TAX

REFORM 2008

HIGHLIGHTS

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English version

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asesores fiscales

Two new taxes were included in the 2008 Tax Reform, aiming to reduce oil income dependency, strengthen public finances and reinforce them with a tax scheme that increases the collection and prevents tax evasion.

Estimations show that 2008 federal income will significantly increase in comparison with the one budgeted for 2007.

Notwithstanding that one of the main objectives of the Tax Reform is to decrease tax evasion levels, we consider that such purpose will not be achieved since most of the modifications mainly target the legally established business.

It is important to outline the creation of the Flat Rate Business Tax (hereinafter referred to as IETU), which substitutes the asset tax and levies, at a fixed rate, the tax profits derived from business activities, on a cash flow basis. This new tax is complementary to income tax, since it allows a credit between them both.

As analyzed in this document, the procedure to determine IETU is, in more than one way, more costly than income tax, due to the fact that it restricts the deduction of necessary items for the companies' operation, which will cause the difference between them to be significant.

Although the reduction of some items is not allowed, direct credits against the IETU will attempt to provide an equivalent economic effect. However, the corresponding application procedure may prevent that from happening.

It is worth mentioning that the IETU Law does not allow the consolidation of tax profits or losses generated in corporate groups.

Accordingly, IETU enforcement will override the Asset Tax Law on January 2008.

As a cash flow control mechanism, tax on cash deposits is incorporated in order to avoid fiscal evasion in the informal market, enforceable on July 1st, 2008.

With a tax rate of 2%, this new tax is levied on cash deposits that exceed $25,000 Mexican pesos made by both, entities or individuals in bank accounts, also allowing the credit of such tax against income tax due by the taxpayer.

The tax will have to be collected and filed by the corresponding financial institutions which should fulfill certain formalities and registries. Banking institutions must collect such tax, observing at all times the required formalities which will imply an additional administrative burden for such institutions.

Another important reform made was the elimination in certain cases, of the income tax exemption for individuals that obtained income derived from the sale of shares made through a public market, enforceable since October 2nd, 2007.

The modifications made to the tax treatment applicable to income derived from a tax haven must be pointed out, since there is an increase in the scope of the provisions that apply to such regime, in comparison with the 2007 tax regime. Definitions and exemptions are now incorporated, and verification faculties of the tax authorities extended regarding this type of income, up to the point of considering simulated, legal transactions carried out by the taxpayers as shams.

This analysis of the most relevant aspects of the tax reform includes our comments regarding the most relevant and widely applied changes, trying to use only some technical concepts, in order for the unspecialized executive in tax affairs to achieve a better understanding of the tax changes.

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FLAT RATE BUSINESS TAX (IETU)

On June 20, 2007 the Mexican President proposed to the Mexican Congress the Flat Rate Business Contribution Law initiative.

Such proposal was modified in relevant aspects by the House of Representatives, up to the point of renaming the new law as the Flat Rate Business Tax Law.

General provisions

Subjects

Individuals and entities considered as Mexican residents for tax purposes are subject to pay the IETU. Permanent establishments of foreign residents are also subject to the payment of this tax, regarding income they receive, which is levied by this tax.

Regardless of the place where income is generated, individuals and entities residing in Mexico must pay IETU in connection with all their obtained income, whereas non-residents with permanent establishment in the country will only be taxed in connection to the income attributable to such permanent establishment.

Object

Income obtained by the aforementioned persons derived from the alienation of goods, rendering of independent services as well as from the granting of temporary use of goods will be subject to IETU.

Tax base and rate

The IETU tax base is determined by reducing from the total taxable income, the authorized deductions and a 17.5% rate will be applied to such base.

By means of a transitory provision, the IETU tax rate applicable for years 2008 and 2009 will be of 16.5% and 17%, accordingly.

Definitions

Taxed activities

In terms of this new tax, definitions contained in the Value Added Tax Law shall serve to define activities levied by IETU. Despite this, it is important to emphasize that value added tax exemptions are not applicable to IETU, since the reference made to such law has the sole purpose of defining the concepts that are subject to IETU payment.

Likewise, certain activities not subject to value added tax payment, like those carried out abroad; do trigger IETU consequences.

Permanent establishment

Permanent establishment and income attributable to such establishments will be defined in the same terms provided in the Mexican Income Tax Law or in the Tax Treaties to avoid double taxation entered into by our country.

The above allows residents of a country with which Mexico has signed a Tax Treaty, to define in terms of such treaty, if they have a permanent establishment in Mexico and therefore, if they are subject to pay this new tax.

Taxable income

Any amounts charged to the acquirer, such as taxes (not transferred), rights and interests, among others will be deemed taxable income for IETU purposes, in addition to the price or consideration paid for the goods or services.

Advanced payments or deposits that are refunded to the taxpayer, as well as rebates or discounts received, will be considered as taxable income for IETU purposes, provided that the deductions regarding such transactions were duly taken.

Income received from insurance companies, in connection with deducted goods for income tax purposes, will be considered income derived from the alienation of goods, in terms of this new tax.

When the price or consideration is paid in goods or services, the income for IETU purposes will be the market or the appraisal value of the goods or services delivered.

In the case of barters and payments made in kind, the income will have to be determined considering the value of the transferred goods, the value of the consideration that would have to be paid in the case of granting the temporary use of the goods, or the value of the service rendered.

Moment of income taxation

Income must be considered as obtained in accordance to Value Added Tax Law provisions.

By means of a transitory provision it is established that income obtained from activities carried out prior to January 1st, 2008, should not be considered as income, unless the taxpayer has elected to consider as a taxable income the amount of the price collected for income tax purposes.

Export of goods and services

For alienation of goods and rendering of independent services that are exported, it will be considered that the income is received when such alienation or rendering of services is charged, except when the income is not received during the following twelve months to the export. In such case the income must be considered as received at the end of this term.

In the case of exported goods that are sold afterwards or that are granted abroad for temporary use, the income will be considered to be obtained when according to the income tax provisions, such income is considered as taxable.

The lack of a definition for export of goods or services in the IETU law will generate legal uncertainty for the taxpayers.

Losses derived from uncollected credits, from acts of God and force majeure will be considered as authorized deductions for IETU purposes, as long as they can be deductible items for income tax purposes, and when the taxpayer has considered them as taxable income for IETU purposes.

In this regard, when taxpayers recover amounts that have been deducted according to the previous paragraph, they will have to consider such amounts as taxable income for IETU purposes.

Exempt subjects

Governmental entities

Income received by the Federation, Federal Entities, Municipalities, constitutional autonomous entities and public administration entities, that are not considered taxpayers for income tax purposes, will be considered as tax exempt for IETU purposes.

Non-taxpayers of income tax

Political parties, labor unions, associations or civil societies organized for scientific, political, religious and cultural purposes and Chambers of Commerce, among others, which are exempted for income tax purposes, will also be exempt for IETU purposes.

Notwithstanding the fact that the IETU Law exempts most of the persons currently exempted by the Income Tax Law, there are certain cases, like educational purpose institutions which could be subject to the payment of the new tax as indicated further on.

Entities authorized to receive donations

Income obtained by entities with non-profitable purposes or trusts authorized to receive deductible donations in the terms of the Income Tax Law, is exempt for IETU purposes, provided such income is used for their main non-profitable purposes, and that no person has any right over any benefit generated in the entity or trust, except when it is delivered to other entity authorized to receive donations.

Benefits are granted on the remains even if they have not been given in cash or goods to their members or partners, to the extent of the amount of the omissions of income or purchases not made and wrongly registered; the non-deductible expenses for income tax purposes carried out; the loans made to their partners, members, or to the spouses, direct ascendants or descendants of the partners or members.

In case that any of the aforementioned assumptions happens, all the income obtained by the entity authorized to receive donations will be considered as subject to IETU payment in the tax year that corresponds to such operation. Therefore, we consider that provision as an excessive measure.

Foreign retirement and pension funds

The law provides an exemption for the entities whose shareholders are foreign retirement and pension funds. The exemption is applicable in the same ratio of their shareholders' participation, as long as they comply with the Income Tax Law requirements.

Exempt income

Income derived from the sale of shares issued by partnerships, documents pending collection and securities will be exempt for IETU purposes, without considering that such exemption can be applied to the sale of the goods supported by said documents.

No IETU will be triggered by the alienation of currency, except when such alienation is carried out by persons whose main activity is such operation.

It is provided that the main business of persons is buying and selling currency, when the income obtained from such activity represents at least 90% of the taxable income for IETU purposes.

Real estate trusts

The alienation of real estate certificates issued by trusts engaged in the construction or acquisition of real estate will not be subject to IETU, as long as such certificates are registered in the National Stock Registry, and their alienation is carried out in a recognized stock market in the terms of the Stock Exchange Law, or in recognized markets according to the international treaties that Mexico has in force.

Notwithstanding that such exemption is adequate, the new tax will hinder the creation of this type of trusts, due to the fact that the contribution of assets in such scheme will be subject to IETU payment, since this new tax does not recognize in a suitable manner the balance pending to be deducted from the assets acquired prior to the entry in force of this new tax, situation which we will explain further on.

The above happens due to the fact that differently from income tax, the IETU Law does not allow the deferral of the income from the asset contribution until the moment in which the certificates are actually sold, as provided in the Mexican Income Tax Law.

