



BDO
informs

**TAX REFORM
2007**

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BDO Hernández Marrón y Cía., S.C.
Contadores Públicos y
Consultores de Empresas.



The following tax guidelines were published on December 27, 2006 in Mexico's Federal Gazette. We are pleased to provide you with our brief comments on the guidelines.

FEDERAL INCOME LAW

Surcharge rates

The following surcharges will be incurred in the extension of fiscal credit payments:

I. 0.75% monthly on unpaid balances.

II. In compliance with the Federal Tax Code, when payments are authorized to be made in installments, the following surcharge rates will be applied on balances over any given period of time.

a) Partial payments of up to 12 months will be surcharged at a monthly rate of 1%.

b) Partial payments from 12 to 24 months will be surcharged at a monthly rate of 1.25%.

c) Partial payments for more than 24 months or deferred payments will be surcharged at a monthly rate of 1.50%.

Write-off of tax credits from non-collection

Mexican tax authorities are allowed to write off tax credits in the event they are not collectible as well as if they cannot be paid for.

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The write-off of tax credits does not discharge the payment.

Tax Incentives

The following tax incentives have been endorsed and changed:

Credit of investments in fixed assets by the agricultural and forestry sectors

I. Taxpayers dedicated exclusively to activities in the agricultural and forestry sectors may only credit investments in fixed assets against an amount equivalent to the tax on assets calculated in the period and which may be credited in subsequent periods until it is exhausted.

Tax incentives application for companies that perform technological research and development

II. Companies that perform technological research and development may benefit from an amount of up to \$ 4,500,000,000 of tax incentive, as established in the Mexican Income Tax Law. The funds would be distributed among all of the candidates as follows:

1. \$1,000,000,000 Mexican pesos shall be earmarked for technological research and development projects in alternative energy sources and for micro- and small businesses research projects and technology development.

2. \$1,000,000,000 Mexican pesos shall be earmarked for the creation of specialized infrastructure projects for research centers. Such projects should have been judged as projects directed toward the development of projects, materials and work in process that represent scientific or technological progress..



3. \$2,500,000,000 Mexican pesos will be distributed among the remaining applicants.

In the event at the end of the third quarter of fiscal year 2007, the applications for tax incentives mentioned in points 1 and 2 were insufficient to assign the amounts established, the remainder could be used to increase the amount established in point 3.

Taxpayers will be able to credit the aforementioned tax incentive against the income tax or tax on assets due in the annual tax return of the year in which the incentive was granted or in subsequent years until it is exhausted.

Credit of the special tax on products and services by individuals who perform business activities

III. Those individuals who perform business activities and who are permitted to deduct diesel fuel when determining their profits, only when it is exclusively used for machinery, could be granted a tax incentive, which consists in crediting the special tax on products and services that Petróleos Mexicanos and its subsidiary organizations may have caused on the alienation of such fuel.

The incentive referred to in the previous paragraph may also be applicable to naval and slow-moving or low-profile vehicles that, according to their characteristics are not authorized to transit on federal or franchised highways.

In the event the diesel fuel is purchased from authorized agencies or distributors, the tax that may be credited will be the amount indicated in the receipt issued by these agencies or distributors.



The credit may be made against the income tax the taxpayer has to pay or against the income tax withholdings made to third parties and against the tax on assets.

Individuals that use diesel fuel in agricultural or forestry activities may credit an amount equivalent to the quantity that results from multiplying the acquisition price of the diesel fuel in service stations as indicated in the respective receipts together with the value added tax by the factor of 0.355 instead of applying the information disclosed in previous paragraphs.

The individuals mentioned in the prior paragraph may apply for a refund of the amount of the special tax on products and services they had the right to credit instead of crediting it, in compliance with certain requirements.

Credit of the special tax on products and services for taxpayers dedicated exclusively to provide public and private transportation of individuals and cargo

IV. Taxpayers that acquire diesel fuel for their consumption for automotive use in vehicles dedicated solely for public and private transportation of individuals and cargo are allowed to credit the special tax on products and services that Petróleos Mexicanos and its subsidiary organizations have charged on the sale of the fuel.

