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TAX BILL FOR 2008

On June 20th the tax bill for 2008 was submitted by the Executive Branch before the Federal Congress, through which ***(i)*** the amendment of several tax laws as well as ***(ii)*** the creation of two new taxes were proposed: the business flat tax and the informality tax.

Hereinafter please find a brief analysis of the main implications that in our opinion are derived from the aforementioned tax proposals.

Please be advised that the present document has an informational purpose, and does not purport to constitute a legal advice,

ENTREPRENEURIAL OR BUSINESS FLAT TAX (CETU)

The main purpose of the CETU is to increase the taxpayers' effective payment rate in direct taxation, who would be obliged to pay the higher amount between the CETU and the income tax due.

1. Taxpayers. The CETU shall be paid by individuals and legal entities resident in Mexico, as well as by permanent establishments in Mexico of non-residents.

2. Taxable object. The effectively income obtained (cash flow based), regardless the place where such revenues are obtained, and derived from the performance of the following acts / activities:: ***(i)*** transfer of ownership of goods, ***(ii)*** rendering of independent services and ***(iii)*** granting the temporary use and enjoyment of goods.

3. Taxable base. The aggregate amount of the income obtained (under a cash flow basis) for the performance of the aforementioned activities, diminished by the authorized deductions. Herein below find the most important elements of both concepts.

a) Income. - All types of income obtained, even derived from operations with no consideration; taking into account in this latter case either the market value or the appraisal value of the taxable activities.

The following activities are excluded as taxable objects, and thus, do not constitute taxable income or deductible items: ***(i)*** certain royalty payments, ***(ii)*** interest that does not constitute part of the price of the goods and ***(iii)*** financial derivatives where the underlying is not subject to CETU.

The aforementioned exclusions are justified in the bill of amendments with economic reasons, but (in our opinion) are not legally justified.

The following are deemed as non taxable revenues:: ***(i)*** derived by institutions authorized to receive deductible gifts, ***(ii)*** derived from the sale of individuals' dwelling house, up to an approximate amount of USD $500,000, ***(iii)*** derived by individuals from the sale of movable goods, ***(iv)*** derived from the sale of partnership interests, documents pending collection and securities and ***(v)*** derived from the sale of Mexican and foreign currency.

b) Deductions.- Their common feature is of being less in number than those provided in the income tax and for being taken in their aggregate paid amount (cash flow basis), and are the following:

(i) Disbursements either for the acquisition of goods, for the payment of independent services or for the payment of temporary use and enjoyment of goods.

(ii) Local and federal taxes Including those withheld to third parties), with exception for the CETU, the income tax, informality tax, social security contributions and those which should be transferred (e.g. value added tax and special production and services tax).

(iii) Refunds.

(iv) Indemnities for damages and certain conventional penalties.

(v) For insurance companies: creation or increase of mathematic reserves of life insurances or retirement pensions, as well as the amounts paid when the risk occurs.

4. **Rate.** 16% for 2008, and 19% for the subsequent years.

5. **Payment period.** The same as established by the ITL.

6. **Particularities**. In our opinion the most relevant are the following:

a) When the amount of deductions is larger than the taxable income, the taxpayer will have a right to a tax credit which will be determined by applying the 19% rate to the surplus. The credit can be carried forward against the annual CETU or the provisional payments, in the following ten fiscal years.

b) In the case of tax consolidating entities, the taxpayer should adjust the tax over the "individual" income that can be credited against the CETU, given that the consolidated income tax in the majority of the cases is different to the sum of the "individual" taxes of the holding and the held company.

c) Regarding trusts, a transparent tax treatment is granted to those who perform the activities for which the CETU is triggered.

d) In the case of occasional operations done by individuals, it is provided that the tax operates under a final payment scheme, without having the opportunity to apply any deduction; and without being obliged to keep accounting records or to file the annual tax return.

7. **Issues.** We emphasize the following:

a) Tax consolidation principles are disregarded.

b) Given its non income tax nature it may not be credited abroad.

c) Non deductibility in the payment of wages. Under a complex scheme, the income tax withheld to third parties (including the one derived from wages) can be credited against the CETU.

d) Only definite imports are deductible.

e) Disbursements for investments during the second semester of 2007 are non deductible.

f) It does not recognize the applicability of tax treaties for permanent establishment matters.

g) Being based on a cash flow system, and not in an accrual system as the income tax is, distortion effects are produced.

h) Non deductibility of the receivables due and payable / uncollectible credits.

i) Being interest a non deductible item, the tax burden over financed taxpayers that may may create disproportional taxation

ASSET TAX

If the tax bill submitted is approved by the Federal Congress, the Asset Tax Law will be repealed. A mechanism is provided under CETU that would allow the recovery of previously asset tax paid even if the referred legal body disappears.

INFORMALITY TAX

With the purpose of challenging tax evasion, a new "informality tax" was proposed, which will levy a tax on cash deposits exceeding the accrued monthly amount of $20,000 pesos (USD $2,000 approximately), in one or several accounts of the taxpayer opened before financial institutions, same which may be accredited in the monthly or annual income tax return.

Said tax constitutes a control measure and facilitates the identification of individuals and entities deriving income not reported to the tax authorities and for which they should pay taxes.

INCOME TAX

In prior years, a 4.9% withholding rate has applied for the interest paid by Mexican tax residents to non resident banks registered before the tax authorities, as long as such banks are resident in a country with which Mexico has executed a tax treaty.

Given that the bill does not mention anything regarding this rate, a 10% withholding tax is foreseen in the Income Tax Law as of 2008 (which could be reduced by the application of a tax treaty).

However, given the recent Mexican governmental policy in this respect, it is likely that during the congressional discussion of the bill, the 4.9% tax rate would be reinstated.

FEDERAL FISCAL CODE

1. **Joint tax liability. -** The following persons would be deemed as jointly liable with the taxpayers:

a) Persons who manage entities, establishing liability specifically for the sole manager, general directors, general managers and members of board of directors or any person who is in charge of its administration, who does not meet the quality of a partner.

b) Services providers who are retained for tax or accounting counsel, and in general for tax advisors, for the amount of the fine originated as consequence of whole or partly omission in tax payments.

2. **Tax authorities' powers.-** Given the case that the Federal Congress approves the submitted bill, tax authorities will be granted more audit powers with respect to the following::

(i) Execution of their review and enforcement powers.

(ii) Execution of audits or inspections.

(iii) Tax refunds.

Should you have any comment or doubt related with the content of this preliminary analysis, please contact us in the telephone number (52 55) 5251 3545 or in the e-mail address info@turanzas.com.mx

Sincerely,

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