

The 13th Annual Americas School of Mines Current Latin American Tax Uncertainties

“Current Mexican Tax Scenario:
Uncertainties and their impact abroad
(e.g. USA Fin 48)”

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Agenda/Contents

1. Current Mexican Tax Scenario: Uncertainties and its impact abroad (e.g. USA Fin 48)
 - What is FIN 48 (as an example)
 - The Mexican Tax Environment
 - Mexican tax uncertainties
 - Other Mexican tax uncertainties

Section

1. Current Mexican Tax Scenario: Uncertainties and its impact abroad (e.g. USA Fin 48)
 - **What is FIN 48 (as an example)**
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Our economies have become globalized

What is FIN 48 (as an example)

What is currently affecting and how should Mexican tax advisory proceed?

At the end, it is not the Mexican
Companies the ones affected, but...

The shareholders!

What is FIN 48 (as an example)

Accordingly: What must be considered in Mexico and abroad, in relation with the current ever-changing tax environment?

- How changes will affect the Mexico itself?
- How will they affect the Headquarters?
- Who must be deeply informed?
 - Local management
 - Management in Headquarters
 - Headquarters advisory team (audit, tax, etc)

What is FIN 48 (as an example)

Fin 48 (as an example)

Affects financial statements in the USA and accordingly the following important issues must be considered:

- FASB 109
- FIN 48
 - Or whatever similar in other Countries

What is FIN 48 (as an example)

Mexican Tax uncertainties and their impact abroad

Companies everywhere in the world seek within a legal frame to succeed in:

- Reducing its tax burden
- At least defer the impact
- Both legally and without major problems

Mexican Tax uncertainties and their impact abroad, (continue)

- Positions taken in tax returns may be well-grounded and taken in good faith, but with the complexities and varying interpretations of the tax law, these may not ultimately prevail.
- For instance FIN 48 establishes the accounting for uncertain tax positions, including recognition and measurement of their financial statement effects”

What is FIN 48 (as an example)

Mexican Tax uncertainties and their impact abroad, (continue)

Criteria, positions and interpretations to determine the lowest tax burden, may be well intentioned, and even well and soundly sustained, but...

- Tax authorities position is quite often different
- Authorities Criteria may likely prevail

Mexican Tax uncertainties and their impact abroad, (continue)

It is here where provisions such as FIN 48 or similar in other countries become important... Not in Mexico, but abroad

e.g. Fin 48 establishes

- The way to consider for accounting/financial purposes **Uncertain Tax Positions (UTP)**
- Including a “measure” and recognition of its effects in the financial statements

Mexican Tax uncertainties and their impact abroad, (continue)

- Applies to all entities that have to prepare financial statements according to US GAAP (similar to Mexican NIF)
- Includes exempt entities
- Changes significantly the treatment of positions that had only temporary effect (e.g. depreciation)
- Has an impact in all the periods in which the criteria may affect the tax results

What is FIN 48 (as an example)

Mexican Tax uncertainties and their impact abroad, (continue)

It is based on the “measure” known as:

MLTN

As per the acronym:

More Likely Than Not

But the issue is: More likely than not...What?

- That the company's criteria will NOT prevail

Mexican Tax uncertainties and their impact abroad, (continue)

MLTN Signifies that:

- A benefit related with a UTP may be recognized in the financial statements when it is MLTN that the criteria from which it arises can be technically sustained
- Exists –in its case- more (or less) than 50% that the position or criteria may be technically supported in case of a challenge by the highest tax/legal authority in case of a litigious legal process

What is FIN 48 (as an example)

Mexican Tax uncertainties and their impact abroad, (continue)

“Measure Unit”

The way to determine what constitutes a Tax Position in each case, is analyzing how one criteria may affect results and is a matter of an adequate professional judgment (e.g. tax attorney)

Mexican Tax uncertainties and their impact abroad, (continue)

... and what must be considered:

- The level of existent documental support to sustain such criteria
- The probability level that the authority will challenge and in its case reject said criteria i.e. the UTP (it may relate to new or very well known issues)

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The Mexican Tax Environment

Current Reality

- Many corporations with foreign headquarters
- Increasing technical knowledge and better follow up by Mexican Authorities
- More control and requirements everyday, and “show of force” from the authorities against tax evaders
- More attention on transactions among related parties

The Mexican Tax Environment, (continued)

Reflections

- The documental evidence and technical support we currently have is sufficient in order to avoid a UTP?
- If the uncertainty arises from a Mexican legal provision, is it still an UTP?
- Are the HQ's fully informed and aware of the potential Mexican tax uncertainties?