IETU Law relieves this kind of trusts from making IETU provisional payments; however, it is criticizeble that IETU does not grant this relief to the real estate entities (Spanish acronym SIBRAS), engaged in the same activities than the trusts mentioned before, even though both, the trusts and such entities are relieved from making income tax provisional payments.

Additionally IETU provisions do not establish a specific procedure to be considered by the real estate trusts for the payment of the income tax and the IETU derived from the activities carried out through such trusts, therefore, we consider that the provisions established in such law for the trusts are applicable; however we consider that this situation could generate certain tax distortions.

In case of residents abroad investing in this type of trusts, it is not clear whether they are subject to the payment of IETU, even when they carry out their activities through such instruments.

Infrequent income

Individuals will not pay the IETU when they carry out any of the activities levied by IETU. Activities are deemed to be when the individual does not receive income derived from business or professional activities, or from lease of goods, for income tax purposes; however, in any of these cases it will be considered that the activity is carried out when the individual has not considered the goods from which said income derived, as a deductible item for IETU purposes.

Sale of home

Income derived from the sale of their home is exempt for IETU purposes as long as they have not considered its acquisition as deductible for purposes of this tax.

Income not subject to IETU

Royalties

In accordance with what was discussed by the Mexican Congress, it is established that notwithstanding that royalty payments made between related parties are apparently determined at a fair market value; it is considered that their intangible nature creates subjective elements that hinder the determination of an objective result of its value, which may not reflect the actual value of the operation. Based on this situation, they are used to erode the taxable base of Mexican taxes.

With the purpose of not allowing the deduction of royalty payments, the IETU law establishes that the income derived from said royalties will not be subject to the payment of such tax. The reason for considering this type of income as not subject to IETU is to consider the payments made by such concepts as non-deductible items. As it is described further on, one of the requirements established in the IETU Law for the deduction of expenses, is that they correspond to concepts subject to the payment of IETU.

We consider that the provision previously mentioned is objectionable, since the tax authorities may determine the price of the operations between related parties, when there is a discrepancy in the value of such transactions. In consequence, this situation should not be a reason to consider this kind of payments as non-deductible items for IETU purposes.

Based on the above, royalty payments will be taxable income, and authorized deductions, for IETU purposes, only when they are made between related parties, for the temporary use of industrial, commercial or scientific equipments; as well as any other royalty payment made between independent parties.

It is established that related parties will be those that are considered as such in the Mexican Income Tax Law.

We consider that the limitation for the deduction of royalty payments made between related parties is contrary to the vertical equity principle stated in the Mexican Constitution, since it does not recognize that the payments made for such concepts affect the taxpayers' contribution capacity, regardless of the fact that this concept is not subject to IETU.

Interest

It is established that interests are not taxable income for IETU purposes, except if they are included in the price of any activity subject to this tax.

Since interest income received by taxpayers is not subject to IETU, interest expense cannot be considered as a deductible item for these purposes. In this regard, it is established that interests shall be deemed to be those considered as such by the Mexican Income Tax Law.

For income tax purposes, even though currency exchange profits and losses are not considered interest, they receive the same tax treatment as interest, and therefore they are subject to IETU, since, in our opinion, taxpayers directly recognize exchange rate fluctuations in the price collected or paid due to the corresponding activity, in the receivable or payable accounts derived from such activities subject to IETU.

The limitation to deduct interest payments results contrary to the vertical and horizontal equity principles provided in the Mexican Constitution, since they have to be considered to measure the real taxpaying capacity of IETU subjects, regardless if they are not considered as taxable income for purposes of this tax.

Educational entities and associations

Notwithstanding that entities and associations entitled by the competent authorities to provide educational services are not taxpayers of the income tax, they are obligated to pay IETU.

It is established that from the date in which the IETU Law enters into force, the aforementioned entities and associations will have to consider as taxable the income received from activities subject to this tax, regardless if they continue to be considered as taxpayers of the income tax.

As it was previously mentioned, entities authorized to receive donations under the Mexican Income Tax Law, will be tax exempt for IETU purposes; therefore entities engaged in educational matters authorized to receive donations, will also be exempted from the payment of IETU.

It is established that entities and associations that have not yet obtained the authorization to receive deductible donations for fiscal year 2008, will be obligated to pay IETU. In case that such authorization is granted for said year, they may request the refund of the tax paid during such year.

It has to be pointed out that income obtained by non-profit entities authorized to receive donations in terms of the Mexican Income Tax Law, will be exempted from paying IETU, provided that such income is used in the activities for which they were created and that they do not grant to any person the benefit on any gain obtained, except if such person is authorized to receive donations.

Authorized deductions

In general terms, any disbursement made by taxpayers to sell goods, render independent services, lease of goods, or to administrate, produce, commercialize or distribute goods and services, will be deductible for IETU purposes. An exception is made for concepts which are not subject to this tax, such as royalties paid to related parties, interests or payments of wages (including the concepts considered as wages by the Mexican Income Tax Law).

Among others concepts taxpayers may deduct certain payments of taxes, as well as refunds received, discounts granted or rebates made and deposits or payments in advance returned by the taxpayers.

Additionally, taxpayers may deduct donations made in terms of the Income Tax Law, considering the reform made to it, which limits its deduction to a 7% of the tax profit or the taxable income obtained in the previous fiscal year.

By means of a transitory provision, expenses made before January 1st, 2008 will not be deductible, even if the payment is made after such date.

Deduction requirements

The law establishes certain requirements that have to be fulfilled in order for taxpayers to be able to take the deductions authorized therein. In general terms such requirements are: (i) the deductions have to correspond to the alienation of goods, rendering of services or to the granting of the temporary use of goods, (ii) they have to be strictly necessary for the taxpayer, (iii) they have to comply with deduction requirements established in the Mexican Income Tax Law and (iv) they have to be actually paid.

In connection to the last requirement, the deduction is considered paid, when: (i) regarding check payment, when they are cashed, (ii) in the case of securities, when they are subscribed by a different person and (iii) in the case of a compensation or payment in kind when such event is agreed.

On the other hand, when disbursements are partially deductible for income tax purposes, they will be deductible for IETU purposes in the same ratio that they are in the income tax. Likewise, in order to deduct goods from abroad, there must exist legal proof of the compliance of its legal import.

Wages and Salaries

For value added tax purposes, neither the rendering of subordinated services nor the services which according to the Income Tax Law are considered as paid through wages, should be considered as rendering of independent services.

Notwithstanding that wages paid by employers to their employees represent significant disbursements; IETU does not allow them to deduct them, since wages are not subject to IETU payment.

Nevertheless, IETU provides that employers may take a credit against the annual IETU that derives from such payments with which the economic effect of such expenses is partially recognized. The credit will be determined as follows:

	Social security payments by the employer
(+)	Taxable wages for income tax purposes
(=)	Subtotal
(x)	0.175 quota (0.165 for 2008 and 0.170 for 2009)
(=)	Credit from taxable wages and social security contributions

Based on the above, the credit is only based on social security contributions payable by the employer and taxable income due to wages and concepts considered as such, and thus, payments of wages and social security contributions that are exempt for income tax purposes are excluded.

The credit determined in the previous terms, will have an economic effect equivalent to the deduction of wages subject to income tax payment, and to the non-deductibility of those exempt from such burden.

Salaries and contributions accrued prior to January 1st, 2008 will not grant the right to apply such credit, even if the payment is made after this date.

As it will be explained further on, this credit may only be applied if the credit for deductions in excess has been previously reduced, which may derive in the non-deductibility of these concepts due to the preference order for the application of such credits established in the new law.

The non-deductibility of wages for the IETU assessment is unconstitutional by being disproportional, since wages are an unavoidable cost that affects the taxpaying capacity of the taxpayers.

Fixed assets

Acquired January 1st, 2008 onwards

In general terms, the fixed assets will be entirely deducted in the tax year in which they are actually paid, unlike in the income tax regime where such goods are deducted through the yearly application of certain maximum deduction percentages. As it can be noticed, the deduction of fixed assets is one of the concepts that will cause differences between income tax and IETU payments.

Acquired between September and December of 2007

By means of a transitory provision, taxpayers will be able to apply a deduction for both, annual tax and monthly tax provisional payments, of the expenses made in new fixed assets, acquired and paid during this period.

Only one third of the total deduction may be taken in each tax year (starting in 2008) until such amount is completely deducted. For purposes of the monthly tax provisional payments, an amount of one twelfth of the annual deduction will be applied, multiplied by the number of months that have passed in the tax year.

The aforementioned deduction will be updated from December, 2007 until the last month of the tax year in which it is applied. For purposes of the monthly tax provisional payments, the corresponding amount will be updated from December, 2007 up to the month to which the tax prepayment corresponds.

Fixed assets will be those that are considered as such in the Income Tax Law and new ones, those used for the first time in Mexico.

It is objectionable that the only allowable deduction is the one referred to goods acquired in this period and defined in terms of Income Tax Law, since such definition does not consider the land as an asset, which may imply a significant effect for real estate developers.

Such deferment in three tax years is not justifiable by simply arguing the avoidance of a tax collection impact in the short term, since it disregards of a real expense made by a taxpayer.

Acquired between January, 1998 and December, 2007

By means of a transitory provision, it is established that taxpayers will be able to determine a credit on the fixed assets acquired in the period between January 1st, 1998 and December 31, 2007, excluding the new assets acquired during the last quarter of 2007 which were deducted for IETU purposes. The deduction of other assets, such as land, is not allowed.

