chooses to be taxed on a net basis, the tax rate is that applicable to top bracket income of the tax schedule for Mexican resident individuals.

Consequently, when the afore-mentioned option is exercised, the tax rate will be 30% from 2010 to 2012; 29% in 2013 and will be brought back to 28% for 2014 and subsequent years.

Deduction of charitable contributions made abroad

As stated in the Preamble to the Tax Reform Act, in reciprocity with the assistance that Mexico receives from various international organizations, the law includes the possibility of treating as deductible any charitable contributions made by individuals

and legal entities to international organizations of which Mexico is a member with full rights, provided that the objectives of such organizations correspond to activities treated as eligible for authorized charitable deductions for Mexican taxpayers.

Residents Abroad

Sale or Disposition of shares

A provision previously contained in the Revenue Law is now included in the Income Tax Law, whereby financial entities resident abroad, in which the Mexican Government participates, may opt to apply the corporate tax rate on the gain realized on the sale or disposition of shares instead of applying a 25% rate on the gross amount, subject to compliance with certain formal requirements.

Debt-related financial transactions

The amended provisions establish that the taxable basis in debt-related financial derivative transactions settled in cash shall be the gain realized, not the taxable interest.

Withholding at the 4.9% rate

In tax year 2010, an income tax provision in effect for one year, establishes that interest paid to non-resident banks registered with the Tax Administration Service (including investment banks), will continue to be subject to a 4.9% withholding rate provided that the beneficial owners thereof are residents of a country with which Mexico has entered into a treaty for the avoidance of double taxation, currently in force, and the requirements set forth in the treaty are met.

VALUE ADDED TAX LAW

Tax Rates

Beginning January 1, 2010, the tax rate is 16% instead of 15% and 11% instead of 10% in the case of activities carried out therein by residents in the border region of Mexico.

Transitional Provision

A transitional provision provides that the amount of the consideration derived from acts or activities consisting of the sale of property, the rendering of services, or the granting of the temporary use or enjoyment of property carried out before January 1, 2010 and collected in 2011 will be taxable at the new rates, except in the following cases:

- a) In the case of the sale of property and the rendering of services between non-related parties, the tax may be paid at the rates in effect in 2009 provided that the property was delivered or the services rendered before January 1, 2010 and payment of the related consideration is made within ten natural days counted from January 1, 2010.

- b) In the case of the granting of the temporary use or enjoyment of property, the consideration that corresponds to tax year 2009 will be subject to the tax rates in effect in that tax year, provided that the property was delivered before January 1, 2010 and payment of the related consideration is made within ten natural days following January 1, 2010.

TAX ON CASH DEPOSITS LAW

Beginning January 1, 2010, the tax rate will be 3% instead of 2% on the full amount of taxable cash deposits, in Mexican or foreign currency, in all the accounts that the taxpayer has with the Mexican financial system.

As of January 1, 2010, the monthly amount not subject to payment of this tax will be Ps 15,000 instead of Ps 25,000 per institution of the financial system.

BUSINESS FLAT TAX

The Revenue Law for tax year 2010 provides that taxpayers will not be entitled to apply the credit determined in those cases in which the deductions exceed revenues, against the income tax liability of the same tax year; however the possibility of claiming the credit against the business flat tax within the following ten tax years is still available.

Beginning January 1, 2010, the business flat tax rate will be 17.5% instead of 17%, as per the temporary provisions included when the law was enacted.

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