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HIGHLIGHTS OF THE 2005

MEXICAN TAX AMENDMENTS AND TAX BENEFITS

1. Income Tax Rate and Base.

A new reduction in the income tax rate for corporate entities was approved. For 2005, the rate will be of 30%; for 2006, of 29%; and for 2007 and subsequent years, of 28%.

These percentages shall also be the superior rates of the income tax tariff applicable to individuals. However, in the case of individuals, amendments were included in the Value Added Tax Law that would permit states that are fiscally coordinated with the Federation to establish local taxes on certain types of individual's income. For this reason, in the future we may well be seeing a number of state taxes on income on salaries, from leasing, from the sale of real estate or from business activities, with rates of up to 5%. These state taxes will be deductible from the individual's Federal income tax base.

Additionally, profit sharing paid to workers (commonly called PTU) shall now also be deductible. Full deductibility of this concept will begin with profits generated during 2005, with respect to which profit sharing is paid in 2006. The Income Tax Law was also amended in such a way that the deduction of the profit sharing shall only affect the income tax base, but not the base for worker's profit sharing.

2. Taxation of Employment Benefits.

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A general exclusion has been established for individuals, which begins to apply in 2006. This general exclusion shall be of \$6,333.33 for each month and of \$75,000.00 on an annual basis; alternatively, employees shall be able to opt to consider certain employment benefits as their general exclusion (for example, wages for extra hours, indemnities for sickness, welfare benefits, or savings and profit sharing). The gross income minus the general exclusion shall be the individual's taxable base. It may be noted, therefore, that as a consequence certain concepts that nominally appear to be exempt income in the Income Tax Law may ultimately be taxed under the salary regime.

Two concepts that affected income tax withholding on salaries will be eliminated as of 2006: the salary credit and the acreditable subsidy. In their place two new subsidies that do not have the same impact will apply: the subsidy for employment, which is similar to the salary credit, and the subsidy for the leveling of income, which will only apply to employees that effectively perceive an amount of net income under the rules that come into effect in 2006 which is lesser than that obtained by them at the end of 2005. However, to qualify for this second subsidy, these employees must earn less than 10 monthly minimum wages.

Additionally, employees that receive options for the acquisition of shares or certain other securities will be obligated to consider as income the difference between the market value of the shares and the stipulated price. This new taxable situation also applies to non-residents that are subject to income tax in Mexico on their salaries.

3. Fiscal Consolidation.

Between 1999 and 2004, the income tax consolidation regime, in which the holding company adds the taxable profits and subtracts the tax losses of each company of

the group, limited such consolidation to 60% of the holding company's participation in the capital stock of each controlled company. As of 2005, such percentage is returned to 100%, which once more favors investment programs, risk dispersion and strategic alliances.

At the provisional tax payment level, however, during 2005, each company of the group that consolidates will continue to make its provisional tax payments as if no consolidation existed. This situation will continue to affect the cash flow of the group and generate favorable tax balances for the holding company at the end of the year.

4. Deduction of the cost of sales.

In 1987, because of the hyper-inflation present at that time in Mexico, the Income Tax Law was amended in order to permit immediate deduction of the cost of acquisition of inventories (primary resources, parts or merchandise), instead of conditioning such deduction to the effective sale of the goods produced or of the merchandise.

As of 2005, the Income Tax Law returns to the system of deducting the cost of what is sold at the time of the sale.

While it is true that the immediate deduction of the inventories was a benefit that did not necessarily have to be maintained in the Income Tax Law, the tax authorities' argument justifying the amendments is not credible, since such argument is that this new method of deducting will simplify the administrative burden of the taxpayers.

Inventories deducted upon their purchase up thru 2004 must be considered as the first inventories sold. However, an option is established according to which the

taxpayer may accumulate such prior inventories as if they were income in order to immediately begin the general deduction of all their inventory upon the sale of goods. Furthermore, such accumulation of the value of the inventories is deferred between 4 and 12 years, to be determined in function of the average inventory rotation the taxpayer has had in the last three years.

A consequence is that, for 2005 and future years, this measure shall generate additional revenue for the government. However, this effect will be compensated in later years. Such impact shall be different for each productive or commercial sector.

5. Thin Capitalization.

Following the tendency of most countries that are part of the OECD, Mexico has implemented rules that impede the deduction of interest generated by debt derived from capital taken on loan that exceeds the proportion of 3 to 1 with respect to the shareholder equity.

