

# GOODRICH, RIQUELME Y ASOCIADOS



PASEO DE LA REFORMA 265  
COL. Y DEL. CUAUHTEMOC  
06500 MEXICO, D.F. MEXICO  
APARTADO POSTAL 93 BIS  
06000 MEXICO, D.F.  
TEL. (52 55) 5533-00-40  
FAX: (52 55) 5525-12-27  
E-mail: [mailcentral@goodrichriquelme.com](mailto:mailcentral@goodrichriquelme.com)  
[www.goodrichriquelme.com](http://www.goodrichriquelme.com)

8/10, RUE VENTADOUR  
75001 PARIS, FRANCE  
TEL: 33 (0) 1 42-60-27-00  
FAX: 33 (0) 1 42-60-27-13  
E-mail: [graparis@goodrichriquelme.com](mailto:graparis@goodrichriquelme.com)

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Dear Clients and Friends,

Following you will find a summary of the main amendments to several tax laws that were published in the Diario Oficial de la Federación (Mexican Official Gazette) on October 1, 2007, and the two new laws, the Ley del Impuesto Empresarial a Tasa Única (Flat Rate Business Tax (IETU) and the Ley del Impuesto a los Depósitos en Efectivo (Law of the Tax on Cash Deposits). The amendments and new taxes will be in full force and effect since January 1, 2008, excepting in certain cases.

On the other hand, it is important to mention that on November 5, 2007, the Diario Oficial de la Federación published a Decree that grants stimuli to mitigate some of the negative effects of the (IETU) in some cases, such as the problem of acknowledging the deduction of the inventories existing as of December 31, 2007, the effect on the in bond plants (maquiladoras) transactions, the non-recognition of loss provoked by the immediate deduction of investments, the loss of taxpayers that sold goods on installments, etc.

## **I. - FLAT RATE BUSINESS TAX**

First, it is important to mention that the Assets Tax will be abrogated on January 1, 2008, and that the IETU is a very different tax to the Asset Tax.

The individuals and corporations residing within the Mexican territory, excepting the individuals who receive wages and salaries, shall pay this tax. Additionally, all the individuals and corporations residing abroad Mexico who have a permanent establishment in Mexico shall pay this tax in relation to the income attributable to such establishment.

The income from the following activities will be subject to the IETU:

- a) Sale of goods
- b) Performance of independent services
- c) Grant of the temporary use or enjoyment of goods

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The definitions of the above listed activities are contained in the Value Added Tax Law.

The tax rate will be applied as follows:

<u>Year</u>	<u>Rate</u>
2008	16.5%
2009	17%
2010 and beyond	17.5%

The tax will be paid in monthly provisional payments and an annual payment on the same dates when the Income Tax returns must be submitted.

The taxable income include any income received in cash, in kind or in services including any interest and the past due interest which are part of the price.

To determine when the income is considered as earned by the taxpayer, the IETU refers to the provisions of the Value Added Tax Law.

The income obtained from the activities performed before 2008 will not be taxed, although the consideration is collected in 2008 or later.

The tax is incurred on the income received in cash, in kind or in services after the application of the deductions authorized by the IETU, including deduction of the investments in fixed assets. It is important to mention that once the payable tax is calculated by subtracting the deductions from the income, several credits can be applied to reduce the payable tax (to be explained later), such as the income tax paid by the taxpayer, the result of applying the IETU rate to salaries, etc., and an offsetting of the assets tax paid in the previous fiscal years, in certain cases and with certain limitations.

The taxpayer may deduct the following concepts from his income:

- a) The expenses paid to other taxpayers to obtain such income and any expenses related to management, production, commercialization and distribution. The expenses made before January 1, 2008, will not be deductible.

The payments of remuneration for subordinate personal work performed are not deductible, but the effect of the tax may be credited as explained later.

- b) The expenses incurred in relation to new investments during the period from September 1 to December 31, 2007, will be deductible in three parts: in the 2008, 2009 and 2010 fiscal years.