The balance pending deduction of such investments for income tax purposes must be determined in order to determine the amount of applicable credit for a certain tax year.

Such balance should be multiplied by the 0.175 quota (0.165 for 2008 and 0.170 for 2009) and 5% of the result shall be creditable in each tax year, but only for the following 10 years, as of 2008. For purposes of the monthly tax provisional payments, one twelfth of the annual credit shall be applicable, multiplied by the number of the month to which the prepayment corresponds.

The balance pending deduction for income tax purposes will be updated from the month of acquisition of the good, up to December, 2007. Afterwards, for purposes of the annual credit, such amount will be updated from December, 2007 to the sixth month of the year in which it is applied. For purposes of the monthly tax provisional payments, such update will be made from December, 2007 to the last month of the year previous to the one in which it is applied.

It is established that when the taxpayer does not apply the aforementioned credit in the corresponding tax year, he will lose the right to do so in the following years.

If the taxpayers sell such goods or if they cease to be useful for obtaining income before 2018, in the year in which it occurs, they will not be able to use the credit pending application, corresponding to such goods.

By only allowing the asset deduction at a 5% annual rate for a period of 10 tax years, the previous credit only represents 50% of the balance pending deduction regarding the fixed assets owned by the taxpayer acquired previously to IETU enforcement, which represents an adverse effect for the taxpayers.

The application of this credit ranks third in the preference order for the application of diverse credits granted for IETU assessment. Thus, if this credit is not applied in the corresponding tax year, an effect equivalent to the non-deduction of these investments will take place.

Without a valid justification, the application of this credit is limited to investments acquired after January 1st, 1998, even if there is a balance pending depreciation for income tax purposes, as in the case of concessions and constructions, or when lower deduction rates were used.

Another significant distortion is caused by the fact that the application of this credit is not allowed in case the goods for which such credit was determined are sold before year 2018 and, at the same time, the price received from the alienated good will be subject to IETU.

The fact that only the partial deduction of the aforementioned investments is allowed, as well as the lack of recognition of the tax losses incurred in previous years breach the vertical equity principle, since they represent elements directly related to the operations carried out by IETU taxpayers and which consequently, affect their taxpaying capacity.

Mergers and spin offs

It is established that in case of a merger, the surviving entity or the one incorporated as a result of the merger, will keep applying the tax credits (investments January 1998 - December 2007) corresponding to the merged entities. For these purposes, the surviving entity or the one incorporated as a result of the merger, shall identify the tax credits individually and separate them from its own credits.

Annual tax return

The IETU will be determined on an annual basis and it will be paid by means of a tax return that will be filed before the corresponding tax authorities, on the same terms as those established for the filing of the annual income tax return.

Annual tax

The annual tax is determined by applying the IETU tax rate to the result of subtracting the authorized deductions from the income. Moreover, the credit of various concepts against the determined tax is allowed, according to the following procedure:

	IETU taxable income
(-)	IETU authorized deductions
(-)	Deduction of new fixed assets September – December 2007
(=)	IETU tax basis
(x)	17.5 % rate (16.5% - 2008, 17% - 2009)
(=)	Annual IETU
(-)	Deductions in excess over Taxable Income Credit
(=)	Subtotal
(-)	Credit of taxable wages and social security contributions
(-)	Credit of investments January 1998 – December 2007
(-)	Taxpayer's own income tax (includes income tax on dividends and income tax paid abroad)
(=)	IETU due
(-)	IETU monthly prepayments
(=)	Payable IETU

Deductions in excess over Taxable Income Credit

It is established that when the authorized deductions of a tax year are higher than the taxable income of that same year, the taxpayers shall have the right to determine a tax credit (credit derived from excess deductions) in the amount resulting from applying the 17.5% rate (16.5% for 2008 and 17% for 2009) to the difference between such deductions and the taxable income.

The credit for deductions in excess determined in a tax year may be carried forward within the following 10 years until depletion against the annual IETU and the monthly tax prepayments.

In general terms, such credit may be restated for inflation since the last month of the first half of the tax year in which it is generated (June, considering a regular tax year), until the last month of the first half of the tax year in which it is applied (June, considering a regular tax year).

The application of such credit ranks first in the preference order established by the IETU Law for the application of the different credits granted by such law.

This means that the credit resulting for the deductions in excess over the taxable income will be applied before any other tax credit and directly to the amount obtained by multiplying the corresponding annual IETU rate, to the result of subtracting the authorized deductions from the taxable income, whether at an annual level or in the monthly IETU prepayments.

When the taxpayer does not apply the credit derived from excess deductions in a tax year, he will lose the right to do so in the following years up to the amount which he could have credited. Likewise, it is specified that the credit derived from excess deductions shall be applied without affecting the recoverable balance generated by the monthly prepayments made in the corresponding tax year.

By establishing as mandatory the application of this credit in the first place, the vertical equity principle included in our Constitution is violated, due to the fact that the taxpayer's contributive capacity is not recognized.

Income tax credit

It is established that the annual income tax, will be the one actually paid in terms of the Income Tax Law. The income tax settled through credits and reductions carried out in the terms of the tax provisions is not considered as actually paid, with the exception of the credit of the tax on cash deposits or when the payment was made by means of compensation.

Income tax paid for the distribution of dividends out of the Net Tax Profit Account (Spanish acronym CUFIN) is also considered as annual income tax. Likewise, and by means of a transitory provision, it is established that for 2008, entities will be able to credit the income tax paid in 2006 and 2007 for dividends paid out of the CUFIN account, provided they have not previously been credited against the income tax.

We might criticize the above, since according to the Income Tax Law, there is a three years carryforward to credit the tax paid for dividends, whereas for IETU purposes it is only possible to apply such credit in the tax year in which it is paid, in addition to the fact that the income tax paid through the dividend credit in the following years shall not be considered as income tax of such tax year.

Income tax paid abroad may also be considered as the taxpayer's annual income tax to the extent of the income levied by the IETU. Likewise, such tax cannot be higher than the amount of the creditable income tax in the terms of the Income Tax Law, neither can it exceed the IETU that would be paid in case of only carrying out operations abroad.

Individuals subject to the IETU that also obtain income from wages and/or income considered as such, will consider as income tax credit according to the following:

	Taxable income (-) wages and income considered as such
(/)	Total taxable income
(=)	Proportion
(x)	Annual income tax
(=)	Taxpayer's income tax credit

Preference order for tax credit application

One of the most questionable characteristics of the new tax system, is the order established for the application of the diverse credits that may be used against the IETU of the tax year.

The provision establishing the credit derived from excess deductions, in the first place, causes an adverse effect for the remaining concepts which give rise to credits, which distorts the whole tax system.

The above due to the fact that this credit represents the economic effect of the years in which the deductions surpassed the income, as if it was a tax loss, and by subtracting it before the other credits, the use of the rest of the concepts recognized through credits may be hindered, as in the case of wages.

We consider the order of credit preference established by the IETU Law is an error, since it forces the application of the credit derived from excess deductions in the first place, and afterwards, those credits corresponding to the same tax year, which cannot be carried forward.

The above implies that the taxpayers' real contributive capacity is not being reflected, violating the vertical equity principle established in our Constitution.

Credit of monthly tax prepayments

The amount obtained after crediting the taxpayer's own income tax will be the payable annual IETU; against which the IETU prepayments actually paid during the corresponding tax year, may be credited.

In case it is not possible to credit the aforementioned IETU prepayments (whether totally or partially), the taxpayers will be able to compensate the amount not credited against the corresponding annual income tax. In case there is a surplus profit for the taxpayer after carrying out such compensation, the refund of such amount may be requested.

We expect the tax authorities to clarify the way in which the excess of monthly IETU prepayments should be compensated against the annual income tax, since according to the written Law, it seems that the annual income tax must be paid before determining the amount of monthly tax prepayments that exceed the annual IETU.

Monthly tax prepayments

As for the monthly IETU prepayments, it is established that such payments should be made on a monthly basis by means of a return that must be filed on the same date as the monthly income tax prepayments, which is no later than the 17th day of the following month.

Such payments should be made considering the aggregate income which means they should be determined by subtracting the authorized deductions from the beginning of the tax year, and until the last day of the month to which the payment corresponds, from the total taxable income of the same period. To the resulting amount, the 17.5% tax rate will be applied (16.5% for 2008 and 17% for 2009).

It must be noted that for purposes of computing the monthly IETU prepayments, as well as the previously mentioned annual IETU, the application of certain additional deductions is established, as well as different credits granted for purposes of this tax.

The monthly income tax prepayments actually paid and the income tax withheld to the taxpayer as an estimated tax payment, follow the same preference order for their application. The monthly tax prepayments are determined according to the following procedure:

	IETU taxable income
(-)	IETU deductions
(-)	Deduction of new investments September – December 2007
(=)	IETU tax basis
(x)	17.5% tax rate (16.5% - 2008, 17% - 2009)
(=)	Monthly IETU prepayment
(-)	Deductions in excess over taxable income credit
(=)	Subtotal
(-)	Credit of taxable wages and social security contributions
(-)	Credit of investments January 1998 – December 2007
(-)	Taxpayer's monthly income tax prepayments (1)
(-)	Income tax withheld
(=)	Monthly IETU prepayment
(-)	Monthly IETU prepayments previously made in the year
(=)	Monthly IETU prepayment due

(1) It does not apply to tax paid with credits or reductions, except with the credit of the Tax on Cash Deposits or compensation.

