Economic Watch

Mexico

November 1, 2013
Economic Analysis

Update of Fiscal Reform: approved in both Chambers with few changes

- **The reform is expected to generate additional tax revenue of approximately 1.0% of GDP, and resources from the public deficit of 1.5% in 2014. A rise in the public deficit of 0.4% of GDP is also approved for this year.**
- **The negative impact on consumption caused by the reform is expected to be offset by the higher public deficit, so that the tax package should not create a negative impact on economic growth in 2014.**
- **A secondary law will be used to finance unemployment insurance, although there appears to be consensus that it will be funded by a federal budget, and not by workers' contributions to Infonavit. However, it is still uncertain when this new program will begin to work, and a possible start as late as 2015 cannot be ruled out.**
- **In the end, the housing sector was not affected by the tax measures initially proposed.**
- **The last step for the amendments approved by the two Chambers to enter into force is for them to be published by the Government in the Official Gazette of the Federation.**

Main elements approved by the two Chambers

Over the last two days, the Senate and the House of Representatives completed their approval of the package of amendments to the laws making up the fiscal revenue reform.

VAT

- The standardized general VAT rate of 16% for the border zone, the general rate of VAT for chewing gum and pet food and for goods imported using temporary import customs regimes, were finally approved. The idea with this latter regime is to grant a certificate to important export companies, which would then be exempt from making that payment.

IEPS special taxes

- As far as special taxes are concerned, the following were approved: i) the tax of one peso per liter on soft drinks, concentrates, powders, syrup, essences or flavor extracts, containing any kind of added sugar, ii) the tax on carbon fuels except for oil and natural gas now with a rate of up to 3% on the most polluting fuels, and a rate of 8% (as against the previous proposal of 5%) on foods with high calorific density (e.g. candy, jellies, chocolate, cakes, peanut butter, milk shakes and ice creams) and of 10% when they are imported

Income Tax

- In the proposal finally approved, the income tax rate has been kept at 30% for natural persons earning annual income of up to 750,000 pesos, when it was initially expected that they would pay a rate of 31% when earning annual income of over 500,000 pesos. A rate of 32% is applied to persons with income of over 750,000 pesos, 34% on those who earn over 1 million pesos, and a minimum rate of 35% for persons earning in excess of 3 million pesos. There are no changes in the rate of income tax for legal entities, which remains at 30%.

- Deductions of natural persons are limited to either 10% of income or four minimum annual salaries, of around 94,000 pesos, whichever is lower. Lastly, the real interests on mortgage loans can be deducted provided the total credit granted is lower than 750,000 investment units (around 3.7 million pesos).

- An increase on the deductibility of workers benefits of was approved, from the initial proposal of 47% initially made by the House of Representatives to 53%.

- The income tax rate of 10% on capital gains obtained in the Securities Market and dividend payments is maintained.

- The income tax exemption for home sales will be applied for amounts of up to 700,000 investment units (approximately 3.7 million pesos). Schools and sports clubs will pay income tax. The tax is maintained at a rate of 7.5% on mining company profits; 50% of these funds will be distributed to municipalities, 30% to States and 20% to the Federation.

- Special regimes are restricted, in particular: the elimination of the Fiscal Consolidation Regime for companies, although there will be new regime called "Optional for Groups of Companies" which shall imply that they will be able to continue to consolidate but now for a three-year period instead of five. The Small Contributors Regime is eliminated, and is replaced with the Incorporation Regime whereby taxpayers only need to pay a proportion of the taxes, though this proportion grows steadily until reaching 100% of the taxes in ten years (instead of the six initially proposed).

Public deficit and other agreements

- Public deficit of 1.5% of GDP, which is equivalent to 250 billion pesos for 2014. A public deficit of 0.4% of GDP is also approved for this year.

- In the debate on the approval of the income package in the Senate, an agreement appears to have been reached whereby unemployment insurance will be financed through the public budget. However, the funding of unemployment insurance will have to be established in a secondary law which will be debated subsequently.

- The payment to be made for the 700 MHz and 2.5GHz telecommunications concessions will be established by Congress.