

Tax & Legal

2010 Mexican Tax Amendments

Tax Reform 2010

On November 4th, 2009, the Mexican Congress approved the Initiative to Amend the Income Tax Law, Cash Deposits Tax Law, Value Added Tax Law and the Federal Tax Code. The Reform Act was published in the Official Gazette on December 7, 2009.

The above mentioned amendments became effective on January 1st, 2010 with exception to the income tax rules applicable for authorized charities receiving contributions that will be in force until May 1st, 2010.

The most significant changes are those related to the payment of deferred income tax as a result of tax consolidation; an increase in the income tax rate from 28% to 30%; an increase of the value added tax from 15% to 16%; and an increase in the tax on cash deposits from 2% to 3%, among others.

The scope of this document is to provide general information about the most relevant facts of this amendment, and could change based on regulations that could be published in the future.



Income Tax

Corporations

Income tax rate

With the main purpose of generating revenues, the Mexican tax authorities established a new general tax for corporations, with a rate of 30% for 2010 to 2012, which will be decreased to 29% for 2013, and finally return to the 28% rate in 2014.

Consequently, the proposed amendments derive with adjustments to utilize the gross-up factor in the case of dividend payments for purposes of determining the basis for corporate taxation; therefore, from 2010 to 2012 a ratio of 1.4286 will apply. This factor will be consequently decreased for years 2013 and 2014.

Contributions - deduction

A deduction for income tax purposes is authorized: contributions made to international organizations of which Mexico, as a country, is a member, provided that the purposes of these organizations correspond to activities which under the Mexican Law would be subject to receive tax deductible contributions.

Requirements - digital tax receipts

Taxpayers that issue tax receipts through the digital website of the Tax Administration Service (SAT) who are subject to file audited financial statements or have chosen to do so, are exempt of filing their annual tax return by submitting the audit tax report on a timely basis.

With regard to the disclosure statement of transactions with customers and suppliers, it is expected that there will be no requirement to submit such statement when taxpayers issue their digital tax receipts through the SAT website.

All of the aforementioned tax benefits are also applicable to individuals with business and professional activities.

Tax Consolidation Regime

In general terms, tax consolidation brings the opportunity to defer taxes as a consequence of the off-setting of losses within the Group, as well as a consequence of dividend payments between entities of the same Group, among others.

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

1. When a controlled Company quits tax consolidation, or when the Group withdraws from tax consolidation;
2. When the participation of the Holding Company in a controlled Company's equity is reduced to less than 50%;
3. When the shares of a controlled Company are sold or disposed of, outside of the Group;
4. When a tax loss carry forward of an entity, which was subject to the consolidated tax result or loss is not utilized individually by such entity.

Beginning 2010, the amendments restrict to a five-year period the deferred tax benefit arising from tax consolidation. This means that any tax deferral derived from the consolidation regime may only be enjoyed during a five-year period. In other words, the deferred tax should be paid back after a five year period has elapsed, notwithstanding that any of the abovementioned events have materialized.

As a result of this new payment obligation, the deferred tax derived from the tax consolidation regime should be paid to the tax authorities when the events referred to in 1) to 4) above materialize, or when five years elapse since the date on which deferral took place, whichever occurs first.

For these purposes, the amendments set forth two procedures to determine the deferred tax, the first one is for purposes of the deferred tax as of December 31, 2004 and the second one applies to the deferred tax since 2005.

Tax on Interest Income

A new procedure for taxation of interest earned by Mexican residents would be in force starting January 1st, 2011. This new procedure consists in the determination of the real accrued interest (gross income less inflation), considering all accounts and financial assets maintained by the taxpayer in financial institutions. The financial institutions will be requested to compute and withhold this tax from Mexican tax residents by applying the corporate rate in force (30% for the period 2010 to 2012).

It is important to mention that as a consequence of the amendments, the withholding made by financial institutions for interest paid in 2011, must be considered as definitive tax for individuals, opposite to the tax regime applicable for 2009 and 2010 that considers the tax withholding only as an advance payment.

The foregoing means that in 2011, individuals receiving interest from financial institutions will not have the possibility to accumulate earned interest to other income received during the year, which implies that the tax on real interest for individuals and non resident taxpayers will be treated separately at the maximum tax rate.