In order to determine the monthly IETU prepayments, it is allowed to credit the advanced income tax payments actually made.

In this regard, when the provision states that the creditable income tax is the one actually paid, it may cause that the tax prepayments of income tax and IETU cannot be filed simultaneously, by means of one transaction, but the income tax prepayment will have to be filed before the IETU tax, so the income tax prepayment can be credited against the IETU one filed afterwards.

We expect that this situation will be amended by the tax authorities by issuing a specific rule that allows the income tax prepayment credit against the IETU tax prepayments, when they are filed simultaneously.

Credit for deductions in excess

Consistent with the complementary nature of the IETU, it is established the possibility to apply the Credit for deductions in excess against the income tax of the year in which such credit was generated.

It is established that the amount of the Credit for deductions in excess that would have been credited against the income tax will not be creditable against the IETU of subsequent years. In addition, the application of this credit will not generate any right of refunding.

According to the Congressional Declaration of Purpose of the IETU Law, it is expected that such tax will promote the acquisition of productive assets by the companies, since it allows the total deduction of said goods, lands, and machinery, among others.

This credit is established to avoid postponing the benefit generated for a company due to the productive investments it makes, considering that the IETU is a minimum tax, with respect to the income tax.

We consider that this situation will generate a positive result in the cash flows of the taxpayers, since they will be able to monetize said credit to pay the income tax due, as discussed above.

It could also be concluded that the application of this credit against the income tax due will result in a double benefit for the taxpayers, since the authorized deductions that originated the Credit for deductions in excess for IETU purposes, are also deductible in the income tax, whether in the same year or in the future, and additionally, the taxpayers are able to apply as cash flow the Credit for deductions in excess.

However, this double benefit is not applicable, since it is established that the credit taken against the income tax, as abovementioned, will not be creditable against the IETU of subsequent years.

Likewise, to avoid that the taxpayers monetize the benefits derived from the Credit for deductions in excess, it is established that the application of the credit against the income tax will not generate any right of refunding whatsoever.

It is noted that due to the phrasing of the tax provisions, we consider that when the taxpayer does not apply the credit mentioned before against the income tax in any year, it will lose the right to take it against the IETU of subsequent years, up to the amount not credited.

Asset tax refund

Starting January 1st, 2008 the IETU Law will abrogate the Asset Tax Law, causing that the regulation of such law, as well as the administrative provisions and resolutions, and the resolutions to inquiries, interpretations or authorizations will cease their effects accordingly.

As a result of the foregoing, it is established in a transitory provision of the IETU Law that taxpayers subject to income tax will be able to request the refund of the asset tax paid in the previous 10 years.

Such refund cannot be higher than the difference between the income tax actually paid in the year and the lowest of the asset tax paid during 2005, 2006 or 2007. In any case the refund will exceed 10% of the total asset tax that can be refunded, as shown in the following example:

Recoverable AT paid in previous years									10% Capture Limitation
2000	2001	2002	2003	2004	2005	2006	2007	Total	
400	500	700	800	300	400	1,000	650	4,750	**475**

AT Refund				
(A) IT 2008	**(B)** AT lowest in 2005, 2006 and 2007	Difference to be refunded **(A) – (B)**	**10% AT Capture limitation to be refunded**	**Net refund**
1,000	400	600	475	**475**

According to what was discussed in the Mexican Congress, the 10% capture limitation was established to avoid any adverse effect in the collection of taxes.

This procedure is contrary to the retroactivity principle for Mexican tax purposes, contained in our Constitution, since it does not recognize the right of the taxpayers to obtain their refund of the asset tax paid in previous years, in terms of the Asset Tax Law.

In addition, it is established that when the income tax is lower than the IETU, taxpayers can compensate against such difference, the amounts that they could request for refund, according to the mechanism described above.

It is also mentioned that when the taxpayer does not request the refund or compensate any amount in any year that it could be possible, he will lose the right to do it in subsequent years.

Trusts

Regarding the income obtained by trusts engaged in activities taxed by IETU, several rules are incorporated to the law, similar to the ones that are contained in the Mexican Income Tax Law for trusts engaged in business activities. These rules refer the obligation of the trustee to determine the tax result for IETU purposes or even the Credit for deductions in excess of each year, complying on behalf of the beneficiaries with the filing of the monthly tax prepayments and other obligations established in the law.

As a result from the above, the beneficiaries of the trust will consider as a taxable income for IETU purposes the tax result determined by the trust in the proportion they have in the trust. Said beneficiaries will apply the Credit for deductions in excess determined by the trustee in such proportion.

Eventually, the beneficiaries will credit in the corresponding proportion, the IETU tax prepayments made by the trustee, as well as any other credits that may apply for IETU purposes, which has already been described in this document, even the credit corresponding to wages and social security paid by the trust.

It is mentioned that for tax prepayment purposes, the trustee shall file a return showing its own activities and others for each one of the trusts administrated by it.

Likewise, it is established that in case the beneficiaries are not designated, or when they cannot be identified, it should be understood that the activities taxed by the IETU carried out through the trust, were carried out by the settlers, provided that the beneficiaries or settlers, as the case may be, will be liable for the tax obligations that the trustee has to comply with on behalf of each one of the beneficiaries.

Pass-through vehicle for tax purposes

The IETU Law recognizes the existence of trusts that obtain income derived from activities taxed by IETU not considered as business activities for income tax purposes. In this regard, it is established that such trusts can be considered as pass-through entities for IETU purposes, when their beneficiaries or settlers, as the case may be, will have to comply with the corresponding tax obligations as if the activities carried out through the trust would have been carried out directly by them.

In order to protect the trustees from the responsibility of classifying which trusts have to be considered as carrying out business activities, it is established that any trust can choose to apply for the pass-through regime, but each one of the beneficiaries or settlers have to file a notice before the trustee stating that the activities carried out through the trust are not business ones.

Likewise, the trustee will have to file a notice to the tax authorities informing that the beneficiaries or settlers of the trust will directly comply with all the obligations established in the IETU Law regarding the activities carried out in the trust. This notice will have to be filed no later than the 17th of the month following that in which the notice was received by the trustee.

Taxpayer obligations

Regardless of the obligations that IETU taxpayers have to comply with, it is established that entities carrying out activities with related parties will have to determine their income and deductions, considering a fair market value basis, applying the transfer pricing rules established in the Mexican Income Tax Law.

It is also established that when there is a community property or joint ownership, the taxpayers may designate a legal representative of such property or ownership, who will comply with the obligations established in the IETU Law on behalf of the members of the community property or joint ownership.

When the spouses in a community property chose that the spouse who obtains the higher taxable income for income tax purposes, also can chose that this spouse pay the IETU for all the income that the community property obtains.

In the case of income derived from inheritance, the legal representative will pay the corresponding tax, by filing the corresponding annual and monthly tax returns on behalf of the beneficiaries of such inheritance.

Tax consolidation

One of the most relevant changes of the tax reform, is that despite of the fact that the consolidation tax regime is allowed for income tax purposes, it is established that IETU shall be paid by each company member that integrates the consolidated group.

Although the companies will have to continue consolidating their tax results for income tax purposes, or they will have to cease consolidation and pay the deferred income tax, for IETU purposes, they will not be able to consolidate their tax results, thus eliminating any possibility of deferring the IETU.

To determine the income tax of the controlled companies as well as the income tax of the controlling company, it is allowed to credit their IETU in both monthly and annual tax payments, considering the order of credit preference previously explained. In the case of controlled companies, they will have to consider the IETU to determine the amount of tax they have to deliver to the controlled company and to the tax authorities.

It is noted that the scope of the term “delivered” to the controlled company includes only the cases in which there is an actual cash flow to the controlling company, for an amount equal to the income tax due.

Regarding the controlling company, the income tax it has to pay before the tax authorities, is the one that it would have determined if it did not consolidate for income tax purposes.

Financial institutions

For IETU purposes, the financial system is comprised by the credit institutions, the insurance companies, the bonded warehouses, the leasing companies, the brokerage agencies, the credit unions, and all the other institutions that the Mexican Income Tax Law considers as part of the financial system.

Entities that are engaged in financial intermediation and those that carry out collection activities are also considered as part of the financial system, regarding the services for which they pay and collect interests.

The financial intermediation will be considered as exclusive, when the obtained income is at least 90% of the total income of the taxpayer.

Income

It is established that the financial system will have to consider as taxable income, the income obtained from their financial intermediation margin, in addition to the one that derives from the activities subject to the IETU.

In this regard, said margin is determined as follows:

	Accrued favorable interest
(-)	Accrued interests due
(+/-)	Net monetary result
(=)	Financial intermediation margin

The net monetary result is determined based on Mexican GAAP, provided that interest will be considered as such, according to the concepts established in the Income Tax Law.

The financial intermediation margin will be subject to IETU. In case a negative result is determined, it will be characterized as a deductible item.

Any other services for which financial institutions charge any fees will also be subject to IETU.

Deductions

Financial institutions are entitled to take the following deductions, in addition to the ones authorized by the IETU Law: (i) the amount of the losses generated from bad debts derived from services rendered which generate interest income determined in terms of the Income Tax Law, (ii) the debt pooling, remissions or discounts made on the credits that represent services which generate interest income, and (iii) the amount of the losses generated from the sale of credit balance accounts, generating interest income, as well as losses generated from the payments in kind.