The credit may only be made against income tax the taxpayer has to pay or has withheld or, if applicable, against the tax on assets to be paid by using the official format issued by the Ministry of Finance. This will also apply to private passenger or cargo transportation or to public or private domestic transportation by taxpayers using national highways and roads.



At no time may this benefit be used by taxpayers that render their services to another local or foreign corporate entity considered to be a related party.

The credit of the special tax on products and services will be made only against the tax from provisional payments for the month in which the diesel fuel is acquired or the twelve months following the date of acquisition or against the tax for the same period.

Credit of expenses for taxpayers dedicated exclusively to the ground transportation of cargo or individuals

V. Those taxpayers dedicated exclusively to the ground transportation of passengers and cargo and that use the National Network of Toll Roads are allowed, as a tax incentive, to credit up to 50% of the expenses from the payment of services for the use of the toll road infrastructure.

Taxpayers will consider this tax incentive when credited as taxable income for income tax purposes.

The credit may only be made against the income tax the taxpayer is responsible for paying or, if applicable, the tax on assets to be paid by using the official format issued by the Ministry of Finance.

The credit of the expenses referred to in this section is made only against the tax that corresponds to provisional payments for the period in which the expenses are made or against the tax for the same period, in the understanding that if the tax is not credited against the provisional payments or in the tax return for the period, the taxpayer will not be entitled to do so after the period ends.



The points described in this section will also apply to private passenger or cargo transportation or public or private domestic transportation provided by taxpayers on national highways and roads.

Credit of the special tax on products and services by taxpayers dedicated to the merchant navy

VI. A tax incentive is granted to taxpayers who purchase special navy diesel fuel for their own use that will be used exclusively as a fuel in shipments earmarked to the development of their own merchant marine activities. The tax incentive consists in the credit of an amount equal to the special tax on products and services that Petróleos Mexicanos and its subsidiaries have incurred from the sale of the special diesel fuel and that meet certain requirements.

In the event the special navy diesel fuel is purchased from authorized agencies or suppliers, the amount taxpayers may credit is that indicated in the receipt issued by the agencies or distributors.

This credit must be made, without exception, no later than the following dates:

- 1.** Value added tax – the day on which taxpayers must file their tax return for the month of December 2007.
- 2.** Income tax or tax on assets – the day on which taxpayers must file their 2007 annual tax return.

The credit may only be made against the income tax or value-added tax the taxpayer has to pay, or against the withholdings made to third parties for these taxes, and against the tax on assets.

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Application of the tax incentive for taxpayers who have their financial statements audited

VII. Those taxpayers that are required to have their financial statements audited by an authorized public accountant or that opt to audit them themselves would be entitled to apply a tax incentive, as follows:

a) When in the audit of the financial statements it is determined that during fiscal year 2007 the taxpayer timely and properly complied with the obligation of filing all monthly returns of the advanced income tax payments required and that all such payments were made for the amount indicated by law, the taxpayer shall be entitled to a tax incentive equal to the amount that results from applying 0.5 per cent to the 2007 taxable result or, in the case of individuals that perform business activities, to the taxable profits of the same period. Taxpayers that apply the tax incentive contained in this paragraph shall not be permitted to apply that contained in the following paragraph.

b) When in the audit of the financial statements it is determined that during fiscal year 2007 the taxpayer timely and properly complied with the obligation of filing all monthly returns of the advanced income tax payments required and that the difference between the amount paid in advanced payments did not exceed 5% in each payment, the taxpayer shall be entitled to a tax incentive equal to the amount that results from applying 0.25 per cent to the taxable result for the respective period in 2007 or, in the case of individuals that perform business activities, to the taxable profits for the period.



The amendment returns will not be taken into consideration for purposes of the aforementioned paragraphs.

The 2007 income tax liability reduced by the incentive applied, shall be credited against the tax on assets from the same period, and shall be the amount paid in order to determine the difference referred to in article 9° of the Mexican Tax on Assets Law.

The tax incentive referred to in this paragraph shall be applied, through amendment return, only against the 2007 income tax for which the taxpayer is responsible. In case the application of this tax incentive results in a balance on behalf of the taxpayer, the balance may only be applied against the income tax to be paid by the same taxpayer or may be offset, but at no time shall it be refunded.

