

# 2008 Mexican Tax

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Corporate Flat Tax Law, Tax on cash deposits and Income tax

October, 2007



# Corporate Flat Tax Law - IETU



# Corporate Flat Tax Law

## GENERAL COMMENTS

- It is an alternative minimum tax. Taxpayers will pay the excess of IETU over Income Tax.
- Substitutes asset tax, which is repealed, and is a permanent tax.
- There are certain income, deductions and credits claimed for purposes of computing IETU.
- Income and expenses for IETU purposes will be calculated on a cash flow basis.
- Eliminates deductions like non-taxed benefits paid to employees, most interest to all parties and certain royalties paid to related parties.
- No exemption for start -up period.



# Corporate Flat Tax Law

## GENERAL COMMENTS (Continue...)

- Aimed to combat tax evasion, and basically taxes consumption.
- Determined similar to the current Value-added Tax (VAT) in Mexico.
- The IETU does not generate CUFIN.
- Transition rule for income and deductions accrued during 2007.
- Limited carry forward of Asset Tax being allowed.
- Transition deductions or credits allowed for certain depreciable assets acquired before 2008.



# Corporate Flat Tax Law

## SUBJECTS

- Mexican resident corporations and individuals with business activities, on their worldwide income.
- Non residents with a PE in Mexico.

## TAX RATE

- 2008 - 16.5%;
- 2009 - 17 %
- 2010 and subsequent years 17.5%



# Corporate Flat Tax Law-IETU

- IETU income collected
  - **Less:** IETU deductions paid

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- Equals: IETU positive or negative base
- **Multiplied by**
- 17.5% (16.5% and 17% in 2008 and 2009, respectively)

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- **Equals:** Initial IETU if positive, or IETU credit if negative.

- Initial IETU
- **Less:**
  - IETU tax credit carryforward
  - Taxed salaries and social security contributions credit.
  - Fixed assets acquired between 1998 through 2007 credit.
  - Income tax paid credit
  - Advance IETU payments.
- **Equals: IETU due**



# Corporate Flat Tax Law

## INCOME

On a cash basis related to the following activities:

- Sale of goods (without deductions of cost of sales).
- Providing independent services.
- Unrelated party royalty income and all rental income from granting temporary use of property.



# Corporate Flat Tax Law

## INCOME (Continue...)

– The gross income includes from sale of goods the following:

Regular sales price plus:

- Interest on financed sale.
- Advance payments or deposits.
- Late charges.
- Taxes or other licenses or fees charged to the taxpayer, other than creditable taxes.



# Corporate Flat Tax Law

## EXEMPT INCOME

- Related party royalties, interest income, dividend income.
- Sale of shares, quotas, accounts receivable, letters of credit, certificates on immovable property on house and non-amortizable certificates on immovable property traded in a stock market.
- Accidental acts carried out by individual with no entrepreneurial activities.



# Corporate Flat Tax Law

## DEDUCTIONS

Amounts paid for:

- General expenses.
- Acquisition of inventory and depreciable fixed assets.
- Payments for independent services paid (excluding salaries / wages).
- Royalties paid to unrelated parties and rents to all parties.



# Corporate Flat Tax Law

## DEDUCTIONS (continue...)

- Federal or Local taxes except:
  - Income Tax,
  - Flat Tax,
  - Tax on Cash Deposits.
  - Social Security and,
  - Housing Fund (INFONAVIT).



# Corporate Flat Tax Law

## DEDUCTIONS (continue...)

- Non recoverable VAT.
- Refunds, discounts and allowances on sales.
- Refund of deposits and advance payment previously included in income.
- Certain penalties paid.
- Interest on IETU taxable purchases/sales.
- Charitable contributions which are not onerous or remunerative subject to a 7% of prior year taxable income limitation (same as income tax rule).



# Corporate Flat Tax Law

## NON DEDUCTIBLE ITEMS

- No deduction allowed for royalties paid to related parties (other than those charged for the use of equipment). Although royalties to related parties for the temporary use or enjoyment of industrial, commercial or scientific equipment are included in or deducted from Flat tax income.
- Salaries and wages, employee benefits and social security contributions.
- Interest expense unless associated with the sale of an asset.
- Depreciation (transitional rules).
- Employee profit sharing (PTU) payments.



