



Highlights of the 2007 Mexican Tax Amendments

The amendments to Federal tax laws in Mexico for 2007 present few changes, although they significantly affect the general community of businesses and taxpayers. The legislative processes were characterized by the speed with which the new legislators (who came into office on September 1st, 2006) carried out each of the stages and their lack of depth in the study of the amendments proposed by the Federal Executive. Another aspect of the process that is noteworthy was the absence of officials of the Ministry of the Treasury responsible for the areas of fiscal policy (the Undersecretary of Revenue was ratified until the 14th of December of 2006).

As a result of the above, on the basis of questionable reasoning from a legislative policy point of view, a very substantial change was made to the taxable base of the assets tax, since no type of debt whatsoever shall now be able to be deducted by taxpayers from the annual average value of their gross assets; in other words, the gross assets, rather than net assets, are now the taxable base. (The asset tax is complementary to the income tax and is effectively paid when its amount is greater than the income tax for the account of the taxpayer).

This first aspect of the amendments is certain to unleash a new and voluminous generation of constitutional litigation on behalf of taxpayers. Simply put, assets do not have the same potentiality to generate future income when the taxpayer has to respond for debt with their assets and is bound to pay interest on debt, than when that is not the case. Therefore, another consequence is that the new characterization of the tax shall no longer equally impact different taxpayers and sectors: taxpayers that incur in debt to acquire productive assets do not have the same potentiality to generate future profits as taxpayers that acquire their assets with contributed capital or with retained profits. This situation did not present itself when only net assets were taxed.

Other important amendments are the following:

1. The asset tax rate decreased from 1.8% to 1.25%.
2. The limit for the deduction of investment in automobiles was decreased from 300,000 to 175,000 (Mexican currency).
3. The right to amortize tax losses from prior taxyears against annual taxable profits is limited in certain cases when partners or shareholders of the company with the tax losses change.

4. New rules are established for trusts with business activities; its significant aspect is that the tax losses generated through the trust may now be only amortized against taxable profits of the same trust, instead of being a deductible concept for each of the individual participants in the trust.
5. The rules under which the deduction of interest is limited for thin capitalization reasons are substituted. The more relevant aspects are: the rules will now only apply to debt contracted with non-resident related parties (before they applied even to debt contracted with non-resident independent parties, when the taxpayers had non-resident related parties); not all debts are taken into account now to determine excess debt, but rather only debts that accrue interest for the account of the taxpayer; debts related to activities linked to strategic areas of the country (typically infrastructure, such as the electric industry) do not fall under the rules; and taxpayers may request an advance pricing agreement to increase the limit of the debt if their activity requires it.
6. The definition of a back-to-back credit is significantly broadened.
7. The income tax exemption for individuals with respect to gains from the sale of their home is restricted.
8. The exemption on income made to insured persons or their beneficiaries for income perceived from insurance companies when the event which is insured against occurs requires that the insurance companies be of Mexican nationality.
9. The 4.9% withholding income tax rate shall also continue to apply in 2007 for non-resident banks and certain financial companies that reside in a country with which Mexico has a double taxation treaty, when certain requirements are met.
10. A fiscal benefit is granted, equivalent to 0.5% of the taxable result for income tax purposes for taxpayers that have their financial statements audited for fiscal effects and that comply strictly with their obligations of making provisional tax payments.
11. There is a notable increase to the special tax on certain tobacco products.
12. The special tax on certain drinks and related products sweetened with an ingredient other than sugar from sugar cane has been eliminated.
13. The duty of the tax authority of answering consultations on real and concrete situations made by taxpayers is substantially altered.
14. The obligation to use the advanced electronic signature ("FEA") is broadened, with respect to the duty of filing returns.



15. The term for which accounting has to be kept is extended, since the tax authorities may review the documentation related to a tax year in which a tax loss was determined, when such tax loss was amortized against taxable profits of a taxyear being audited by such authorities; in a related aspect, the option of microfilming accounting from prior tax years is extended to all taxpayers (before, only taxpayers that audited their financial statements for fiscal purposes had this option).

It may also be noted that in the beginning of December 2006, amendments were published to the Executive Regulation of the Income Tax Law and new Executive Regulations were issued for the Value Added Tax Law and the Law of the Special Tax on Production and Services.

Finally, a noteworthy development is that the new legislators of the three principal political parties have agreed to pursue a more comprehensive set of amendments throughout 2007 in order to achieve greater tax revenue for the Federal government, something which, fiscally speaking, our government urgently requires.

Contact Person:

Mr. Carl Koller

Editor:

Despacho Parás, S.C.
Bosque de Alisos No. 47-A, of. 2-21
Col. Bosques de las Lomas
05120 México, D.F.
México

Phone +52 (55) 5259-1060
Fax + 52 (55) 5259-0099

ckoller@paras.com.mx
www.paras.com.mx

www.wts-alliance.com

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