In the event the Mexican tax authorities exercise their faculty of inspection and determine, the taxpayer applied the tax incentive referred to without being entitled to according to the aforementioned paragraphs a) or b), the taxpayer must pay the income tax improperly decreased with inflationary and surcharges, notwithstanding other sanctions and consequences that proceed in terms of the applicable guidelines.

Exemption from the Tax on Assets for individuals and corporate entities

VIII. A tax incentive is granted to individuals and corporate entities consisting in the tax on assets incurred during the period. The federal government shall determine the characteristics of this incentive no later than January 31st, 2007.



Exemptions

The exemptions for fiscal year 2007 shall be as follows:

Tax on assets

1. Taxpayers that enter into contracts with federal non – centralized public organizations are exempt from paying the tax on assets for the property of accounts receivables derived from such contracts, in regards of productive infrastructural investments earmarked to priority activities authorized by the Mexican Ministry of Finance, in terms of its article 18 of the General Public Debt Law.

Tax on new automobiles

2. Individuals or corporate entities that alienate to the general public or import new automobiles powered by rechargeable electric batteries, or those electrics with internal combustion engines, in accordance with the Mexican Customs Law, shall be exempt from paying the tax on new automobiles.

Customs duties

3. The import of natural gas shall be exempt from the payment of customs duties according to article 40 of the Federal Duties Law.

Income tax withholding rate from interest

The withholding rate in accordance with articles 58 and 160 is confirmed to be 0.5%.



Amnesty of surcharges and fines from tax credits prior to 2003

The Tax System Administration Service (SAT) once again may enter into agreements with taxpayers to totally or partially condone fines and surcharges for tax credits from federal tax payments incurred as follows:

The amnesty shall be agreed upon with the tax authority prior to the taxpayers' application under the following parameters:

a) Tax credits consisting of federal taxes, compensation fees, and fines from non-compliance of federal tax obligations different from payment requirements, incurred before January 1, 2003, shall have a forgiving of 80% of the tax, compensation fees, and fines from non-compliance of federal tax obligations different from payment requirements, updated with the inflationary rate in force, and 100% of the surcharges, fines and procedural expenses derived. In order to take advantage of the amnesty, the portion of the tax credit not forgiven must be paid in full in one payment.

If the taxpayers referred to in the last paragraph who have been audited by the Mexican tax authorities for the fiscal years 2004, 2005 and 2006, and who were determined to have properly complied with their tax obligations, or, have paid omissions determined and are up-to-date in complying with their tax obligations, a 100% of the tax credits shall be forgiven.

b) In the case of surcharges and fines derived from tax credits for compensation fees and federal taxes different from those the taxpayer should have withheld, transferred or collected, that were incurred between January 1, 2003 and December 31, 2005, the forgiven amount shall be 100%. To apply this



procedure, the portion of the tax credit not forgiven must be paid in full in one payment.

The remit shall proceed in the case of tax credits determined by the tax authorities or determined by the taxpayers either spontaneously or through corrections made.

2. In the case of tax credits that are being paid in installments, according to article 66 of the Federal Tax Code, the remit shall apply to the unpaid balance, in compliance with the rules established in paragraphs a) and b) above.

3. The remit of tax credits referred to in clause 1 shall also proceed even though the tax credits have been disputed by the taxpayer, either before the administrative or jurisdictional authorities, so long as of the date of the filing of the remit application, the respective dispute has been concluded through a definitive resolution.

4. Paid tax credits may not be remitted and in no case the forgiving referred to in this article may be refunded, offset, credited or a refundable balance.

5. Tax debts shall not be remitted from fines for which there is a judicial decree for imprisonment, a formal indictment, or a criminal conviction.

6. Payment in-kind, surrender of property or compensation shall not be accepted as payment for tax credits that have not been forgiven.



Assuming the taxpayer does not comply with the obligation of payment, the tax authority will deem the remit application was not filed and shall immediately initiate the administrative procedural process.

7. The application to forgive the debt shall not constitute a request and the resolutions handed down by the tax authority may not be disputed.

8. The tax authority may be able to suspend the administrative procedural process if so requested by the interested party in the written application to forgive the debt, and so long as the tax interest is guaranteed.

