



**BDO Seidman, LLP**  
Accountants and Consultants

October, 2004

## Subject: Mexico

### Proposed Tax Bill— For 2005

# International Tax Alert

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### Date\Timing:

On September 8, 2004, a Proposed Tax Bill was presented by Mexico's government to the Mexican Congress. If the proposed Tax Bill is approved by the Mexican Congress, it will be effective on January 1, 2005.

### Details:

1. **Corporate Tax Rate:** Under the current law, the Corporate Income Tax Rate is 33% and is scheduled to be reduced to 32% in 2005. The Proposed Tax Bill establishes a reduction of the Corporate Tax rate to 30% in 2005 with further reductions of 1% in each of the following tax years until it reaches 28% in 2007.
2. **Profit Sharing Deduction:** The Proposed Tax Bill would allow Mexican Companies to deduct for income tax purposes the 10% mandatory profit sharing paid to their employees. Currently, the deduction of the mandatory profit-sharing is so limited that, in practice, it is not a deductible expense for Mexican Companies.
3. **Cost Of Sales v Purchase Deduction:** In the current law, inventory is deductible in the tax year of the purchase. The Proposed Tax Bill is restoring a system (which was previous used in Mexico in 1996) that would require that Mexican companies deduct their cost of sales instead of the inventory purchases made in a given year.
4. **Thin Cap Rules:** Currently, there are no thin capitalization rules established in the Mexican Income Tax Law. The proposed tax Bill includes the enactment of Thin Capitalization Rules. In general terms, these thin capitalization rules state that interest payment would be deductible as long as the debt-equity ratio of 2-to-1 is not exceeded. Also, special rules would apply for loans between related parties, whereby an Advance Pricing Agreement (APA) would be required to determine the debt-equity ratio.

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## Details:...(continued)

5. **CFC Rules for Jurisdictions with Preferential Tax Regimes:** The Mexican Income tax law currently establishes that income obtained for investments made in a “Black Listed” jurisdiction should be taxable in Mexico in a current year basis. The Proposed Tax Bills suggests the elimination of the “The Black List” and to consider all jurisdictions in which the effective rate is less than 75% of the Mexican Corporate rate.
6. **Transfer Pricing:** The current Transfer Pricing Regulations are applicable to all Mexican taxpayers that carry out transactions with their related party, except for the taxpayers operating under the simplified tax regimen. The Proposed Tax Bill suggests that these taxpayers should also be subject to the Transfer Pricing Rules.
7. **Independent Services:** The Proposed Tax Bill establishes a new assumption to determine whether or not the source of income for independent services is located in Mexico. This new assumption establishes that a service would be to be rendered in Mexico if the payer of the service is a Mexican resident.
8. **Credit Rights:** The Proposed Tax Bill establishes that the gain obtained by a foreign resident from the sale of credit rights issued by a Mexican resident or a foreign resident with a permanent establishment in Mexico should be subject to taxation in Mexico as an interest income,, when these rights are acquired by a Mexican resident or a foreign resident with a permanent establishment in Mexico.
9. **Value Added Tax:** The most relevant aspect of the Proposed Tax Bill related to the VAT is the reduction of the general VAT rate from 15% to 12%, and from 10% to 7% on the borders areas.
10. **Sales and Service Tax:** Another relevant changed being proposed is to empower the States and Municipalities to impose a 3% federal sale and service tax (2% for the state and 1% for the Municipality).
11. **Other Taxes:**
  - a. **Individuals:** The Proposed Tax Bill will grant the authority to the local governments to impose a tax on individuals at rates that would fluctuate from 2% to 5%. This local tax would be deductible for Federal Income Tax purposes.
  - b. **Excise Taxes:** In respect to the excise tax, additional products would be subject to this tax, including liquid gas derived from petroleum, as well as beverages which are not exclusively sweetened with sugar.

The above analysis was prepared by Roberto Aiza, a Partner with BDO International Member Firm, BDO Hernandez Marron y Cia., SA in Mexico City.

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*Material Discussed in this newsletter is meant to provide general information and should not be acted on without obtaining professional advice tailored to your firm's individual needs.*

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