For the rules to apply, the debt must be contracted with related parties or with non-resident independent parties, when the taxpayer also has related parties. It should be noted that there is no disposition that specifies whether the related parties must be non-residents or may also be residents in Mexico.

These new rules contain a few cases of exception.

6. Payments to Non-Residents.

A presumption is established that services provided by non-resident, related parties to Mexican taxpayers are provided in Mexico in their entirety, rather than abroad. This presumption admits evidence to the contrary.

Regarding the sale of shares, the income will be taxed even when the value of the stock originates indirectly in real estate found in Mexico, or when what is granted or transmitted are enjoyment rights and not full property (the case of usufructus). Also, deferral of tax by reason of corporate restructures will be conditioned to exchanges of stock and will therefore not apply if the price of the stock is paid in cash.

Additionally, an amendment was included to establish that none of the concepts taxed for non-residents under Title V of the Law are to be considered business profits. This measure is directly related to the application of double taxation treaties and its certain to create controversy, specially in cases where: the relevant income is generated by the non-resident's principal business activity; such income is not covered by special provisions of the rest; and such income is taxed under the rules of Title V of the Income Tax Law.

7. Investment in Tax Heavens.

For a number of years now Mexico has established a special regime for income obtained through investments in tax heavens, according to which the income must be considered obtained at the time it is generated in the investment and not at the time in which the income is effectively distributed to, or perceived by the taxpayer. Up to 2004, this regime applied to income originating or obtained in countries mentioned in an annual list issued to that effect.

As of 2005, the hypothesis that makes this regime applicable has changed and consists of the following: that the income coming from a source of wealth found abroad is not subject to tax outside of Mexico or that such income pay a tax that is less than 75% of the tax that would have been paid in Mexico, regardless of the country where the income originates.

Because of the above, the new regime may apply to income obtained in countries with high income tax rates when for some specific reason such tax rate is not applied.

In principle, the tax is paid in this regime with respect to each individual operation considered, although an option is established to consider aggregate calculations.

8. Accreditation of the Value Added Tax.

The formula established in the VAT Law from 1999 to 2004 for accrediting VAT transferred to the taxpayer by reason of the acquisition of goods and services, or paid by the taxpayer because of imports, was recognized to be unconstitutional for a number of reasons under the jurisprudence of the Supreme Court. Ironically, the detriment generated by the unconstitutionality affected federal revenue, since it permitted the accreditation of VAT exclusively related to exempt activities; it also harmed taxpayers insofar as it reduced the accreditation of the VAT related exclusively to taxed activities.

A new formula in effect in 2005 seeks to correct the deficiencies of the previous system. In general terms, the new rules would permit full accreditation when the underlying expense relates exclusively to taxed activities; no accreditation when the relation is exclusively to activities for which the tax is not paid; and an accreditation in the proportion that taxed activities represent of all activities of the taxpayer, for acreditable VAT generated by other expenses or investments.

9. Asset Tax.

As of 2005, the Asset Tax Law is amended to permit the deduction from the taxable base of debt contracted with the financial system or with its intermediation, or with non-resident enterprises that do not have a permanent establishment in

Mexico. The motivation of this amendment is also that the Supreme Court determined that not permitting this deduction was unconstitutional.

10.- Fiscal Benefits Established by Presidential Decree (January 2005).

In addition to the above amendments that came into effect on January 1st, 2005, a Presidential Decree establishing fiscal benefits for a number of taxpayers was published on January 26 of this year. The following are among the more relevant benefits included:

1. In a manner similar to the American Jobs Creations Act, taxpayers that return resources that have been maintained in tax havens to Mexico for their investment in the country shall see their taxable base for such resources reduced in 75%. Taxpayers may invest in the acquisition of fixed assets, or in research and development. Corporate entities may additionally pay off debt contracted with independent parties. Individuals may also invest in shares and securities issued by residents of Mexico.
2. A different benefit allows individuals to pay in an anonymous manner their income tax with respect to resources maintained in tax havens.
3. For the food industry, a deduction that is additional to the cost of the sale of goods shall apply when food is donated to non-profit organizations that seek to cover the nutritional requirements of the needy.
4. A tax forgiveness of 80% is established with respect to 2004 for income tax on income derived from the leasing of movable goods, and an income tax withholding rate reduction, also of 80%, is

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established with respect to non-resident, lessors of trailers imported temporarily into Mexico.

- 5.** For certain taxpayers with an elevated number of employees receiving low wages, the Decree permits the accreditation of salary credit paid to the employees against VAT or the asset tax, when it has not been possible to accredit it against income tax.