However, an option is established which consists in deducting the global preventive reserves created or increased, instead of the aforementioned concepts. In such case, the deduction will not be higher than 2.5% of the average annual balance of the total credit balance accounts. If this option is elected, the taxpayer will not be able to change it.

Likewise, if the reserve is decreased or the credits are recovered, such decrease will be characterized as a deemed income for IETU purposes.

Financial derivative transactions

It is established that financial derivative transactions are not taxed for IETU purposes, as long as the sale of the underlying asset is not subject to the payment of this tax.

It is pointed out that the payments of this kind of transactions will not be included in the determination of the financial intermediation margin, since those payments are not characterized as interest for IETU purposes, as they are according to the Mexican Income Tax Law.

Insurance companies

Income

Insurance companies, besides considering the income obtained from the sale of goods, rendering of independent services or granting of the temporary use of goods, will have to consider as income derived from the rendering of independent services, the financial intermediation margin determined as follows:

The favorable interests accrued, regarding resources subject to the mathematical reserves of life and pension insurances shall be added to the favorable interests derived from resources subject to administration funds linked to life insurances. This result shall be subtracted with the interests credited against the referred mathematical reserves and the additional accrued interests in favor of the policy holder.

The financial intermediation margin will also be modified with the sum or reduction, as the case may be, of the net monetary result corresponding to credits or debts whose interests are part of such margin. For these purposes Mexican GAAP should be applied at all times.

In case such margin is negative, such amount may be deducted from the other income subject to IETU obtained by the insurance companies.

Deductions

The insurance institutions may deduct, besides the aforementioned concepts, the amounts paid to their beneficiaries when the insured risk occurs, as well as the amounts applied to the creation or to the increase of certain reserves linked to certain insurances, according to the following:

Life insurances	- Mathematical reserves
Pension insurances	- Mathematical reserves - Special mathematical reserves - Other reserves that comply with the condition that every liberation must be used for a special fund
Earthquake and other catastrophic risk insurances	- Catastrophic reserve in the proportion exceeding the real interests

If the real interests are higher than the creation or reserve increase, the higher amount will be considered as income subject to IETU payment. It is important to mention that when such reserves are reduced, such reduction will be considered as income subject to IETU.

Concessions

It is determined that in the case of taxpayers holding a concession in order to exploit public goods or to render a public service, the term for the application of the credit from excess deductions determined in a fiscal year will not expire in the following 10 years but instead, they will be able to apply such credit in a term equal to the period for which the concession is granted.

Mergers and spin offs

It is established that the credit of the excess deductions should only be applied by the taxpayer and cannot be transferred to another person, not even as a result of a merger.

Regarding corporate spin offs, like in the case of tax losses for income tax purposes, such credit may be divided between the former and the spun off entities, in the proportion in which the total value of inventories and receivable accounts related to the commercial activities of the former entity were divided, if such entity mainly carried out such activities, or in the proportion of the fixed assets when it carried out other business activities, excluding investments in real estate not subject to the main activity.

IETU credit for members of non-taxpayer entities

It is mentioned that the members of non-profit entities will be able to credit against their annual income tax, the IETU actually paid by the entities who have paid them the distributable surplus, provided that such members consider as accruable income, their proportional amount of both, distributable surplus and IETU actually paid by such entity, and additionally have a certificate which states their corresponding amount of distributable surplus.

Likewise, non-profit entities that have foreign members without permanent establishment in Mexico will be able to credit against the income tax paid on behalf of the resident to which they paid the distributable surplus, the proportionally paid IETU by this entity, provided they also add to such amount, the proportional IETU.

For these purposes, it is established that the members of the aforementioned entities may credit their corresponding IETU in the same proportion in which the distributable surplus was assigned.

Additionally, a procedure is established which intends to limit the previously mentioned IETU credit for the Mexican members of such entities up to an equal amount to the income tax that is separately caused by such member due to the accrual of the distributable surplus obtained, regardless of the income tax due by other types of income.

Therefore, it is adduced that the aforementioned IETU shall be creditable for such member, up to the resulting amount from applying to the annual income tax, the proportion representing the total accruable income obtained in such year, without considering those obtained under the concept of distributable surplus, regarding the total accruable income obtained in the same tax year by such member.

$$\frac{\text{Total income - distributable surplus}}{\text{Total income}} = \frac{\text{Proportion (x)}}{\text{Annual income tax}}$$

We consider that the proportion determined according to the previous procedure is inadequate for determining the isolated effect of the income tax attributable to the distributable surplus accrued by the member in case, since it should actually consist on the opposite, this is, the correct proportion should only consider the amount of accruable distributable surplus divided by the total income of such member.

$$\frac{\text{Distributable surplus}}{\text{Total income}} = \frac{\text{Proportion (x) Annual}}{\text{income tax}}$$

The literal application of the procedure established in the applicable provisions could result in the extreme case in which the proportion of creditable IETU of a taxpayer who only had accruable income under the concept of distributable surplus would be of zero percent, hindering the possibility to credit any amount of IETU paid by the entity of which he is a member, against the income tax that such member would have caused, since such income tax would clearly derive from the accrual of the distributable surplus.

We understand that the intention of the legislators with the establishment of the mentioned IETU credit limit, is confirmed if we revise the rule which establishes that the creditable IETU of foreign members without permanent establishment in Mexico shall not exceed the income tax corresponding to the one derived from the distributable surplus given to them.

Thus, we consider that the distortions of the aforementioned procedure derive from an error of the legislators at the time of drafting the applicable text, without the desired resulting effect for such procedure; however, it is necessary to analyze further if this situation is amended by the tax authorities.

It is established that the credit of the IETU paid by the non-profit entity, would not be applicable for distributable surplus resulting from: (i) the omissions of income, (ii) purchases not carried out and unduly registered, (iii) non-deductible expenses and, (iv) loans made to the partners or members, even though the distributable surplus was not paid in cash or goods to such partners or members.

Authorities' abilities

Likewise as in income tax, the IETU Law grants the tax authorities the ability to estimate income to the taxpayers in a presumptive basis. The tax authorities will apply the rate of 17.5% (16.5% for 2008 and 17% for 2009) to the result obtained from subtracting the income determined presumptively with the deductions that the taxpayers verify.

It is established that instead of the procedure indicated in the previous paragraph, taxpayers will be allowed to choose that the fiscal authorities apply a coefficient of 54% to the presumptive income, and then apply to the result the corresponding rate, according to the tax year.

The establishment of such a high coefficient might be criticized, since for income tax effects, the applicable coefficient is 20%.

Constitutional considerations

As we have stated previously, there are certain aspects of the IETU Law that result unconstitutional, which can be summarized as follows:

(i) It is forbidden to carry out several deductions related to concepts that necessarily affect the taxpayer's contributive capacity (royalties, interests, salaries and wages, investments, tax losses, among others).

(ii) There are several vested rights on the abrogated Asset Tax Law that are not recognized; specifically those related to the refund of the asset tax paid in the previous 10 years.

(iii) The IETU credit preference order is not correct; therefore it affects the taxpayer's real contributive capacity.

We consider that the IETU generates a double taxation, thus it finally relapses on a taxable profit, and consequently, breaches the horizontal and vertical equity principles established in our Constitution.

The IETU represents a tax system that can be challenged through a constitutional injunction lawsuit that shall be filed within the 30 next business days in which the IETU Law enters into force.

TAX ON CASH DEPOSITS

In order to increase the tax collection level and avoid the increase of fiscal evasion practices in the country, a new complementary tax to the income tax is created as a cash flow control mechanism which directly levies cash deposits, shall enter in force in July 1st, 2008.

The main objective of the tax on cash deposits (Spanish acronym IDE), according to the Congressional Declaration of Purpose, is to target those who obtain income and do not inform the tax authorities, whether obtained through an informal market, on the rendering of services or the sale of goods without the issuance of receipts, or through the creation of sophisticated tax evasion schemes, among others.

However, we consider that the objective will not be reached, since this tax will mainly impact the legally established business.

In our opinion, the creation of a tax on informality like the one analyzed, is contrary to the legal certainty guaranty contained in our Constitution, since such tax is created under the premise that people who make cash deposits also carry out informal activities or evade taxes through sophisticated schemes, without being able to refute such assumptions.

General Provisions

The tax levies at a 2% rate the cash deposits exceeding $25,000 in one month, whether in national or foreign currency, made in any type of account that individuals or entities resident in Mexico or abroad, including permanent establishments, have in financial institutions.

According to the above, cash deposits up to an aggregate amount of $25,000 for each month of the fiscal year shall be exempt from this tax and thus, any exceeding amount shall pay the corresponding tax.

The amount of $25,000 shall be assessed considering all the cash deposits made on all the accounts registered under a taxpayer's name, in the same financial institution.

Deposits made in favor of individuals and entities through electronic transfers, account transfers, securities or any other document or system accorded with financial institutions, are excluded from this new tax.

As a general rule, the financial institutions are obligated to collect the tax the last day of the month, except for certain cases, like in case of time deposits or when there are no funds in the corresponding accounts.

We consider that the exemption for deposits lower than $25,000 is contrary to the horizontal equity constitutional principle, since there is no distinction which justifies the differential treatment for persons who receive deposits exceeding such amount, regarding those who receive lower deposits.

It is important to note that for IDE Law purposes, the acquisitions of cashier checks in cash are considered taxable deposits, without the $25,000 exemption being applicable.

Thus, people who acquire cashier checks in cash shall have to pay the IDE at the rate of 2% on the total amount of the acquired check.