# Corporate Flat Tax Law

## NON DEDUCTIBLE ITEMS (Continue...)

- Cost of goods sold (deductions of purchases is allowed.)
- Net operating loss (NOL) carry forwards do not reduce IETU income.
- Cost of sales for inventories sold (cost of purchases are allowed).
- However, the preamble to IETU bill leaves to the Executive branch, the legislation of transitional rules for inventory on hand as of December 31, 2007 and NOLs attributed to immediate deductions claimed between 2005 and 2007.
- Dividends, capital gains and losses from the sales of shares and interest inflows and outflows are excluded from the computation of the IETU taxable or loss.



# Corporate Flat Tax Law

## DEDUCTION OF NEW ASSETS ACQUIRED IN 2007

- Applicable to payments made for the acquisition of new fixed assets and deferred charges and expenses from September 1, 2007 through December 31, 2007.
- New fixed assets are defined as used for the first time in Mexico.
- Deduction equal to 33% of the acquisition amount in 2008, 2009 and 2010 (restated for inflation). Payments in 2008 for acquisitions made from September to December 2007, would be deductible when effectively paid.



# Corporate Flat Tax Law

## DEDUCTION OF NEW ASSETS ACQUIRED IN 2007 (Continue...)

### EXAMPLE:

- Payments for acquisitions of new fixed assets **Sept. 07 – Dec. 07.** \$ 9,000
- Annual deduction - IETU ( $\$9,000/3$ ) \$ 3,000
- Monthly payments deduction – IETU ( $\$3,000/12$ ) \$ 250 (a)

(a) The advance payments will be based on a determination of the total accumulated IETU gross income from the beginning of the taxable year and until the month for which the payment is being determined, minus the authorize IETU deductions for that same period.



# Corporate Flat Tax Law

## TRANSITIONAL RULE- ACRUALS IN 2007

- No deduction is allowed in 2008 for payments in 2008 relating to salaries, wages and social contributions accruing to calendar year 2007.
- No deduction is allowed in 2008 for payments in 2008 relating to:
  - Purchases of inventory and fixed assets in 2007 accruing to calendar year 2007.
  - Services received prior to 2008.
  - Temporary use or enjoyment of property prior to 2008.



# Corporate Flat Tax Law

## TRANSITIONAL RULES- ACRUALS IN 2007 (Continue...)

- Revenues collected in 2008 will not be taxable in the case of:
  - Sales made during 2007.
  - Services provided by the taxpayer before 2008.
  - Temporary use or enjoyment of assets for periods before 2008.
- The above rule only applies if income is recognized prior to 2008 for regular income tax purposes.



# Corporate Flat Tax Law

## CREDIT-ACQUISITION OF ASSETS BETWEEN 1998 THROUGH 2007

- Direct tax credit, applicable to fixed assets acquired from 1998 to 2007. Based on the net tax value as of 12/31/2007.
- 5% of such amount would be deductible every year from 2008 to 2018.
- 50% of basis essentially lost.
- Cannot deduct remaining basis for purposes of computing gain and can not continue to depreciate if sold.



# Corporate Flat Tax Law

## CREDIT-ACQUISITION OF ASSETS BETWEEN 1998 THROUGH 2007

### (Continue...) EXAMPLE

Undepreciated amount (assets acquired between Jan 1998 – Dec.2007)	\$ 200,000
(x) IETU rate (0.165 in 2008 and 0.17 en 2009)	\$ 33,000
Credit for the year ( 5%)	\$ 1,650
Credit in monthly payments (\$1,650/12)	\$ 138

\* This credit is adjusted for inflation annually within the 10 year period. A credit for the excess of expenses over income for IETU purposes may be applied against income tax for the year, and is also available for carryforward to reduce IETU for a 10 year period.



# Corporate Flat Tax Law

## IETU CREDIT

- When IETU deductible expenses exceed IETU income. Limited to the IETU rate (16.5% for 2008, 17% for 2009, and 17.5% after 2009) multiplied by excess IETU deductions over IETU income.
- Applied against IETU advance payments paid in prior months of the same taxable year.
- 10 year carryforward to offset IETU.
- Can applied partially or totally against the same year income tax and can only be carryforwarded for IETU.