9. Fines imposed during fiscal year 2007, from non-compliance of federal tax obligations different from payment obligations, with the exception of those charged for declaring excessive tax loss carryforwards, shall be reduced on a 50% so long as they are paid within the first thirty days after notice.

10. As of January 1, 2008, the Mexican tax authorities shall provide the authorized credit bureaus, in accordance with the general rules issued by the Tax System Administration Service, the information of taxpayers who have tax credits that, as of that date, have not been paid or guaranteed in the terms established in law and those credits which from that date and forward would not be paid or guaranteed in the installments legally established in the law.



FEDERAL TAX CODE

Consultations and authorizations to taxpayers

The Federal Tax Code establishes that during the consultations the taxpayers perform before the tax authorities, the principle of the self determination of the tax liability and the right to a hearing should be respected, arguing that the taxpayer may know the authority's criteria through a consultation or authorization, deferring the right to dispute it until its application as a result of the exercise of the faculties of verification.

Tax incentives

Tax incentives and subsidies are granted only to taxpayers who are up to date with their tax obligations.

Integration of tax losses carried forward

The tax authorities are allowed to verify the source of the tax losses carried forward to be applied in the year under review, without implying the extension of the verification faculties.

Review of the same fiscal year, with different facts

The possibility of a new determination of the same taxes becomes limited, unless, as a result of the new review, the facts different from those already reviewed are proven. This does not prevent the taxpayer to go under a new tax review.



Review of monthly tax payments following the audited period

The tax authorities are allowed to review provisional or monthly payments that correspond to the year following the previous audited without the need to apply the sequential review procedure.

Reduction of fines

It is proposed to reduce the range of fines for the omission of tax payments from 75% - 100%, and from 55% - 75%.

INCOME TAX LAW

Rate of 28%

The decrease of the income tax rate to 28% for 2007 has been confirmed.

Trust fund with business activities

Trust funds are regulated to limit the amortization of tax losses against tax profits coming from the trust fund, and to treat it comparably to a taxpayer in the event of dissolution. It would be required to manage Capital Contributions and Tax Profits accounts.

Tax deductibility of consumptions in restaurants

The tax deductibility for the consumption in restaurants is reduced from 25% to 12.5%.



Thin capitalization

Some adjustments are made to determine the happening of the thin capitalization and the non-tax deductible interests, by establishing calculation rules for the averages of debts incurred in lieu of credits obtained.

Deduction of investments on automobiles

The tax deductible original amount of investment in automobiles is decreased from \$300,000 to \$175,000. By means of a transitory tax rule, it is set forth that investments of this nature that were made before January 1, 2007 will continue to be deducted according to the guidelines prevailing as of December 31, 2006.

Decrease of tax losses

The sale of companies with tax losses is being combated by hindering their deduction against profits of various lines types of business when there is a change of more than 50% of its partners in a period of three years and no profits are generated from the operating income of the same lines of business.

Secured loans

The definition of secured loans is expanded to consider as dividends the interests from these loans, when payment is conditioned on the drawing up of certain agreements.

Exemption for alienation of dwelling-house

The tax exemption from the sale of a dwelling-house is limited to an amount that does not exceed 1,500,000 UDIS. The amount in excess is proportionally burdened based on the determination of the non-taxable profit.



TAX ON ASSETS LAW

Reduction of the rate

The rate has been decreased from 1.8 % to 1.25%.

Tax base with no decrease of debts

The tax base is determined based on assets with no possibility to decrease in the taxpayers' debts.

SPECIAL TAX LAW ON PRODUCTS AND SERVICES (EXCISE TAX LAW)

Lowering of taxes on soft drinks

Taxes have been lowered on the sale and import of soft drinks, hydrating or rehydrating drinks, concentrates, powders, syrups, essences, or flavor extracts that when diluted produce soft drinks, hydrating or rehydrating drinks; syrups or concentrates for the preparation of soft drinks sold in opened bottles using automatic, electric or mechanical machines, that use sweeteners other than sugar cane.

Gradual increase in the tax rate on cigarettes

The tax applicable to the sale and import of cigarettes, cigars and other tobaccos will gradually increase from 140% in 2007, 150% in 2008, and 160% in 2009, which for other cigars and tobaccos made completely by hand will be 26.6% in 2007, 28.5% in 2008 and 30.4% in 2009.



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