Co-holder accounts

It is understood that the deposits correspond to the account's registered holder, unless it is informed in writing to the corresponding financial institution that the amount of the tax shall be distributed between the amount's co-holders in another way.

The way in which the $25,000 exemption shall be applied is not clear in case of this type of accounts. It seems that such exemption should be distributed between the main holder and the total of co-holders in the corresponding ratio, and not that such exemption should be of $25,000 per person.

Tax exempt subjects

It is established that the subjects exempt from IDE payment are, among others, the non-profit entities established in the Income Tax Law; the financial institutions, on the cash deposits made in their own accounts with purposes of their financial intermediation or the ones made to purchase and sell foreign currency.

Diplomatic and consular agents, among others, shall also be exempt from IDE payment, on the income they obtain which is exempt according to the Income Tax Law, as well as the individuals and entities on the cash deposits made in their accounts, opened due to credits granted by financial institutions.

It is important to point out that among the exemption cases, income obtained by diplomatic and consular agents, among others, are included, while some other types of income obtained by individuals which are also exempt from income tax payment are not, which implies an unequal tax treatment.

Obligations of financial institutions

As we mentioned, the financial institutions shall be obligated to collect the tax from any of the accounts held by the taxpayer in such institution, the last day of each month.

In case that no collection is made, due to the lack of funds, the financial institution shall collect such tax at the moment in which any deposit is made in any of the taxpayer's accounts registered in such institution.

It is established that financial institutions are jointly liable with the taxpayers for the tax not collected, whether by a mistake of the institution or because the taxpayer's funds were not enough to collect such tax, as long as in this last case, the situation was not informed to the corresponding tax authorities.

Additionally, the financial institutions shall have, among others, the following obligations: (i) keep a record of the cash deposits they receive; (ii) inform in a monthly and annual basis to the tax authorities about the amount of the collected tax and the one pending collection due to the lack of funds in the taxpayers' accounts, or by omission of such institutions, (iii) provide the taxpayer, on a monthly and annual basis, certificates which indicate the payment or the amount not collected of IDE as the case may be; and (iv) inform the holders of pool accounts about the cash deposits made in them.

In their majority, the aforementioned obligations shall be complied within the terms established by the tax authorities in administrative rules.

The financial institutions are obligated to pay the tax in the terms established in the administrative rules issued by the tax authorities, without exceeding three business days following the tax collection.

This reference to administrative rules is contrary to the legal observance constitutional principle provided in the Mexican Constitution, since the administrative authority is allowed to determine the moment of tax payment unilaterally.

Given the obligations imposed on the financial institutions, especially the joint liability with the IDE taxpayers, these institutions have a legal right to challenge and question the constitutional legitimacy of the aforementioned tax.

It is established that in case of the tax which financial institutions could not collect due to a lack of funds, they shall calculate such amount, considering the corresponding surcharges and restatement for inflation from the last day of the fiscal year and until the date in which such tax is paid.

The foregoing could be interpreted in the sense that there would not be any restatement for inflation or surcharges for the tax that could not be collected, as long as it is paid in the same fiscal year.

It must be pointed out that it shall be understood by "financial system", what is defined in the Income Tax Law. Moreover, it its established that the cooperative savings and credit entities authorized to operate as savings and credit entities, in the terms of the Savings and Credit Law, among others, shall comply with the obligations established in law.

Pool accounts

In case deposits subject to IDE are made through pool accounts between financial institutions, the holders of such accounts are the ones who must identify the final beneficiaries of such deposits, in order to collect the corresponding tax and comply with all the obligations provided for this tax.

It is understood as a pool account, the one under the name of a certain financial institution, created to receive resources from its clients in another financial institution.

According to the IDE Law, the final beneficiary is defined as the individual or entity who is a client of the financial institution and holder of a pool account.

Due taxable amount assessment

In case that from the annual information provided by the financial institutions to the tax authorities, which must be filed no later than February 15 of the following fiscal year, it is proven that there is a payable IDE amount, the corresponding due taxable amount shall be assessed.

Once the due taxable amount is notified to the taxpayer by the tax authorities, such taxpayer has 10 business days to argue in his legal right.

After this term, the authorities shall require the payment of such due taxable amount, which would be restated for inflation and shall consider surcharges since the month in which the amount could not be collected and up to the month in which it is paid.

A critic shall be made to the fact that the law in analysis establishes that the tax authorities shall determine the taxpayer's due taxable amount in the first place and then grant them a 10 day term to argue in their legal right, since such authorities do not have the faculty to unilaterally modify the due taxable amount resolution, not even as a consequence of the arguments made by the taxpayers in such term.

Due to the above, it would be necessary for taxpayers to challenge in their legal right as provided in our legal system, in order to modify the due taxable amount determinant resolution.

We consider that this situation does not comply with the legal hearing constitutional principle established in the Mexican Constitution, since the tax authorities are granted with the faculty to determine due taxable amounts to taxpayers, without considering the arguments they can make in this regard.

Credit against the fiscal year's income tax

The tax paid in the fiscal year can be credited in the first place, against the income tax due in such year, after diminishing it with the monthly provisional payments of such tax.

If there is a surplus, the taxpayer may credit such amount against the income tax withheld to third parties, and in case there is still any amount left, it can be offset against any federal tax, in terms of the Federal Fiscal Code.

In case that after applying the aforementioned credits and offsets, there is still a surplus, the taxpayer may request its refund.

The IDE paid in the fiscal year cannot be credited against the corresponding income tax when it has already been credited, offset or requested in refund, in the aforementioned terms.

When the taxpayer does not credit in a fiscal year the IDE actually paid, being able to do so, he would lose this right up to the amount in which it could have been done.

The right to credit this tax is exclusive of the taxpayer and cannot be transferred to another person, not even as a consequence of a merger or a spin off.

We consider that there is a practical problem to carry out the offset of the tax, since according to the Federal Fiscal Code, the amounts in favor of the taxpayer which are offset shall be restated for inflation from the month in which the tax return containing the favorable surplus was filed and up to the month in which the offset is made.

However, according to the procedure established in the law, there would not be any surplus in favor of the taxpayer or any tax return in which such amount is declared, thus, the tax authorities must issue administrative rules in order to clarify this situation.

Credit against income tax monthly provisional payments

In congruence with the procedure established for crediting the IDE paid in a tax year against the annual income tax, a similar procedure is established for the case of crediting such tax against the income tax monthly provisional payments.

The taxpayer may credit the IDE paid in the month against the income tax monthly provisional payments after diminishing this last amount with the corresponding year's monthly provisional payments.

If there is any surplus, the taxpayer may credit it against the monthly income tax withheld to third parties, offset it against federal taxes or request its refund, following the same preference order established for the annual procedure.

It is important to point out that the taxpayer may request the refund of the exceeding amounts of this tax which result on a provisional payment level, as long as said amounts are audited by a certified public accountant and the requisites established by the tax authorities through administrative rules are complied with.

It should be criticized that the aforementioned requisites are established in case of refund requests for monthly provisional payments, and they are not provided in case of refund requests generated at an annual level.

Credit option

An option is provided to determine the amount of IDE that the taxpayer may credit against the income tax provisional payments, which consists in estimating the amount of tax that would be paid in the following month, instead of the tax actually paid in the current month.

In case the estimated tax is higher than the one actually paid, the difference shall be paid together with the income tax provisional payment of the following month; however, if this difference exceeds in 5% or more the amount of tax actually paid, it shall be paid together with the corresponding restatement and surcharges.

On the other hand, if the estimated tax is lower than the tax actually paid, the taxpayer may credit, offset or request the refund of the resulting difference, in the same terms established for the case of credit on a provisional payment level, mentioned above.

We consider that in this case there are certain distortions, since it only allows the credit, offset or request the refund of the difference between the estimated tax and the one effectively paid, and not the difference between the latter and the income tax monthly provisional payment.

Derived from the above, the taxpayer would only be able to credit, offset or request the refund in a monthly level of a part of the surplus of such tax obtained in the month.

It must be noted that the tax credited in terms of this option is not susceptible to being credited in a consolidated level by the holding company.

In case taxpayers choose this option, they will not be able to change it in the same fiscal year.

Consolidation credit

Annual consolidated tax

In the cases of entities which consolidate for tax purposes, it is established that the subsidiary companies shall pay the income tax resulting after crediting the IDE, directly to the holding company. The same shall apply in order to determine the tax that they should pay to the tax authorities in an individual level.

The holding company may credit against the same year's consolidated income tax, the tax credited in the consolidated income tax monthly provisional payments, as we describe in the following section.

When the creditable tax is higher than the consolidated annual income tax, the surplus would be creditable against the income tax withheld to third parties, offset it or request its refund, according to the procedure established in the law.

Consolidated tax provisional payments

In order to determine the consolidated tax provisional payments, the holding company may credit against the consolidated income tax monthly provisional payment, the tax that the subsidiary companies, as well as itself, may have credited, in their consolidation ratio.

In this sense, it is established that when the creditable tax is higher than the consolidated income tax monthly provisional payment, the exceeding amount may be credited against the income tax withheld to third parties, offset or refunded, by complying with the requisites established for such purposes.

It should be pointed out that the option of crediting the estimated tax cannot be carried out at a consolidated level, both in monthly provisional payments and in the annual tax.

INCOME TAX

Back to back credits

It is specified that the transactions in which a loan is granted to a person and guaranteed by shares or debt securities owned by the debtor or its related parties resident in Mexico, shall not be considered as back to back credits.