The Mexican Tax Environment, (continued)

- Mexican tax structure is similar to that of the United States of America (US)
- There is an Income Tax (MIT) which, as it happens in many countries, taxes “ Profits from doing business”
- Due to the economical ups and downs and to highly effective tax planning, many companies have been reporting tax losses for a considerable time
- This made it necessary to introduce an alternative minimum tax in order to assure the government to receive at least part of what enterprises obtain from doing business in Mexico

The Mexican Tax Environment, (continued)

Asset Tax:

- First it was the AT- introduced in 1988
- Provided the government with a minimum contribution from Mexican enterprises, whether corporations or individuals
- It carried a tax burden based in the gross financial and fixed assets used in the enterprise operation
- The rate after some minor adjustments, was first 2% and eventually came down to 1.25%

The Mexican Tax Environment, (continued)

- AT was particularly criticized and detested
- Complicated to compute and legal provisions were somehow obscure and subject to different interpretations
- Constant legal uncertainty
- Since the base was assets, it was argued against this tax that it obstructed investment in companies
- After 2007 AT was finally repealed

The Mexican Tax Environment, (continued)

But a new tax emerged:

- IETU/Flat Tax
- IETU became effective on January 1, 2008 and replaced the AT
- Applicable on Mexican resident taxpayers' income from worldwide sources and foreign residents with a PE in Mexico
- A rate of 17% in 2009 and 17.5% in 2010 is applied to the Flat Tax base
 - Future rate?

The Mexican Tax Environment, (continued)

- In general, Flat Tax is based on cash flow
- On the excess of income from: the sale or disposition of property, the provision of independent services, and the granting of the temporary use or enjoyment of assets (i.e. rental income and unrelated party royalty income)
- Over amounts paid for: the acquisition of assets, the receipt of independent services and the temporary use or enjoyment of assets, as well as certain other expenses

The Mexican Tax Environment, (continued)

- Salaries/wages, employer contributions to Social Security, employee non-taxable benefits, most interest income, as well as royalties received from related parties for the temporary use or enjoyment of intangible assets, are not included as income
- Payment for these types of expenses are also nondeductible
- Nevertheless, employer is allowed a Flat Tax credit on “taxable” wages and social security contributions, which provides a similar effect to deducting these items

The Mexican Tax Environment, (continued)

- As mentioned, this Flat Tax operates as a supplemental tax to the Income Tax
- To the extent the computation yields an amount which is higher than the Income Tax for the taxable year
- Accordingly, the initial Flat Tax computation is reduced by a “credit” for an amount equal to the Income Tax of the taxable year, as well as the Income Tax arising from distributions of dividends exceeding the cumulative tax basis earnings and profits account (CUFIN)

Mexican tax uncertainties:

IETU (flat tax): its effects on foreign subsidiaries

- No “group” taxation (consolidation)
- May increase effective tax rate
- Some payroll expenses not deductible
- Limit the benefit of tax crediting and/or recognition of losses

Mexican tax uncertainties, (continued)

IETU (flat tax): its effects on foreign subsidiaries

- Limits depreciation
- Sale of assets may have severe consequences
- Investment may create a tax credit with limits to this benefit
- Ergo: need for better projections and budgeting
- Good legal planning is possible

Mexican tax uncertainties, (continued)

IETU (flat tax): its effects on foreign subsidiaries

- All this must be considered for purposes of determining deferred taxes if at the end IETU will be paid in lieu of IT

Other Mexican tax uncertainties:

- IETU: According to Law:
 - Not known whether IT or IETU will remain
 - Rate may change
- IETU: other
 - Not known whether it will remain applicable for purposes of FTC

Other Mexican tax uncertainties, (continued)

- As stated, going beyond FIN 48 and similar regulations worldwide, a thorough evaluation of the possible risks provided by the Flat Tax should be performed and the valuation of such effects should be kept, if not in books, at least in mind when operating in Mexico.

With good legal planning, investing in Mexico has many good opportunities.