

Tax Alert

Mexican Tax Reform for 2010
approved by Congress



On October 31, after intense legislative debate, the final tax reform bill (the "Reform") was resubmitted to the Mexican Senate for final approval before being sent to the president. The approved bill includes various important changes including rate increase for income tax and value added tax (VAT), expanded excise taxes, as well as changes to the consolidation regime that will require recapture of benefits after five years and an immediate recapture of certain pre-2004 benefits in 2010. The voting on the bill by the two houses of the Mexican Congress has been back and forth, since major changes in each house had to be approved by the other. The bill must now be signed by the president, which should happen shortly. Most provisions of the law become effective January 1, 2010. Following is a summary of the most relevant changes of the approved tax reform:

1. Value Added Tax (VAT)

The original bill was submitted by President Felipe Calderon to the Mexican Congress on September 8. Much of the final Reform was part of President Calderon's original request, except for the changes to VAT. The VAT increase was a compromise to the original proposal that included a 2% tax on sales, services and leases in the form of a new tax (the Tax Against Poverty), which in essence was an additional 2% VAT applicable to a wider base. The discussion about the Tax Against Poverty was intense and found general opposition because it would have taxed items that are currently not subject to VAT like medicines and food. After the discussion in the Chamber of Deputies, this proposed tax was eliminated and the general VAT rate was increased from 15 to 16% (and change the rate applicable for the border region from 10 to 11%). The VAT still will not be levied on food and medicines.

2. Income Tax

a) Tax rate

The Reform includes a temporary 2% rate increase on Income Tax for all taxpayers, including individual taxpayers and taxpayers under the "simplified regime", a regime available for taxpayers in the agricultural and livestock business. The general rate will be increased to 30% for 2010-2012. The tax rate reduces to 29% in 2013 and goes back to 28% in 2014.

b) Tax Consolidation regime

In what is perhaps the most important change to the Income tax Law, the changes to the consolidation regime were passed and will require a recapture of benefits obtained under consolidated tax returns, even for prior periods. In 2010, a recapture of pre-2004 benefits will be required. The final Reform does however limit the recapture period of certain items to 1999.

The Reform, as approved will require taxpayers to annually calculate the tax on benefits obtained in consolidation after five years. The actual payment is then made in the following terms: 25%



A detail analysis of the Tax Reform will be provided once this document is published in the Official Gazzete.

in years 6 and 7, 20% in year 8, and 15% in years 9 and 10. The recapture relates to: losses used in consolidation; dividend distributions between members of the group; and cumulative differences between the accumulated after tax earnings accounts ("CUFIN") on an individual versus consolidated basis. The amount of the potential recapture is not yet clearly known to taxpayers, as the proposed rules for the calculation of recapture are complex and include various options. Therefore, taxpayers in Mexico should be estimating this cost and evaluating the impact.

3. Excise Tax

Also, included in the final Reform are changes to the Excise tax on Goods and Services, including a new 3% tax on telecommunications services. Exemptions have been provided for rural telephone services, public telephone services and, internet services. This tax will apply to all other cell phone and land line services, cable TV and satellite services. The Reform also contains increases to excise tax on alcoholic beverages and cigarettes.

Further, the Reform increases the excise tax rate for gambling games and lottery tickets, from 20% to 30%. Moreover,

new obligations were introduced to make taxpayers engaged in this type of business obliged to report every transaction made to the tax authorities by electronic means.

4. Tax on Cash Deposits

The Tax on Cash Deposits (a tax currently imposed on cash deposits exceeding \$25,000 pesos per month, at a rate of 2%), was increased to 3% on monthly cash deposits exceeding \$15,000. Note that this tax may be recovered, once the income is recognized, through a credit system.

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