Mexico: 2014 Tax reform law passed

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In brief

Mexico passed a tax reform law that will take effect on January 1, 2014. There are many broad changes, including new income tax brackets, new taxes on certain dividends and gains, and an additional restriction on personal deductions. The overall tax liability on compensation and investment income will likely increase for tax resident individuals, causing a potential increase in the tax equalization costs for companies with international assignees in Mexico.

In detail

The 2014 Mexican Tax Reform contains several changes that negatively affect individuals who are tax residents of Mexico. These new rules will take effect January 1, 2014. Highlights of the tax reform law are outlined below:

Income tax brackets

Three new brackets were added to the tax table, and the top rate will now be 35% on annual taxable income above 3,000,000 pesos (about US$240,000).

New taxes on certain dividends and gains

There is a new 10% tax on dividends received from foreign corporations. The tax must be paid monthly, and it is a final tax. This new tax must be paid in addition to the (up to 35%) tax to be paid with the annual tax return.

This is the change that will cause the greatest additional administrative burden for individuals, especially international assignees.

There is also a new 10% tax on dividends received from Mexican corporations. The tax must be withheld by the Mexican corporation, and it is a final tax. This new tax must be paid in addition to the (up 35%) tax to be paid with the annual tax return (net of the deemed credit for the 30% Mexican corporate tax paid).

There is a new 10% tax on net gains realized on the sale of Mexican or foreign shares in the Mexican stock exchange (or on the sale of shares of Mexican companies on recognized foreign stock exchanges). Prior to 2014, these gains were completely tax exempt.

Losses can be offset against gains, but not against other income. The net gains must be reported and the tax paid with the annual tax return. It is a separate tax, and the net gains are not included with other taxable income for the regular income tax.

Principal residence exemption

The amount of exemption for the gain on the sale of an individual's principal residence has been reduced. The exemption will now be limited to the gain corresponding to approximately US$280,000.

The complete exemption that was previously allowed when the individual had lived in the house at least 5 years has been repealed. This applies to homes located in Mexico as well as abroad.

Personal deductions cap

Personal deductions will be further restricted. A new overall cap will apply to the total amount of personal deductions. They will be limited to the lesser of (a) 10% of current income (including tax exempt income), and (b) 4 times the annual minimum wage (about US$7,500).

Home mortgage interest is subject to this overall limit, and to the additional limit, which is the amount of real interest(inflation adjusted) paid that corresponds to mortgage principal of about US$300,000. Charitable donations are not subject to this cap, but they remain subject to a separate cap of 7% of the prior year's taxable income. Medical expenses paid in cash will no longer be deductible.

Other changes

Several other changes are aimed at complementing a new anti-money laundering law, and at strengthening the ability of the tax authorities to prosecute tax audits.

There are two items of good news. The tax reform repealed the tax on cash deposits in Mexican banks (IDE). In addition, the flat tax on business income (IETU) which functions like a minimum tax has been eliminated for 2014. With respect to international assignees in Mexico, the IETU tax applied to rental income, and in some cases caused a significant additional tax burden, which will now be relieved.

The takeaway

There are significant tax increases for 2014 in Mexico that affect tax resident individuals, whether they are Mexican nationals or foreigners. Consideration should be given to how these changes will affect international assignment programs. They will probably cause an increase in the tax equalization costs for companies with international assignees in Mexico, as well as increase the taxes on personal income and make tax compliance more complicated.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact the following representatives from PwC Mexico:

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