For this purposes, the debtor may not legally dispose of the goods in guarantee, unless any of the obligations agreed upon in the credit contract are not met.

In such cases, the debtor may deduct the interests accrued regarding such credit. This exception is not applicable when the loan is guaranteed with goods of a non-resident related party of the debtor.

Individuals

Alienation of shares traded in a stock exchange

In case of individuals who obtain income on alienation of shares issued by Mexican or foreign entities, traded in stock exchange authorized by the Stock Exchange Law, new restrictions are established, which eliminate in certain cases, the exemption provided in the Income Tax Law for this type of transactions.

It is important to point out that this modification entered in force in October 2nd, 2007, unlike the rest of the provisions included in the tax reform for 2008.

With this reform, the individual or group of people who alienate 10% or more of the paid shares of the listed entity, in one or several simultaneous or consecutive transactions, within a period of 24 months, shall be subject to pay income tax.

The above, as long as the sellers hold, direct or indirectly, 10% or more of the representative shares of the entity's equity, considering the shares that such individual or group of people own, jointly or in a separate manner.

The individual or group of people who, having the control of the listed entity, sell it in one or several simultaneous or consecutive transactions within a period of 24 months shall also lose the exemption.

The aforementioned cases shall be applicable despite if such alienation was carried out through a public offer or through any other type of financial transaction, including those made through capital derivative transactions or through the sale of securities representing shares.

The taxation of shares alienated outside an authorized stock exchange remains.

These provisions will affect both, individuals who were shareholders of the listed entity at the moment of the registry of the shares in the National Stock Registry, and those who acquired such shares when they were already listed, in case the alienation of such shares is made in the aforementioned terms.

For the application of said provisions, the definitions of group of people and control will be those established in the Stock Exchange Law.

Such law establishes that a group of people is deemed to be those who have agreements of any nature, to take decisions in the same direction. Unless proven otherwise, a group of people shall be: (i) those that have a blood affinity or in-law relationship up to the fourth degree, the spouses and concubine, (ii) the entities which integrate a corporate group and (iii) those that have control over such entities.

The Stock Exchange Law also defines, in general terms, that control is the ability of an individual or a group of people to: (i) impose decisions in shareholders meetings, name or remove the majority of the counselors or managers of an entity, (ii) maintain the ownership of the voting rights of over 50% of an entity's equity, and (iii) run the administration, and/or manage the strategy or main policies of an entity.

According to what is established in the Congressional Declaration of Purpose, one of the objectives of this reform is to solely consider as exempt the alienations of shares traded in authorized stock exchanges which do not intend to transfer the ownership of entities, either through the sale of control or of a percentage of over 10% of the shares, as we previously commented.

Regarding the sale of the percentage previously mentioned, the law makes a direct reference to the Stock Exchange Law, which contains the obligation of informing to the Securities and Exchange Commission about the acquisitions and alienations made by shareholders who own over 10% of the shares representing the equity of the listed entity. This situation as explained in the Congressional Declaration of Purpose, would simplify the taxation of this type of transactions.

The wording of this provision is not quite correct, since there are several situations which are not clearly explained or not even considered.

Regarding the above, the procedure for the determination of the 24 month period we previously referred to (for exemption purposes) is not clear in case of individuals or groups of people who, at the moment of enforcement of this provision, own 10% or more shares of a listed entity.

It is also important to mention that the reform does not include provisions for financial institutions who deal in the alienation of shares carried out through authorized stock exchanges, which release them of the joint liability of withholding the tax that would have corresponded, when the alienation of shares is taxed according to the new provisions.

The above, considering that such financial institutions would probably not have the information which would allow them to know if such alienations of shares are taxed.

It is also not considered that individuals may choose to have a tax report of the alienations of shares which in terms of this tax reform are subject to income tax.

The problem remains regarding the prohibition of deduction of losses incurred by individuals, on taxed sales of shares traded in authorized stock exchanges.

The fiscal symmetry is lost, since the consequence of not solving such problem is that when a loss is generated, it shall not be deductible for income tax purposes, whereas the income obtained from such transaction shall be deemed to be taxed.

Another issue worth noting is that in case of shares acquired before the entry in force of this reform (October 2nd, 2007), the exemption of tax gains corresponding to such shares, from their acquisition and up to the enforcement date, is not recognized, whereas its alienation would be taxed according to the new provisions.

In this sense, a background exists in a transitory provision for year 2002, when the current Income Tax Law entered into force, which establishes a procedure that taxpayers must follow in order to determine the acquisition value (tax basis) of the shares considered as traded in public markets (average value of the last 22 transactions or the average value of the last transactions of the previous six months), which were acquired before the enforcement of the law, and sold after such date.

Actually, confusion arises regarding how the transitory provision shall be applied together with the general procedure established in the Income Tax Law for the determination of the average cost per share.

Capital derivative transactions

Regarding the taxable gain obtained in capital derivative transactions, an exemption case is included regarding those in which the underlying asset refers to stock indexes which represent shares traded in authorized stock exchanges in terms of the Stock Exchange Law, as long as they are carried out in recognized markets defined for such purposes in the Federal Fiscal Code.

In accordance with the above, the restriction which stated that capital derivative transactions must be paid in kind is eliminated. Thus, since the entry in force of the provision previously mentioned, the exemption shall be applicable regardless of whether the payment is made in cash or in kind.

Foreign residents

Alienation of shares

The alienation of securities exclusively representing shares is included in the income tax exemption cases, as long as for such alienation, the taxpayer is not subject to income tax payment in terms of the applicable provisions.

As part of the 2008 Tax Reform, the cases of exemption in alienation of shares through the Mexican Stock Market and other recognized markets changed significantly. Such cases were analyzed in the Individuals section of this document.

Capital derivative transactions

The tax reform for 2008 includes an exemption for gains obtained from capital derivative transactions referred to shares traded in the Mexican Stock Exchange or to stock indexes related to such shares, or to securities which exclusively represent shares, as long as such transactions are carried out in recognized markets and the exemption requisites established by the applicable tax provisions are met.

4.9% withholding tax rate

The withholding rate of 4.9% on interests paid to foreign banks registered before the tax authorities is still in force for 2008, through means of an annual provision. Such rate is only applicable in the case of residents of a country with which Mexico has a Tax Treaty in force and the requisites contained therein are met.

Preferential tax regimes

General provisions

One of the most significant tax reforms made for 2008 is the one related to the modification of the tax treatment applicable to income subject to a preferential tax regime (tax haven). The above, since the scope of the provisions applicable to such regime is extended, compared to those which, until fiscal year 2007, regulated these type of income. Definitions and exemptions are now incorporated, and faculties of verification of the tax authorities extended with respect to this type of income.

Income, entities and pass-through vehicles

Until the year of 2007, one of the basic elements for considering income as subject to a tax haven was that such income originated from a source of wealth located abroad. However, the reference stating that income from a foreign source of wealth in order to classify it as subject to a tax haven, has been deleted.

This situation broadens the scope of income which may qualify in the aforementioned tax regime, up to the point of including income from a source of wealth located either in Mexico or abroad, like in the case of dividends paid by a Mexican resident to a foreign entity or vehicle, owned by another Mexican resident.

As a reform for year 2008, it is established that the provisions contained in the Chapter of tax havens shall be applicable to: (i) income subject to tax havens obtained through entities or vehicles which are considered as pass-through entities for foreign tax purposes, regardless of the fact that the corresponding income is not subject to a preferential tax regime, that is to say, that income may be taxed abroad by an income tax equal or higher than 75% of the tax that would be caused in Mexico.

The reference establishing that income obtained due to a direct investment made by the taxpayer in a foreign country shall be considered as subject to a tax haven, is eliminated.

Income subject to a tax haven

In order to determine whether the income is subject to a tax haven, it is established that taxpayers must consider separately each transaction that generates such type of income.

When income is obtained through a foreign entity of which the taxpayer is a member, partner, shareholder or beneficiary, or through a foreign vehicle considered as a tax resident of a country subject to income tax payment, the tax gain or loss generated by all the transactions carried out in each of the entities or foreign vehicles must be considered.

Foreign legal entities or vehicles with business activities

In case of foreign entities or vehicles which carry out business activities, it shall be considered that income obtained from such activities is subject to a tax haven if their passive income amounts over 20% of their total income.

Such ratio was already included in the Income Tax Law in force for 2007; however, until this year, taxpayers had the option of not considering as income subject to tax havens those obtained by entities or vehicles from their business activities, as long as at least 50% of their total assets consisted in fixed assets, land, inventories, accounts receivable derived from the alienation of inventory goods of the entity located in the tax haven used to carry out of such business activities, providing that their passive income did not exceed 20% of the total income.

Passive income

In addition to interests, dividends, royalties, income on alienation of shares and securities, the definition of passive income is modified to include: (i) alienation of intangible assets, (ii) derivative transactions with the underlying asset referred to debts or shares, (iii) commissions and mediation fees, (iv) alienation of goods which are not physically in the tax haven where the foreign entity or vehicle resides or is located and (v) services rendered outside such tax haven.

From tax year 2008, the income derived from alienation of real estate, granting of temporary use of goods, as well as the one obtained without any consideration shall no longer be considered as passive income.

Definitions

Starting in tax year 2008, the Income Tax Law includes a series of definitions regarding what must be understood by foreign pass-through entities or vehicles for tax purposes, foreign entities and foreign vehicles.

