

IETU, A CONTROVERSIAL TAX.



The Consolidate Rate Business Tax Law was published on October 1, 2007 and came into force on January 1, 2008. The "IETU" (formerly "CETU") is incorporated into the Mexican tax system based on a taxation system know as the "Flat Tax" utilized in other countries, the primary purpose of which is to simplify the administrative system by imposing a consolidated tax. However, it can be said that the IETU will possibly have a negative impact on the business and professional sectors in Mexico since, in addition to the intention of simplification, its purpose is to collect taxes, which results in discrepancies by placing this new tax in conflict with the Income Tax Law (ITL).

To whom does it apply?

Individuals and corporate entities resident in Mexico which obtain income subject to the tax and residents abroad with a permanent establishment in the country, on the income obtained from this establishment which is also considered accruable for IETU purposes.

Although it is understood from the statement of motives that the tax is specifically addressed to those engaged in business activities, the applicability spectrum of this tax can vary, since it affects other sectors of the population such as members of the professions subject to a fees system, who will be affected by the IETU as the providers of an independent service.

Subject matter.

According to the IETU Law, the IETU taxes the income obtained from the rendering of services, and the sale of or granting of the temporary use or enjoyment of properties, effectively received by the taxpayer. However, this description does not cover all items of the taxpayer's wealth, deductible items are also primarily recognized for ITL purposes, which is questionable since the purpose of the IETU is to tax the income of taxpayers which obviously generates a profit.

Basis for its determination.

In general terms, the basis for the IETU consists of all income considered subject to the tax, from which the deductions authorized by law will be made, and it would thus seem that determination of the IETU is simple from an administrative viewpoint, as argued by the authorities. However, some questions arise regarding the income subject to this tax, together with the authorized deductions and credits.

Income taxed.

The income taxed by the IETU is the price of or compensation in favor of whoever sells goods, renders independent services or grants the temporary use or enjoyment of an asset, together with the amounts charged or collected from then acquirer in taxes or duties payable by the taxpayer, normal or late payment interests, contractual penalties or payments for any other reason, including advances

or deposits, except taxes transferred in the terms of law. The IETU law also provides that advances or deposits restored to a taxpayer who has acquired assets, received the use or enjoyment of such assets or a service, together with any bonuses or discounts, will be considered taxable income, always providing that the corresponding deduction was made for the original operations.

The first thought that every taxpayer should carry the market is that the legal situation today has saved compared to ITL, to determine whether the subject is IETU.

In the same way, the Law under study provides that advances or deposits restored to a taxpayer who has acquired assets, received the use or enjoyment of same or a service, together with any bonuses or discounts, will be considered as taxable income, always providing that the corresponding deduction was made for the original operations. Obviously, taxes as the Added Value Tax are not considered as income taxes.

Activities not affected by IETU

For purposes of the IETU, granting of the temporary use or enjoyment of assets between related parties resident in Mexico or abroad and giving rise to the payment of royalties, will not be subject to the tax. Otherwise, payments of any kind for granting the temporary use or enjoyment of industrial, commercial or scientific equipment will be considered as income subject to payment of the IETU. The foregoing differentiation is questionable in the following hypothetical case. Companies which, due to their line of business, are obligated to pay royalties to a related party will be unable to make the corresponding deduction since the activity is not subject to the tax. However, royalties must be considered taxable under the IETU should these companies grant the use or enjoyment to an independent party.

The circumstance would create an unfair differentiation which can directly affect company competitiveness, as compared to the treatment given by the

ITL, resulting in turn in a disproportionate effect contrary to the taxpaying capacity of the taxpayer. Certain income is exempt from payment of the IETU, amongst which we would emphasize income received by individuals when they temporarily engage in any of the activities considered subject to tax, together with income received by taxpayers which are tax exempt. The law itself defines such activities as those performed by an individual when the latter does not receive taxed income from business or professional activities or from granting the use or temporary enjoyment of properties.

Authorized deductions.

The IETU Law provides that taxpayers can only deduct payments corresponding to the acquisition of assets, independent services or from the administration of such activities or the production, commercialization and distribution of goods and services giving rise to taxable production, commercialization and distribution of goods and services giving rise to taxable income. Tax payments made by taxpayers payable in our country will also be deductible, with the exception of the IETU, IT Tax on Cash Deposits, Social Security contributions and other taxes which must be transferred pursuant to the law. Also deductible is Value Added Tax or the Special Tax on Production and Services, when these cannot be credited by the taxpayer.

IETU tax benefits.

In an attempt to mitigate the negative effects, was published a Decree under which he granted IETU-related tax benefits, outstanding among which is the fact that the negative effect of the losses and inventories mentioned is recognized. However, these supposed benefits only partially resolve the problem, since the tax incentives mentioned can only be gradually applied in a limited percentage. The foregoing makes clear the failure of the Executive and the Legislative to recognize these items as authorized deductions within the IETU Law itself, an omission which could be considered a violation of the guaranty of tax equality granted in our Constitution.

Crediting

A characteristic of the IETU is that, for calculation purposes, a series of credits is established which the taxpayer can apply progressively in different percentages in order to determine the IETU payable for the period.

In summary, the following credits are progressively deducted from the payable IETU:

- i) The credit from previous periods for deductions in excess of income for the effects of the IETU itself.
- ii) Credit for taxed salaries and social security contributions.
- iii) Credit for investments pending depreciation from 1998 to 2007.

The terms of the Decree published on November 5, 2007, provide that credits for inventories and tax losses will be applied after the credits hereinabove mentioned, prior to crediting any individual IT which has been effectively paid.

Rate

In the terms of applicable law, the IETU will be calculated by applying a rate of 17.5% to the amount resulting after authorized deductions have been made from the total taxable income. In view of numerous criticisms from different sectors of the population, a transitory provision was included during the legislative process resulting in the tax under study, which provides that during the 2008 tax year a rate of 16.5% will be applied and during 2009, a rate of 17%, to remain finally at a rate of 17.5% as from 2010.

Disappearance of Assets Tax

Under transitory provisions, the IETU Law provides that, as from January 1, 2009, the Assets Tax Law will be repealed, leaving the related Regulations and other applicable provisions null and void. Although said transitory provisions provide for taxpayers to request the return of Assets Tax effectively paid during the ten periods prior to payment of the IT, the Assets Tax for which return can be

requested is limited to 10% of the total. This restriction on the return of Assets Tax which companies would be entitled to claim, violates the non-retroactive principle of Law, in addition to failing to recognize a right acquired by the taxpayer, a situation which can clearly be protested.

Strategy.

Each company is different and thus, determine the impact that this tax will in each case requires individual attention. There may be cases where taxpayers feel that the entry into force of this tax will not represent any change in its tax scheme, where they find a negative impact or who do not have clear effects of these new provisions. We will naturally be happy to assist in identifying the specific aspects of the IETU which negatively affect your company, and in implementing a strategy of defense in line with your needs. For the foregoing recommend widely analyze the new provisions of the Act and if IETU require assistance, please contact us. We should also mention that it is possible to impugn Laws when they affect the basic rights of the individual, and the IETU Law is no exception to this rule. Therefore, considering that some parts of this Law attack the individual guarantees recognized by our Constitution, these can be impugned under an action for relief ("amparo"), the purpose of which would be to decide on their constitutionality and application. Since this is a new tax system which negatively affects taxpayers by its simple entry into force, the action for relief should be filed within the thirty days after coming into effect, that is, up to February 12, 2008 next.

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