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Tax Consulting

2013-7

Bill of Tax Amendments for 2014 approved by the Lower House of the Mexican Congress

The Bill of Tax Amendments submitted by the Executive Branch to the Mexican Congress was approved by the Lower House of the Mexican Congress including some relevant changes that were included to the original bill. The revised version is now being analyzed and discussed within the Mexican Senate, and it is expected that it will be approved in the following days with only minor changes.

This Tax Flash includes a general description of the changes approved by the Lower House of the Mexican Congress to the bill of tax amendments for 2014 that we consider most relevant for our international readers investing in Mexico. The objective of this summary is to provide our clients with information to assist them in timely identifying whether these amendments require any specific course of action in connection with their investments in Mexico, prior to the enactment of the proposed modifications.

Since the bill is now being discussed within the Senate, the information contained in the bill that is herein described may be subject to change.

Income tax

Mexican residents

- Corporate tax rate and dividend taxation

The Lower House agreed that the corporate tax rate of 30% on taxable income generated by Mexican corporations in a fiscal year should remain unchanged.

However, the Executive's proposal to include an additional corporate tax of 10% on dividends distributed by Mexican companies that would apply only when the recipients of the dividends or profits are either Mexican resident individuals or non-residents, was modified to substitute such proposal by a 10% income tax withholding.

Indeed, the Lower House considered that a 10% withholding tax should be triggered on dividends distributed by Mexican corporations and paid to individuals resident of Mexico and non-residents in general (individuals or corporations). This new tax on profit distributions also applies to the distributions made by permanent establishments in Mexico to their head office or to another permanent establishment.

If approved by the Senate, and considering that this tax would be collected via withholding, the reduced withholding rate provided by a relevant treaty could be applied directly by the withholding agent, whenever such treaty indeed provides relief under the applicable rules, and all requirements to benefit from such treaties are met.

A transitory provision is proposed to establish that this 10% income tax withholding will apply only to profits generated beginning 2014. For these purposes, the transitory provision establishes that Mexican legal persons or permanent establishments in Mexico will be obligated to keep a net after-tax profit account (CUFIN) as of December 2013, and create a new CUFIN account starting 2014. Otherwise, all profits would be subject to the new 10% withholding.

However, this transitory provision is not clear as to whether the distributions made by a Mexican corporation to another Mexican corporation from the 2013 CUFIN account will increase the 2013 CUFIN account of the company receiving the dividends, as under the current wording any such distribution would increase the CUFIN account of the recipient at the time the dividend is received.

- Base Erosion and Profit Shifting rules (BEPS)

The proposal to prohibit the deduction of payments made to related parties in Mexico or abroad that are not taxed, or who are subject to a tax lower than 75% of the income tax that would be payable in Mexico, which was included following the OECD project referred to as BEPS and was intended to prevent multinational companies from artificially relocating profits, was amended by the Lower House. The new version only applies to specific type of payments (interest, technical assistance and royalties), and only to the extent some tests related to having effective control and whether the item of income is taxable for the non-resident or the participants in the case of transparent vehicles, are complied with.

In addition to the limitation above, the Lower House agreed to include that payments made by a Mexican resident and which are also deducted by a related party either resident in Mexico or abroad are non-deductible, but only when the related party deducting the payment does not also recognize the income of the first-mentioned Mexican entity in the same fiscal year or the subsequent year.

- Tax consolidation

The Lower House approved the proposal to eliminate the tax consolidation regime, as well as the rules provided in order for those groups currently filing consolidated tax returns to pay the income tax that has been deferred over time. However, it included amendments to the procedure provided in the transitional provisions, which are aimed at determining the amount of the deferred income tax arising from the tax consolidation regime, in order to avoid distortions that implied double or triple counting of the deferred tax effects.

Also, the Lower House included an additional transitory provision which establishes a new optional procedure to compute the income tax that has been deferred over time.

The Lower House also passed the new optional regime for groups of companies that would allow the deferral of taxable income generated by each of the companies integrating the related group for 3 tax periods; the tax so deferred would be payable on the same date on which the return for the tax year following the aforementioned 3 tax periods is due.

- Toll-manufacturing "Maquiladora" companies

In the case of the maquiladora preferential tax regime, the Lower House considered that the proposed changes should be approved and thus, the definition of maquiladora should change for income tax purposes; now, these entities may only qualify as such whenever all of their income deriving from their activity corresponds to their maquila operation, and to the extent other requirements are met, such as utilizing fixed assets furnished by the non-resident.

Additionally the Lower House agreed to only including one of the alternatives to determine the income tax available, consisting of applying the "safe harbor" method of transfer-pricing.

- Other relevant changes

the Lower House approved the Executive's proposal of eliminating certain authorized deductions and tax incentives for Mexican corporations, such as: (i) the accelerated tax depreciation for investments (one-time depreciation deduction); (ii) the special deduction of reserves for banks;

and (iii) the special regime applicable to real estate investment entities (SIBRAS/Mexican REITS) 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.