Foreign entities which are considered as pass-through entities for tax purposes are those not subject to income tax payment in the country in which they are established or where they have their management or main direction headquarters, and their income is attributed to their members, partners, shareholders or beneficiaries.

For tax year 2007, a similar definition to the one previously mentioned, was provided. The main modifications consist basically in the specification of the cases in which the corresponding entity or foreign vehicle is not considered resident of a certain country for tax purposes, as well as in the fact that income generated by such foreign entities or vehicles is attributed to their members, despite the level in which they are subject to pay the corresponding tax.

In this last case, we consider that the tax authorities should issue administrative rules to define in which cases it shall be understood that the income is attributable to the members of a foreign pass-through entity or vehicle, in order to grant more legal certainty to taxpayers who participate through such vehicles.

Foreign legal entities are those created or incorporated according to foreign laws and have their own legal personality, as well as entities incorporated according to Mexican laws who are resident abroad.

Foreign vehicles are the trusts, associations, investment funds and any other similar vehicles created under foreign law which do not have their own legal personality.

We consider the incorporation of the definitions of both foreign entities and foreign vehicles as adequate, since the provisions established in administrative rules only included what should be understood by foreign vehicle, but not by foreign entity, besides the fact that such definition was not as specific as the one incorporated in the law for the tax year of 2008.

Deleted provisions

A significant reform to the tax provisions applicable to tax havens, is the elimination of the provision which allowed taxpayers to not consider as income subject to a tax haven those generated through a pass-through entity or vehicle, in which their indirect participation did not allow them to have effective control over such income or over the management of the entity or vehicle, to the extent in which they could decide the moment of profit distribution.

We must criticize such reform, since the provision does not recognize certain cases in which the taxpayers cannot effectively decide the moment in which they will obtain the income, like the case of investments made in foreign investment funds which are considered as pass-through entities for tax purposes, in which significant resources are pooled in order to obtain higher benefits, since commonly, the participation of the taxpayer in this type of vehicles is of little or no significance and thus, they cannot control or influence its management to decide the moment of profit distribution.

Based on the new regime, despite our previous comments, taxpayers shall consider that income obtained through this type of vehicles (pass-through entities for tax purposes) is subject to a tax haven and consequently, must pay the income tax in the year in which it is generated.

Certain options are eliminated, regarding the taxpayer's ability to not consider as income subject to a tax haven those generated in a country with which Mexico has entered an Information Exchange Treaty or, when not having such treaty, the taxpayers, as well as the foreign entities or vehicles through which such income were generated, shall have their financial statements audited by an independent public accountant who is part of an accounting firm with presence in Mexico.

Exceptions

Royalties

Taxpayers may not consider as income subject to a tax haven, those obtained by foreign entities or vehicles paid for the use or concession of patents or industrial secrets, as long as certain requirements are met, which mainly consist in:

(i) That the corresponding intangible assets were created and developed in the country in which the entity or vehicle who owns them resides or is located or, in case of acquired intangible assets, that such transaction was agreed upon at a price according to its fair market value.

(ii) That such royalties do not generate any tax deduction for a Mexican resident.

(iii) That income on royalties obtained by such foreign entities or vehicles is determined on a fair market value basis.

(iv) Keep the accounting books of the foreign entities and vehicles at the tax authorities' disposal and file the Informative Return.

We consider that the requisites provided for such effects are rather strict regarding the administrative and evidence burden they imply, and therefore only a few taxpayers shall be able to place themselves in the case considered by the tax authorities and thus, the scope of the benefits of this provision shall be severely limited.

Financing entities

Another exception added is the one related to not applying the tax treatment corresponding to income subject to a tax haven, to income derived from the granting of credits, as long as they are generated by a foreign entity or vehicle which is authorized by the authorities of the country it resides in, and the following is complied with:

(i) The taxpayers have authorization from the Mexican tax authorities in order to apply the referred exception.

(ii) The credits are not granted to related parties.

(iii) No tax deduction is generated for the Mexican resident.

As it also happens in the case of royalty payments, the tax authorities' objective by establishing this type of exceptions, besides keeping the taxpayer from additional taxes, is also to avoid that any Mexican resident takes a deduction regarding the payment of interests related to credits granted by this type of financing entities.

International corporate restructure

Another modification included in the tax reform is the one related to the cases of international corporate restructures in which shares are sold within a group of entities and consequently, income subject to a tax haven is generated. In this case, the taxpayers would be exempt from the provisions regarding such income, as long as they comply with:

(i) File a notice before the tax authorities, prior the restructure takes place.

(ii) Support the restructure with valid economic and business reasons.

(iii) File, within 30 days following the end of the restructure, the documents which support the acts comprised in it.

(iv) That the shares alienated due to the restructure are not transferred, in a two year-term following the restructure, to an individual, entity or vehicle not related to the Group.

It should be understood as Group, entities whose voting shares representing their equity are directly or indirectly owned by the same entity, in at least 51%.

Estimation of the tax gain or loss

In case of foreign entities or vehicles which are deemed resident for tax purposes and subject to income tax payment in certain country, the gain or loss shall be determined in terms of Title II "Corporate Entities" of the Mexican Income Tax Law, considering as tax year the one such entity or vehicle has in its corresponding country, as well as the foreign currency in which it should keep its books.

The tax gain shall be taxable for the taxpayer in Mexico, in the calendar year in which the business year of the foreign entity or vehicle ends, in the ratio of its participation. The final day of such business year, the conversion of foreign currency into national currency must be made.

Foreign vehicles

In case of foreign vehicles who do not pay income tax as residents of the country in which they are located, they shall consider each type of income in a separate manner, whether in terms of Title II "Corporate Entities" or Title IV "Individuals" of the Mexican Income Tax Law, according to the type of taxpayer, without the possibility of taking any deduction whatsoever in this case.

In this regard, the income would be taxable in the calendar year in which they are generated, in the ratio of the taxpayers' direct or indirect participation, causing that the conversion to national currency with the exchange rate of the last day of the year may result in adverse effects for the Mexican resident taxpayer in case of a currency devaluation, since the conversion would take place at the end of the year, and not really when the transaction was carried out, situation which we consider should be corrected by the tax authorities.

The income subject to the regime we hereby analyzed, shall pay the corresponding tax in an isolated way; this is, such income should not be combined with other types of income obtained by Mexican residents, for tax purposes.

Income, profit or tax result account

It is established that the account which should be kept by taxpayers related to the taxable income, profit or tax result of each tax year, shall be determined for each foreign entity or vehicle in which they participate and which generate the corresponding income, pointing out that the income, profit or tax result added to such accounts should not include the income tax paid regarding such amounts. We consider this situation incorrect, since the amount corresponding to such tax was already paid for with the taxpayer's resources in Mexico, and when withdrawing the corresponding profits of the foreign vehicle, an additional tax would be generated over the amount of the previously paid tax.

We shall criticize that the income derived from dividends obtained from a Mexican source of wealth, is not included as a concept with which the aforementioned account can be increased, since such income, when distributed to a foreign entity would have already paid the corresponding income tax, whereas at the moment in which the entity redistributes such resources to a Mexican resident, that person would not be able to consider that such dividends were generated from the account of income, profits and tax result subject to a tax haven and thus, that they already paid the corresponding tax in Mexico, generating a double taxation on the same income.

In addition, it is pointed out that in case of income derived from the liquidation and/or capital redemption, the taxable income should be determined in terms of the Income Tax Law established for these purposes, while such provision is applicable to entities and not to foreign vehicles.

Paid tax credit

In relation to the credit of the tax actually paid abroad by all the foreign entities or vehicles in which a taxpayer participates, the reference which established that the general procedure established in the Income Tax Law must be applied, is eliminated, issuing a specific procedure which allows the credit of this tax in the same ratio in which the income of the entities or vehicles is taxable for them, taking into consideration that such credit would not exceed the tax that would be caused in Mexico (28% rate).

A critic should be made to the fact that the tax paid by Mexican taxpayers different from the one stated in Title V of the law "Foreign residents with income from a Mexican source of wealth", regarding income distributed abroad and subsequently returned to the country as income subject to a tax haven according to the new regime provisions, was not included among those subject to credit.

Sham of legal acts

A rather significant addition to the current tax regime is the one related to the auditing faculties granted to the tax authorities, allowing them to determine, in case of transactions carried out with related parties, whether those transactions are shammed acts ("administrative sham") which supposedly were carried out by the taxpayers.

According to the Mexican legislation, the authority capable of determining the shamming of acts can only be a civil judge, which is why the actual reform grants the tax authorities the faculty for determining, without mediation of such judge, the sham of acts for tax purposes, thus, simplifying the procedure which they would have to follow in order to exercise their faculties and determine due taxable amounts.

In this sense, the tax authority shall be forced, during the audit procedure, to support and explain the cause of sham, as well as to declare its existence in the taxpayers fiscal situation, whereas in the resolution they should: (i) identify the shammed act and the one really carried out, (ii) assess the amount of the tax benefit obtained from the shammed act and (iii) point out the elements due to which the existence of such sham was determined, including the intention of the parts carrying out this type of acts.

It is important to point out that in order for the authorities to be able to demonstrate the shamming of a legal act on behalf of the taxpayers, they may base themselves on presumptive elements, which could create a situation of legal uncertainty for the taxpayers, who shall have the obligation of demonstrating to such authorities that the legal act does not consist on a shamming.

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