JANUARY 2014
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AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

BDO KNOWS:
INTERNATIONAL TAXATION

SUBJECT

MEXICO TAX LAW CHANGES

DISCUSSION

On January 1, 2014, various Mexican tax laws became effective, either replacing or supplementing the existing tax laws. This alert highlights several of the changes we think will most likely affect our clients with Mexico operations.

Changes to Income Tax Rates

Changing course from previous years in which tax rates where scheduled to be reduced, Mexico's income tax rate for companies will continue to be 30% and the tax rate on individuals is increased to a top marginal rate of 35%. Note: United States companies should review their deferred tax balances for these changes.

A ten-percent capital gains tax will be applied on the sale of shares for companies listed in the Mexican stock exchange.

Repeal of Flat Tax (IETU Law) and Tax on Cash Deposits

Mexico's Flat Tax and tax on cash deposits have been repealed effective as of January 1, 2014. Note: United States companies should review their deferred tax balances for these changes.

Non-deductibility of Certain Payments

Payments to related parties located outside Mexico are not deductible if the payment is not recognized as taxable income by the payee. In addition, payments made to parties located in a preferred tax jurisdiction are not deductible if the payment is not at arm's length and supported by a transfer pricing study. Finally, interests, royalties, and technical assistance payments to related parties will not be deductible to the extent such payments (1) are made to a fiscally transparent entity unless the owners of such entity are

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subject to tax on the entity's income and the payments are made at arm's length, or (2) are not recognized or accrued for purposes of the tax laws in the country where the payee is a resident.

Royalties must be effectively paid to be deductible.

Elimination of Tax Consolidation and Introduction of New Optional Regime

The Mexican tax consolidation regime is repealed. The new law provides transition rules for the deconsolidation of Mexican companies.

Mexican taxpayers may elect a new optional regime in which a three-year deferral period is applied.

Ten-Percent Withholding Tax on Dividends

As of January 1, 2014, Mexican resident companies must withhold a ten-percent tax on dividend distributions to individuals and non-Mexican resident companies. The new withholding tax will apply to distributions of profits earned on or after January 1, 2014. Mexican resident companies will have to maintain separate pre-2014 and post-2013 profits accounts (or CUFIN accounts as they are known by their acronym in Spanish).

Dividends are defined to include (1) declared dividends, (2) interest from long-term loans issued to shareholders, (3) nondeductible payments benefiting the company's shareholders, and (4) transfer pricing adjustments.

Note: Non-Mexican resident shareholders should review the application of income tax treaties to reduce the withholding tax.

Creating a Uniform Value Added Tax ("VAT") Rate

The 11% VAT rate on goods and services applicable in the border regions has been increased to make the 16% VAT rate a uniform rate throughout the country.

Revisions to Maquila Operations

Companies that operate under an IMMEX program (commonly known as maquiladoras) will need to review and perhaps revise their operation as there are some significant modifications to the maquiladora rules. First, all the revenue of these companies will need to be related to the maquiladora's activities. Second, repealing the Flat Tax has the effect of increasing a maquila's tax rate on profits to 30%. Third, Mexico will now impose value added taxes on maquila operations. However, a certificate can be obtained to exempt these operations from value added taxes. The certification will be granted as long as the maquila satisfies the new rules discussed above as well as other requirements, including compliance with the tax obligations as well as accreditation of the maquila processes and criteria. The certificate will also exempt the non-Mexico principal from Mexico's permanent establishment rules.

It is expected that maquilas will be given the option of requesting a refund for overpayments of VAT or avoid making such payments if the company can guarantee the tax liability by providing a bond that is granted by an authorized institution.

Some non-Mexican companies conduct business operations through shelter maquiladoras. Although this manner of operation will continued to be allowed, non-Mexican companies operating in this manner after four years will not have the protection found in the Mexican tax laws against having a permanent establishment.

Maquiladoras will now have only two transfer pricing methodologies that may be used to determine their tax base. These two methods are the safe harbor and advanced pricing agreement methods.

Establishment of Taxpayer Mailbox and Electronic Filing Requirements

The new rules establish that Mexican taxpayers will have a "mailbox" located in the Mexican tax authority's Internet page. Mexican tax authorities will send notices to taxpayers through this system. Taxpayers will be able to respond, if necessary, to the notices and make request to the tax authorities. As early as June 30, 2014, the tax authorities could use these mailboxes to transmit documents to corporate taxpayers.

Taxpayers would file monthly returns through this Internet page. Mexico's tax authorities will carry out tax reviews through this system. Taxpayers should be aware that tax notices or assessments will be posted in this system.

Salaries

Payments to employees for salaries and benefits that are exempt from income tax will only be partially deductible. New rules will apply a 53% or 47% factor to limit the employer's deduction.

HOW BDO CAN HELP

BDO USA, LLP, through its United States/Latin America Country Desk, has extensive experience in United States and Mexico cross-border structuring matters. BDO USA, LLP, and the foreign members of the BDO International network can assist you in analyzing the effects these changes may have on your operations.