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- c) The taxes paid in Mexico, excepting the IETU, the Income Tax, the social security contributions and the pass-through taxes.
- d) Any reimbursements, discounts and compensations, as well as deposits or advance payments reimbursed, when they have provoked an accrual of income in relation to the tax.
- e) Indemnifications for damages and injuries, and conventional penalties, in some cases.
- f) Any prizes paid in cash for taxpayers that organize sweepstakes, lotteries, etc.
- g) The non-burdensome, non-remunerative donations with the limits set forth in the Mexican Income Tax Law.
- h) Any loss due to bad debts, acts of God or force majeure events.

The credits that the taxpayers may apply against the tax to be paid in monthly provisional payments are as follows:

- a) The result of applying the tax rate to the amount by which the deductions exceed the income.
- b) The tax paid in the previous provisional payments of the fiscal year.
- c) The provisional payment of the income tax actually paid, including the tax withheld from the taxpayer.
- d) The result of subtracting the amount equivalent to the IETU rate, both from the expenses paid in relation to personal services to subordinates from which the income tax was withheld, and the social security fees to be paid by the tax-paying employer.
- e) An amount equivalent to 5% of the IETU rate applied to the indexed balance pending deduction from the investments made from January 1, 1998, to December 31, 2007, pro rata the months of the fiscal year actually elapsed. This credit may be applied to the following ten fiscal years, starting since 2008.

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The credits that the taxpayers may apply against the tax of the fiscal year are as follows:

- a) In the case of the IETU monthly provisional payments, and when they exceed the payable tax of the fiscal year, the difference may be offset over the following ten fiscal years against the Income Tax of the fiscal year in question, and if there is still a remnant, the taxpayer can ask for a reimbursement. This credit is not transferable upon merger.
- b) The result of applying the tax rate to the expenses paid in the fiscal year for personal subordinate services for which income tax has been withheld and to the social security fees to be paid by the tax-paying employer.
- c) An amount equivalent to 5% of the IETU rate applied to the balance pending deduction of the investments made from January 1, 1998, to December 31, 2007. This credit may be applied in the following ten years, starting since 2008.
- d) The income tax paid on the distribution of dividends or profits of the fiscal year. Regarding 2008, also the tax paid in the 2006 and 2007 fiscal years for this concept.

Last, the taxpayers may offset against the IETU of the fiscal year, the updated assets tax paid in the ten fiscal years previous to the year in which they had paid income tax.

No IETU tax will be paid for the following income:

- a) Royalties received from related parties residing in Mexico or abroad (they are not deductible for the persons who pay them). This does not include the royalties obtained from the grant of the temporary use or enjoyment of industrial, commercial or scientific equipment.
- b) Interest that is not part of the price of financing transactions. In relation to the definition of the concept of interest, the IETU refers to the Income Tax Law (they are not deductible for the taxpayers who pay them).
- c) Sale of equity interest, shares, documents outstanding collection, loan instruments (excepting, in some cases, deposit certificates), non-amortizable real estate participation certificates or other titles that grant rights on real estate (in Mexican Pesos or other currency), excepting the sales of this kind of property made by people who are exclusively dedicated to such activity.

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- d) The income received by individuals in an accidental way, excepting in the case of sale of assets which were deducted for the purposes of this tax.
- e) The income received by companies for non-profit purposes or trusts authorized to receive donations that are deductible from the payment of income tax.
- f) The income obtained by companies whose partners are pension and retirement funds that reside abroad Mexico.
- g) The income received by individuals or companies dedicated to agricultural, livestock raising, forestry or fishing activities that are exempt according to the Income Tax Law.
- h) The income that is exempt according to the Income Tax Law received by parties, associations, unions, chambers of commerce, etc.
- i) The income received by the Federation, the Federation Entities, the Municipalities, etc.

In the case of group of companies that file consolidated tax returns, the parent company and the controlled companies will calculate and pay any payable IETU individually. The income tax delivered by the controlled companies to the parent company will be considered as part of the tax that they may credit against the payment of the IETU.

### **II.- DECREE CREATING INCENTIVES ON IETU**

The Decree provides incentives consisting in tax credits against the IETU covering the following matters:

- a) Recognition of the cost of inventories at December 31, 2007.
- b) Maquila operations for taxpayers that pay income tax under the safe harbor rule.
- c) Net operating losses for income tax in years 2005, 2006 and 2007 produced for having taken immediate deduction of investment in fixed assets.
- d) Net operating losses incurred by tax payers of the so called simplified regime.
- e) Sales on installments before 2008.