# Corporate Flat Tax Law

## IETU CREDIT - (Example)

### CASE 1

	INCOME TAX	IETU
Taxable income	\$100.00	\$160.00
Authorized deductions	<u>(150.00)</u>	<u>(260.00)</u>
Base or (difference)	(50.00)	(100.00)
Tax rate	<u>28.00%</u>	<u>16.50%</u>
Tax or IETU tax credit	-	<b>(16.50)</b> (1)

(1) It is available for carryforward to reduce IETU for a 10 year periods.



# Corporate Flat Tax Law

## IETU CREDIT- (Example)

### CASE 2

	INCOME TAX	IETU
Taxable income	\$ 100.00	\$ 120.00
Authorized deductions	<u>(50.00)</u>	<u>(220.00)</u>
Base or (difference)	50.00	(100.00)
Tax rate	<u>28.00 %</u>	<u>16.50 %</u>
Tax or IETU tax credit	\$ 14.00 (a)	\$ <b>(16.50)</b> (b)
Less IETU tax credit	(16.50)	
Income tax payable	\$ -	

(a)-(b)=\$2.5 It is available for carryforward to reduce IETU for future periods.



# Corporate Flat Tax Law

## IETU CREDIT- (Example)

### CASE 3

	INCOME TAX	IETU
Taxable income	\$ 100.00	\$ 120.00
Authorized deductions	<u>(50.00)</u>	<u>(140.00)</u>
Base or (difference)	50.00	(20.00)
Tax rate	<u>28.00 %</u>	<u>16.50 %</u>
Tax or IETU tax credit	\$ 14.00	\$ <b>(3.00)</b>
Less IETU tax credit	(3.00)	
Income tax payable	\$ <b>11.00</b>	



# Corporate Flat Tax Law

## TAXABLE SALARIES AND SOCIAL SECURITY CONTRIBUTIONS CREDIT

- A credit against the IETU is allowed for taxable salaries and social security contributions, limited to the IETU rate (16.5% in 2008).
- The credit will be computed with the IETU rate multiplied by the salaries subject to income tax.
- IETU credit amount is provided by multiplying the IETU rate by the amount of social security benefits paid in Mexico by the employer.
- Exempt salaries and wages do not provide a credit for IETU.



# Corporate Flat Tax Law

## TAXABLE SALARIES AND SOCIAL SECURITY CONTRIBUTIONS CREDIT

Taxed salaries paid

(+) Social contributions paid (employer share)

(=) Sum of taxed salaries and social contributions

(X) 0.175 (0.165 in 2008, 0.17 in 2009)

(=) Taxed salaries and social contributions credit

Notes: Credit only available to the extent the taxpayer complies with withholding obligations, including remittance of such withholding to the government. Non-taxed wages are excluded from such credit.



# Corporate Flat Tax Law

## TAXABLE SALARIES AND SOCIAL SECURITY CONTRIBUTIONS CREDIT

### EXAMPLE:

Wages and Salaries paid in the year	20,000.00
Social Security dues	10,000.00
Sum of taxed salaries and social contributions	30,000.00
(x) IETU rate	0.165
Tax credit for the period	<b>\$ 4,950.00</b>



# Corporate Flat Tax Law

## CREDIT FOR INCOME TAX PAID

- Taxpayer's income tax for the year, including tax on dividends.
- Foreign income taxes when the foreign income is taxable for IETU (e.g., permanent establishment abroad).

## ADVANCE PAYMENTS

- Determined on monthly and cumulative revenues and allowed deductions.
- Frequency and due dates same as income tax.
- Any overpayment of IETU estimated payments can be offset against the income tax estimated payments and vice versa (IETU overpaid can be refunded).



# Corporate Flat Tax Law

## SUMMARY OF CREDITS ALLOWED

- Income Tax paid
- Tax Credit equal to Taxed wages multiplied by IETU rate
- Social Contributions Credit multiplied by IETU rate
- Tax credit for IETU credit carry forwards
- Transitional rule - Tax credits on fixed assets acquired before 2008
  - 5% on net value for acquisitions  
1/98 – 12/07 (until 2018) multiplied by IETU rate
- Estimated IETU Taxes paid



