

# Newsalert

## International Tax Services – Latin American Tax

Mexico

October 27, 2009

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This Newsalert does not provide a comprehensive or complete statement of the taxation law of the countries concerned. It is intended only to highlight general issues which may be of interest to our clients.

For issues relating to this news alert please contact your local international tax services advisor or the specialists listed at the end of this article.

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Solicitation

### Mexican House of Representatives Passes Version of 2010 Mexican Tax Reform Bill

On October 20, 2009, the Mexican House of Representatives (Cámara de Diputados) passed a revised version of the 2010 tax reform bill, which differs in some respects from the revenue package that the Executive Branch sent to Congress in September (please refer to our Newsalert dated September 8, 2009 for a summary of the Executive Branch's tax reform proposal). It is important to note that the bill still needs to be voted on and approved by the Mexican Senate, and that further changes therefore may be introduced. The following is a summary of the principal elements of the House version of the 2010 tax reform bill:

#### Income Tax Rates and Flat Tax Credit

As proposed by the Executive Branch, the House bill includes a temporary increase in the highest marginal income tax rates for individuals, with a new top rate of 30%.

Additionally, in line with the Executive Branch proposal, the corporate income tax rate would be increased to 30%. In this regard, the rate would be increased from 28% to 30% for the period from January 1, 2010 through December 31, 2012, and would then be scaled back to 29% in 2013, and finally to 28% in 2014 and future years.

The House bill does not include any changes to the Flat Tax ("IETU") Law, although there is a proposed change in the Revenue Law for 2010 which limits the credit for excess IETU to future IETU liabilities. Under current law, the excess of IETU over the regular income tax may be used as a credit in the same year against the regular income tax liability. This credit would now not be available for income tax purposes.

## Tax Consolidation Regime

The Executive Branch proposal to modify the Mexican tax consolidation rules, to require the recapture of certain consolidated group items, has also been included in the House bill. As one example, under current Mexican tax consolidation rules, dividends paid by a consolidated group member to the group's parent company do not normally trigger taxable income for Mexican income tax purposes; irrespective of whether the paying company has a positive accumulated net after-tax earnings ("CUFIN") account. Outside of consolidation, a dividend paid by such a subsidiary without sufficient CUFIN to its parent would trigger a grossed-up corporate income tax at the paying company level at a rate of 38.89%. Under current rules, in consolidation (as well as in certain other cases) no Mexican income tax would be triggered until such time as the paying company leaves the consolidated group.

The House bill would now require the triggering of the grossed-up tax after a period of 5 years – and for the tax liability to be recognized and paid over a 5-year period. In this regard, the House bill would require that 40% of the tax liability be recognized and paid in year 6, and 15% of the item in each of years 7 through 10. The Executive Branch proposal included a 60% year 6 recapture, with 10% due and payable in each of the subsequent 4 years.

Another item that would require recapture after 5 years would be tax losses by a consolidated group member that were utilized in consolidation, to the extent not utilized against separate company taxable income. Under current rules, the separate company that generated the loss has 10 years to earn an equivalent amount of income in order to avoid the recapture of the loss as taxable income in year 11. The House bill would reduce this recapture period from 10 years to 5 years, and would require a gradual payment of the tax liability in accordance with the percentages referenced above (i.e., 40% in year 6, and 15% in each of years 7 through 10).

Multinationals which maintain leverage at the Mexican holding company level, in cases where the top company does not have sufficient levels of ordinary income to offset losses generated by virtue of interest expense, may be affected by these new rules.

There are certain other similar items which may also be subject to the proposed recapture rules.

It is important to note that this rule would have somewhat of a retroactive effect in that consolidated group items attributable to tax periods through the end of 2004 would need to be assessed for potential recapture beginning in 2010, assuming the new rules are eventually introduced as proposed.

Thus, all multinationals with Mexican consolidated tax groups should consider assessing the potential cash, deferred tax and/or P&L impact of the proposed recapture rules now, as they may ultimately take effect in 2009, and become due and payable starting in 2010.

## Research and Development Tax Credits

The research and development credit would be repealed from 2010.

## Tax on Cash Deposits

The tax on cash deposits (IDE) would be increased from the current rate of 2% to 3%, and the monthly limit on the aggregate tax-free cash deposits would be reduced from a current floor of Mx\$25,000 to Mx\$15,000. The IDE would continue to be creditable by the taxpayer as prepaid income tax from the month it is withheld by the financial institution.

## Excise Tax

The excise tax would now apply to telecommunications charges, and certain increases were passed with respect to alcoholic beverages, cigarettes and gambling/lottery activities.

As an example, a new excise tax of 3% on telecommunications services, including internet services, cable and telephone charges, would be introduced as from January 1, 2010, except with respect to interconnection charges, and certain public and rural services.

## Value Added Tax

The Value Added Tax (VAT) rate would increase from 15% to 16% (from 10% to 11% in the border zone) under the House bill. Certain limited-term transition rules would apply. Note that this change was not part of the proposal submitted by the Executive Branch.

## New Consumption Tax

The new general 2% consumption tax, which was proposed by the Executive Branch to help reduce poverty, was not approved by the House.

## Governmental Mining Royalty

The 4% Governmental Mining Royalty is not included in the House bill, but may nevertheless continue to be debated through December 15, 2009, when the ordinary Congressional period ends for the current calendar year.

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**Federal Tax Code**

Amendments to the Federal Tax Code were also recently approved by the House of Representatives and have been passed along to the Senate. These proposed changes include, for example, new rules relating to invoicing procedures for tax purposes which can be issued in either pre-printed or electronic formats.

The bill also proposes Federal Tax Code measures to strengthen the tax audit and collection powers of the tax authorities.

We will continue monitoring the evolution of these reforms and will issue future Newsalerts as necessary.

For more detailed information, please do not hesitate to contact:

**Your LATAX team in the U.S.:**

Jorge Gross (US LATAX Leader)	(305) 381-7641	jorge.gross@us.pwc.com
John Salerno (NY LATAX Leader)	(646) 471 2394	john.salerno@us.pwc.com
Eduardo Pupo (Partner)	(646) 471-7007	eduardo.pupo@us.pwc.com
Olga Castells (Director)	(305) 381-7634	olga.m.castells@us.pwc.com
Josue Rivera (Director)	(646) 471-7915	josue.rivera@us.pwc.com
Julian Vasquez (Director)	(646) 471-5883	julian.r.vasquez@us.pwc.com
Agustin Mercado (Partner)	(646) 471-5308	agustin.mercado@us.pwc.com
Mario Alberto Gutierrez (Manager)	(646) 471-0979	mario.a.gutierrez@us.pwc.com

**Your LATAX team in Mexico:**

Carlos Montemayor (Mexico ITS Leader)	(52) (55) 5263-6066	carlos.montemayor@mx.pwc.com
Fred Barrett (Partner)	(52) (55) 5263-6069	fred.barrett@mx.pwc.com
Oscar Castañeda (Partner)	(52) (81) 8152-2029	oscar.castaneda@mx.pwc.com
David Cuellar (Partner)	(52) (55) 5263-5816	david.cuellar@mx.pwc.com
Carlos Gradwohl (Partner)	(52) (55) 5263-5824	carlos.gradwohl@mx.pwc.com
Carlos Orel Martinez (Partner)	(52) (55) 5263-5798	carlos.orel.martinez@mx.pwc.com
Karina Perez (Partner)	(52) (55) 5263-5735	karina.perez.delgadillo@mx.pwc.com
Adriana Rodriguez (Partner)	(52) (55) 5263-8527	adriana.rodriguez@mx.pwc.com