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- f) Acquisitions of inventory between November 1 and December 31, 2007 by taxpayers that make sales to the final consumers.
- g) Consolidated Tax Regime.
- h) Cost of concessions incurred during the period of September 1 through December 31, 2007.

We will be pleased to meet with you, in order to discuss these new legal provisions and the possibility of filing an injunction (“amparo”) against IETU.

### **III.- LAW OF THE TAX ON CASH DEPOSITS**

This Law will be in full force and effect since July 1, 2008.

This tax applies to the individuals and companies whose cash deposits (in Mexican Pesos or other currency) are made to any type of accounts in their names in any institution of the Mexican financial system up to an accrued amount of \$25,000.00 every month. This tax will be paid on any amount exceeding such limit of \$25,000.00.

Moreover, the individuals and companies will pay this tax upon acquiring a cashier check in cash.

The tax rate is 2% of the amount of the deposits affected. This tax will be withheld by the financial institution in which the deposit is made in cash or where the cashier check has been acquired.

This tax can be credited against the own income tax or the withheld income tax, and if there is an excess, it can be offset against any federal tax.

### **IV.- MEXICAN TAX CODE**

The authorities may require the taxpayers to authenticate the signature contained in any filings.

To prove the representation before the tax authorities (it will be necessary to submit the original and a copy of the official identification card of the representative of the taxpayer or of the taxpayer).

The terms of forty five and twenty five days in which the tax authorities can make the reimbursement of the taxes paid in excess or balances in favor of the taxpayers will be suspended while the resolution about the applicability of the reimbursement is issued. The period of time for the tax authorities to exercise their review and

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enforcement powers in order to decide whether a reimbursement is applicable may not exceed ninety days.

In the above case, if it is necessary to have information of third parties or tax authorities of other countries, the period to exercise the tax authority's review and enforcement powers to determine the application of the reimbursement may be extended to one hundred and eighty days.

When the reimbursement request is for an amount equal or higher than ten thousand Mexican Pesos, the request must be submitted with electronic signature.

The chief executive officers, general managers or sole administrators of companies will be jointly liable, together with the company, when the official domicile is vacated without notifying the tax authorities about such address change.

In some cases, upon exercising their review and enforcement powers, the tax authorities will be empowered not to apply the order set forth in the Law to review the tax resolutions.

Within the assumptions that accept evidence to the contrary, there is an assumption that considers as income the deposits in bank accounts that do not match the accounting records, as well as the deposits made by the taxpayers that do not submit their accounting records when required to do so by the authority. Last, the deposits in bank accounts for amounts higher than one million Mexican Pesos during a fiscal year, made by people who are not registered in the Mexican Federal Taxpayer Registry will be considered as income.

In the cases in which the tax authority, upon exercising its review and enforcement powers, knows facts with information from other authorities, it must grant the taxpayer a period of fifteen days to submit its defense arguments according to law.

The tax consultants will be penalized in the cases in which the criterion of the tax authority is different from the one contained in the opinion issued in writing by the consultant to the taxpayer, if the consultant does not express clearly that such difference exists.

The penalty for the case mentioned in the previous paragraph is from thirty five thousand to fifty five thousand Mexican Pesos. The penalty will be increased from 10 to 20% of the unpaid tax if the opinion issued by the consultant is different from the one published by the tax authority and such circumstance is not contained in the opinion given to the taxpayer.

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### **V.- INCOME TAX**

#### **Companies**

For companies, the amounts in cash received as contributions for future capital stock increases, loans obtained and capital stock increase for amounts higher than \$600,000 Mexican Pesos will be considered as income when the applicable notice is not filed.

The bad debts of up to \$115,000 Mexican Pesos may be deducted after one year has elapsed after declaring the bad debt status.

The deductible donations are limited to an amount equivalent to 7% of the profit obtained by the taxpayer in the previous fiscal year.

The loss incurred in the sale of shares can be now deducted from the profit obtained for the same concept in the ten following years, starting since 2008.

The credit to salary pending crediting as of December 31, 2007, may continue to be deducted in the following fiscal years until the amount is completely credited.