However, the proposal to eliminate the following tax incentives was rejected: (i) the immediate tax deduction of land and the deduction of estimated costs for real estate developers; (ii) the deduction of estimated expenses for long-term assets; and (iii) the special deduction of reserves for insurance and bond institutions.

In the case of exempt compensations paid to employees (mandatory year-end bonus, overtime extraordinary compensation, welfare expenses, etc.), employers may only deduct up to 47% of the exempt compensation paid to employees instead of the 41% proposed by the Executive Branch.

Regarding the proposal to amend the foreign tax credit computation procedure, the Lower House approved the corresponding amendments which would now include baskets per foreign country, among other changes.

The Executive Branch proposal consisting on determining the basis for purposes of the employees' profit sharing under the same rules as those used to determine the income tax basis was approved; however, the possibility to reduce the basis by fully deducting the tax-exempt compensations to employees was incorporated.

Non-residents

When increasing the top bracket applicable to Mexican individuals to 35%, the Lower House also increased the general withholding rate applicable for non-residents obtaining Mexican source income, who are eligible for the application of the tax on their net gains. However, bear in mind that this rate may be reduced through the application of the Tax Treaties in effect.

- Tax on gains from sale of shares traded on the Mexican Stock Market

The Lower House agreed with the Executive on the imposition of a 10% tax to non-residents that realize gains through the Mexican Stock Market, as a result of the sale of shares of stock issued by resident or non-resident companies traded on such market. However, residents of a country with a Tax Treaty may benefit from other rates or may be exempt of this tax in some situations, in which case they will need to make a representation (under oath) to the financial intermediary to avoid the 10% withholding rate.

- Foreign pension funds

In the case of the foreign pension and retirement funds who are exempt in their country of residence and who enjoy a Mexican income tax exemption on certain items of income, the Lower House agreed with the proposed changes submitted by the Executive, including those regarding the extension of the minimum rental period of the immovable property that is required (directly or indirectly) to a four-year period, instead of the one-year period currently in effect. There is no transitory provision regulating this increase.

Also, the Lower House agreed to include in the Income Tax Law that in computing the required qualifying rental income for Mexican corporations in which such pension and retirement funds participate to be exempt, exchange gains and monetary income (adjustment for inflation) should not be included.

Furthermore, the Lower House agreed to eliminate the registration obligation for these pension and retirement funds, or the vehicles through which they invest in Mexico.

Considering that Mexican corporations in which these pension and retirement funds (and vehicles through which they invest in Mexico) hold a participation may enjoy a full exemption, in the proportion of the participation of such funds and provided certain requirements are met, it stands out that they did not include a rule eliminating the 10% withholding tax on dividends that would apply when the Mexican corporation distributes dividends to pension funds that qualify for the aforementioned exemption. If this distortion is not modified, it could imply that the pension and retirement funds will no longer be fully exempt in respect of the rental income earned through Mexican corporations.

- Treaty benefits

The rule proposed by the Executive Branch intended to avoid the double non-taxation of income, by applying the benefits of the treaties for the avoidance of double taxation entered into by Mexico, was approved by the Lower House for transactions between related parties. In these cases, the tax authority may request the non-residents to produce information on the provisions of foreign law, in order to verify the existence of double taxation that would justify the application of treaty benefits.

- Other relevant changes

In the case of Mexican source interest income received by non-resident banks, the Lower House agreed to renew the applicability of the 4.9% income tax withholding rate, provided that such banks are the beneficial owners of the interest in question and reside in a country with which Mexico has a treaty in effect for the avoidance of double taxation. Also, the Lower House passed the proposal to eliminate the registration obligation for non-resident banks to be eligible for this reduced rate.

Value added tax (VAT)

Several changes that were proposed in order to eliminate specific exemptions were rejected by the Lower House. Therefore, items such as private school tuition fees, sale of housing and interest on mortgage loans, among others, will continue to be exempt of value added tax.

The increase from 11% to 16% in the tax rate applicable to transactions carried out in the border region was passed by the Lower House.

The Lower House also approved the elimination of the exemption applicable to transactions carried out by entities with an IMMEX program; however, they proposed a mechanism through which taxpayers may request a certification issued by the Mexican tax authorities that would grant them a 100% credit over the tax paid. Also, the Lower House considered convenient to postpone the taxation of entities with an IMMEX program, in order to allow them to apply for the referred certification.

Other amendments

The Lower House also approved 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 eliminated commencing January 1, 2014.

b) The general anti-abuse rule that was proposed by the Executive was rejected, as the Lower House considered that the authorities currently have enough grounds to prevent tax avoidance.

c) 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.

d) The Lower House proposed an excise tax on the sale of food which is considered as not basic and that has a high caloric value.

e) The statutory CPA report (*dictamen fiscal*) would be optional for certain taxpayers starting 2014.

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Mexico City
October 2013