# Corporate Flat Tax Law

(+) Income from sale of goods (cash collected)		\$140,000
Deferred Income	139,000	
Cash collected from sales for the prior year	3,000	
Income not collected at the end of the year	-2,000	
(-) Deductions:		\$ 90,000
Deferred cost and expenses	130,000	
<b>Cost of sales</b>	<b>- 40,000</b>	
<b>Salaries and Social contributions</b>	<b>- 30,000</b>	
<b>Royalties paid to related parties</b>	<b>- 1,000</b>	
<b>Expenses not deductible for Income Tax</b>	<b>- 2,000</b>	
<b>Interest</b>	<b>- 1,000</b>	
<b>Depreciation</b>	<b>- 1,800</b>	
<b>Expenses not paid at the end of the year</b>	<b>- 4,000</b>	
Purchases paid in the year	32,000	
Investments paid in the year	4,800	
Additional deduction (investments 2007)	3,000	
IETU BASE		<b>\$ 50,000</b>



# Corporate Flat Tax Law

## EXAMPLE OF THE APPLICATION OF THE IETU

IETU BASE	<b>\$ 50,000.00</b>
Transitional rate (16.5% applies in 2008 and a 17% rate applies in 2009)	16.5%
Calculated IETU	8,250.00
Credit for the new depreciable assets acquired prior 2008	1,650.00
Credit for salaries and social contributions	4,950.00
Income Tax	1,220.00
IETU amount	<b>430.00</b>
Monthly payments for IETU	400.00
IETU OWED	<b>30.00</b>



# ASSET TAX REFUND



# Asset Tax Refund

## CARRYFORWARDS OF OLD “ASSET TAX” ON EFFECTIVE DATE

- Asset tax repealed after 2007.
- Taxpayers required to pay the income tax during the taxable year, will be able to request a refund of the unrecovered asset tax paid in the previous ten years.
- Up to the difference between the income tax paid in the carryforward year and lowest unrecovered asset tax calculated for 2005, 2006 or 2007, but the allowed credit cannot exceed 10% of total unrecovered asset tax carryforwards as of December 31, 2007.
- Limited benefit of Asset Tax carryforwards per above and due to ordering rule as follows:  
Utilize Asset Tax credit against the initial IETU in carryforward period (i.e., not just the excess of the initial asset tax over the income tax).



# Asset Tax Refund

## Example of the recovery of the Asset Tax paid as of December 31, 2007.

Asset Tax of previous ten years			<u>\$ 1,000.00 (a)</u>
Tax year	<u>2005</u>	<u>2006</u>	<u>2007</u>
Asset Tax paid	\$ 400.00	<b>\$ 250.00</b>	\$ 300.00
Lowest Asset Tax paid. (\$250)			
Tax year	<u>2008</u>	<u>2009</u>	<u>2010</u>
Income Tax	\$ 400.00	\$ 300.00	\$ 350.00
Lowest Asset Tax paid.	<u>(250.00)</u>	<u>(250.00)</u>	<u>(250.00)</u>
Difference	\$ 150.00	\$ 50.00	100.00
Recoverable Asset Tax			
Limit (\$1,000x10%= 100)	<u><b>\$ 100.00</b></u>	<u><b>\$ 50.00</b></u>	<u><b>\$ 100.00</b></u>



# TAX ON CASH DEPOSITS “IDE”



# Tax on cash deposits (IDE)

## TAX ON CASH DEPOSITS (“IDE”)

- 2% of cash deposits made to bank accounts (except checks and wire transfer deposits) exceeding \$25,000 as of July 1, 2008.
- Can be credited against taxpayer’s own income tax, and any excess can be credited against the income tax withheld on payments to third parties. The remaining balance, can be applied against other federal contributions. If after applying the previous procedures there is a remaining balance, this balance will be eligible for a refund request.



# INCOME TAX



# Income Tax Law

## INCOME TAX

- Taxpayers must inform the Mexican Tax Authorities of the amounts received for loans, capital contributions or contributions for future capital increases that exceed \$ 600,000 Mexican pesos, in the following 15 business days.
- Losses generated in a sale of shares can be applied against the profits obtained in similar transactions. The excess balance can be carried forward for a period of 10 years.
- Amendment to the definition of back-to-back loans.
- Donations are deductible up to a 7 % of the tax profit obtained in the previous year.
- 4.9% withholding rate on interest payments made to banks residing in a country that has a tax treaty in force with Mexico.