The informative tax return of the credit to salary for 2007 must be filed by February 15, 2008.

The loans guaranteed with shares or debt instruments held by the borrower or a party related to him may not be considered as guaranteed loans, provided that the lender cannot use legally such instruments.

#### **Individuals**

Any loans, donations or prizes obtained exceeding \$600,000 Mexican Pesos in the same fiscal year must be included in the tax return, otherwise they will be considered as income that has not been reported.

The exemption on income obtained from the sale of shares in the stock market will not be applicable anymore, when the person or group of persons hold 10% or more of the stock of the issuer and sell 10% or more within a period of twenty four months.

#### **Companies residing abroad Mexico**

The exemption of taxes on income from the sale of shares in the stock market for companies residing abroad will have the same limitations as the exemption set forth for individuals.

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For 2008 fiscal year, a tax rate of 4.9% will be applied to the interest paid to banks and financial entities residing abroad Mexico, which have been duly registered with the tax authorities, when the actual beneficiary resides in a country with which Mexico has a current treaty to avoid double taxation.

### **Preferred Tax Jurisdictions and Multinational Companies**

The chapter on preferred tax jurisdictions is restructured by re-defining several concepts, such as the foreign legal entities and figures and transparent entities, as well as the way to calculate the income and the periods in which such income was earned.

The income obtained directly from tax transparent entities will be considered as income obtained from preferred tax jurisdictions.

The concept of passive income includes commission fees, mediation fees and income from the sale of assets that are not physically within the country, territory or jurisdiction where the foreign legal entity or figure resides or is located, as well as the income from services performed outside of the jurisdiction in question.

The royalties for the use or grant of use of a patent or industrial secrets will not be considered as income subject to any preferred tax jurisdictions if they meet certain circumstances such as the income not causing a deduction for a person residing in Mexico and that the prices and amounts of the compensation agreed comply with the transfer price standards.

The Federal Tax Authority is empowered to calculate the income subject to preferred tax jurisdictions and the income from source of wealth located in Mexico, when simulation of legal acts is detected but the Tax Authority must meet the grounded in law and fact requirements, in any assessment. Nevertheless it can base such determinations on presumptions, among other elements.

Sincerely,

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## GOODRICH, RIQUELME Y ASOCIADOS

Raúl Moreyra Suárez	(52-55)- 5525-6167	moreyra@goodrichriquelme.com
María del Rosario Huet Covarrubias	(52-55)- 5207-5203	rhuet@goodrichriquelme.com
Ana Celia Salinas Romero	(52-55)- 5208-2035	asalinas@goodrichriquelme.com
Mario Ramírez Vargas	(52-55)- 5208-1097	mramirez@goodrichriquelme.com
Sergio Ruiz López	(52-55)- 5525-3908	ruizsl@goodrichriquelme.com
Marisol Cervantes Culebro	(52-55)- 5533-0040	mcervantes@goodrichriquelme.com
Francisco L. Gómez Víquez	(52-55)- 5525-6369	fgomez@goodrichriquelme.com
Ana Ruth Herrera Gómez	(52-55) 5533-0040	arherrera@goodrichriquelme.com
Gabriela Ayram Fuentes Gil	(52-55)- 5533-0040	gfuentes@goodrichriquelme.com
Edgar Leonardo Espejel Muciño	(52-55)- 5533-0040	eespejel@goodrichriquelme.com
Paulina Mariana Hernández Tejeda	(52-55)- 5533-0040	fiscal2@goodrichriquelme.com
Mauricio Jaramillo Reyes	(52-55)- 5533-0040	fiscal5@goodrichriquelme.com
Eduardo Avila Pérez	(52-55)- 5533-0040	fiscal6@goodrichriquelme.com
Yoselin Sanabria López	(52-55) 5533-0040	fiscal@goodrichriquelme.com

### GOODRICH, RIQUELME Y ASOCIADOS

Paseo de la Reforma 265

Col. Cuauhtemoc

México 06500 D.F.

Tel: (52-55) 5533-0040 / 55

Fax: (52-55) 5525-12-27-

[mailcentral@goodrichriquelme.com](mailto:mailcentral@goodrichriquelme.com)