Individuals

Sale of housing

In terms of the Mexican Income Tax Law the sale of the taxpayers living quarters is considered as an exempt income for individuals, provided that the amount of the sale does not exceed one million five hundred thousand investment units (UDIS).

For purposes of applying this exemption, the amendment establishes that it will be applicable as long as the taxpayer had not used this exemption during the five preceding years from the date in which the transfer takes place. The taxpayer is requested to declare, under oath, such circumstance at the moment of execution of the transaction before a public notary.

Deduction of mortgage interest

Currently, the law grants individuals the possibility of deducting real mortgage interest paid for the acquisition of a home or living quarter.

As a measure of generating tax revenue, the Mexican tax authorities limit the deduction to be applied only in the case of loans obtained from members of the financial system for the acquisition of the taxpayer's house, provided that the amount of credit does not exceed one million five hundred thousand investment units (UDIS).

We consider that this tax provision was very poorly drafted since this fact would give rise to the non-deductibility of the total amount of mortgage interest and not only on the excess portion of the deductible loan limits, which amount to one million five hundred thousand investment units (UDIS).

Residents Abroad

Sale of shares

With the amendments made, financial entities residing abroad, in which the Mexican Government participates, may elect to apply the corporate rate on the gain realized on the sale of shares, instead of applying the 25% rate on the gross amount of the transaction. However, different requirements must be fulfilled to apply this option.

Single Rate Business Tax (IETU)

As stated in the premises of the amendments of the Law, in order to reinforce tax control, it is deemed necessary to limit the tax credit generated by the excess of deductions over income established in the Single Rate Business Tax Law, so that it is only creditable against the single rate business tax in the ten subsequent years.

In this sense, the credit determined in case tax deductions exceed revenues and generates "negative base credit" will no longer be creditable against income tax liability in the year in which the credit is generated.

It is questionable that the Revenues Law limits a credit, when the procedure is expressly established in the Law. This generates grounds for legal defense.

Value Added Tax

Tax rate

Starting January 1st, 2010 the tax rate is 16% instead of 15% and 11% instead of 10% in case of activities carried out by residents in the free zone (border and certain States).

A transitional provision provides that in case of transfer of property, services, or the granting of temporary use or enjoyment of property entered into prior to January 1st, 2010, with collection taking place after that date, the tax will be computed in accordance with the provisions in force at the time of collection, by applying the new rates (16% and 11%).

Notwithstanding the foregoing, this provision establishes some exceptions to this general rule, as follows:

a) In case of transfer of goods and services, the value added tax could be computed at the rates prevailing until 2009, as long as the goods and services are delivered or provided before January 1st, 2010 and the payment of the compensation is made within ten calendar days immediately following that date (January 10th).

b) In case of temporary use or enjoyment of property (rental income), the value added tax could also be computed at the rates prevailing until 2009, as long as the goods had been delivered before January 1st, 2010 and the payment of the compensation is made within ten calendar days immediately following that date (January 10th).

It is important to note that these provisions shall not apply between related parties resident in Mexico or abroad.

Cash Deposits Tax

Beginning January 1st, 2010, the tax rate will be 3% in lieu of 2% on the excess amount of taxable cash deposits, in Mexican or foreign currency, considering all the accounts that the taxpayer has with the same Mexican financial institution.

Likewise, starting January 1st, 2010, the tax exempt amount is \$15,000.00 pesos in lieu of \$25,000.00 pesos, per financial institution.

Special Product and Service Tax

Telecommunications

A new special tax on production and services of 3% is incorporated on services provided in Mexico, through one or more public telecommunications networks.

However, public and rural telephone services, interconnection services, as well as internet access telecommunications services provided via a fixed or mobile network consisting of all services, applications and contents that are provided through a telecommunications network, are exempt, providing internet services do not exceed 30% of the total value of the services.

Alcoholic beverages

Through a transitional provision, a temporary increase of the ad valorem rate in the case of the sale and importation of alcoholic beverages with more than 20° GL will be 53% for years 2010 to 2012 and during 2013 the rate will be reduced to 52%. Starting 2014 the rate will be reduced again to the rate applicable in 2009 of 50%.

Likewise, through this provision, it is established that in the sale and importation of beer, the rate will be 26.5% for the period 2010 to 2012 and during 2013 the rate will be 26%; also in this case the rate for 2014 and subsequent years will return to the 25% rate applicable in 2009.

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