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Bill of Tax Amendments for 2014

On September 8, the Executive branch submitted a tax bill to the Mexican Congress which contains several relevant amendments to the federal tax laws currently in force. If approved, the proposed amendments would apply in 2014.

The objective of this summary is to provide our clients with general information to assist them in timely identifying whether these amendments may require any specific course of action in connection with their operations in Mexico, prior to the enactment of the proposed modifications. The proposed bill for tax year 2014 will be subject to discussion and approval by the Mexican Congress, and thus the information contained herein may be subject to change.

Some of the most important modifications that are being proposed are the following:

Income tax

- Mexican residents

Although the current Mexican Income Tax Law would be substituted by a new law in its entirety, most of the provisions of the current law are reorganized and maintained in the bill. Under the proposed bill, the corporate income tax rate would be maintained at 30%. However, it is proposed that an additional 10% income tax be established in respect of the dividends distributed to individuals or non-residents. Such dividend tax would be payable by the company distributing the dividends, and thus it would not be a withholding imposed on the shareholders.

The proposed bill also eliminates several tax incentives for Mexican corporations, such as: (i) the accelerated tax depreciation for investments; (ii) the immediate tax deduction of land and the deduction of estimated costs for real estate developers; (iii) the deduction of estimated expenses for long term assets and contractors; (iv) the special deduction of reserves for financial and insurance institutions; (v) and the special regime applicable to real estate investment entities (SIBRAS) with a limited transition regime; among others. Additionally, the regime applicable to real estate investment trusts (FIBRAS) would be modified in order to restrict the possibility of obtaining variable rental compensation under the lease agreements executed by these vehicles.

Also, the Executive branch is proposing to limit certain deductions for corporations, such as salaries and other remunerations that qualify as exempt income for employees, and payments to related parties whose income is subject to a preferential tax regime (tax haven).

The proposed bill would also eliminate the tax consolidation regime and thus certain rules are provided in order for those groups currently filing consolidated tax returns to pay the income tax that has been deferred over time. Payment would be made during a five-year period under either of two procedures provided by the new law. In lieu of the consolidation rules, a new system that allows a "group-taxation" would be incorporated. This system would allow for a three-year income tax deferral for Mexican qualifying groups.

Modifications to the Income Tax Law would also include amendments to the foreign tax credit system, which would now include baskets per foreign country, among other changes.

It is proposed that the basis computed for purposes of the employees' profit sharing be the same as that used to determine the income tax payable, except for the possibility to use net operating losses to reduce the basis.

In the case of income tax benefits established for Mexican companies operating under the "*maquiladora*" regime, which result in lower taxes payable and the absence of a permanent establishment for the non-resident principal, it is proposed that they be limited to industrial "*maquiladoras*" exporting the majority of their production as defined by the new law.

- Mexican-source income of non-residents

It is proposed that the 4.9% withholding tax rate applicable to Mexican-source interest payments made to banks who are residents in a treaty country be included in the new Income Tax Law. Such rule would be valid during 2014, and it would be subject to the compliance of all requirements established in the corresponding tax treaty for such interest payments.

Sales of shares undertaken by non-residents through the Mexican Stock Exchange would no longer be exempted (consistent with the proposed regime applicable to Mexican-resident individuals). Instead, a 10% income tax would apply on the gains obtained, as determined by the broker dealers participating in the transactions.

Also, the proposed bill establishes that in order for the foreign pension and retirement funds (or the Mexican resident companies in which they participate) to be exempt from income tax in respect of the gains arising from the sale of real estate, the properties should have been leased during a period of at least four years (instead of the current one-year term).

Additionally, it is proposed that the Income Tax Law establishes that Mexican entities in which pension and retirement funds participate be entitled to exclude foreign exchange gains and the taxable adjustment for inflation derived from the loans contracted to acquire real estate property, in determining the proportion of rental income required for applying the income tax exemption.

In the case of non-residents seeking to apply the benefits of a tax treaty, new informative returns would need to be filed as proposed in the new law. Also, it is established that the tax authorities may request the non-resident taxpayer to prove that the income received is also subject to taxation in its country of residence, when dealing with transactions among related parties.

Value added tax (VAT)

The proposed bill includes the elimination of the 11% rate currently applicable in the cases of transactions undertaken with the so-called border region, by residents thereof; instead, the 16% rate would generally apply.

Also, the proposed modifications to the VAT Law include the repealing of several exemptions, including those applicable to certain foreign trade transactions (such as those carried out by entities with an IMMEX program), as well as those applicable to interest and commissions derived from loans granted for the acquisition of housing, to the sale and leasing of housing, and to payments related to educational services, among others.

Other amendments

The bill submitted to the Mexican Congress also proposes the following amendments that we consider may have an impact on how businesses are made in Mexico:

a) The business flat tax (commonly known as IETU) and the tax on cash deposits (IDE) would be repealed on January 1, 2014.
b) Additional excise taxes would be established in respect of sugar-based beverages, as well as environmental taxes on the sale and importation of fossil fuels and pesticides.
c) A general anti-avoidance rule would be included in the Federal Tax Code that would empower the tax authorities to re-characterize transactions in cases where the tax authorities consider there was an abuse of law.

d) The elimination of the statutory CPA report on both the financial statements and tax obligations of Mexican resident corporations *(dictamen fiscal)* would apply starting 2014.

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Mexico City
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