

October 24, 2006

MEXICAN FISCAL UPDATE 2/2006

Issuance of Administrative Rules Regarding Controlled Foreign Corporation's Regime

As of 2005, Mexican tax residents acquired the obligation to anticipate the recognition of foreign sourced income generated directly or through foreign legal entities or figures in which they participate, as long as said income: *(i)* is not taxed abroad or *(ii)* the income tax triggered and paid abroad results in less than 75% of the corporate income tax that would have been triggered and paid in Mexico.

Additionally, Mexican tax residents must file in February of each year, an informative return stating *(i)* the income referred in the previous paragraph generated in the previous fiscal year, *(ii)* the income generated in territories listed in the transitory provisions of the Income Tax Law (territories of the so called "black list"), and *(iii)* the transactions undertaken through fiscally transparent entities or vehicles.

In this regard, some administrative rules on the controlled foreign corporation's Mexican tax regime recently entered into force, mainly referring *(i)* to exceptions for an income to be considered as subject to the tax havens regime and *(ii)* to cases in which a Mexican taxpayer is relieved from filing the informative tax return. Following please find a summary with respect to the content of such administrative rules:

1.- **Exceptions of income subject to controlled foreign corporation's regime**

- a) Income subject to a 22% rate.- As of June 2005, it was incorporated an exception to fall under the legal hypothesis of tax havens, when the profits of foreign legal entities were taxed at least at a 23% rate, to the extent that all of their income was taxable, except the dividends received from legal entities resident in the same country, and their deductions have actually been disbursed, regardless they are accrued or deducted in different moments than those established in the Mexican income tax legislation.

Due to the reduction of the Mexican income tax rate to 29% in 2006, the rate by which the profit of foreign entities is taxed in order for it not to be considered subject to a tax haven is decreased to 22% instead of the previous 23% rate.

- b) Indirect participation.- Residents in Mexico that indirectly participate in one or more foreign legal entities or figures, through a legal entity resident in Mexico, have been excluded from the obligation of considering the income obtained in said entities or figures as subject to a tax haven, neither they are obliged to file the corresponding informative tax return.

The legal entity resident in Mexico that directly or indirectly participates through foreign residents, in said foreign entities or legal figures, will be the one to consider its income subject to the tax haven and the one that will be obliged to file the informative tax return.

- c) Direct participation below 10%.- The income obtained through legal entities and figures in which the taxpayer has a direct participation in their capital or patrimony below 10% will not be considered as subject to the tax havens regime, provided the Mexican resident taxpayer does not intervene in the management of such legal entities and figures.

The above is relevant given that the absence of control exception established in the law is only applicable for indirect participation. Nevertheless, we consider that the absence of control should be sufficient, regardless of their participation percentage.

2.- Informative tax return of controlled foreign corporations

- a) Indirect participation below 10%.- Taxpayers that indirectly derive income in foreign entities and legal figures incorporated in the territories referred to in the legal transitory provisions of the Income Tax Law (territories of the so called "black list"), through entities or legal figures in countries or territories different from the mentioned, are relieved from filing the informative tax return provided that they have a participation in the capital or patrimony of said entities or figures below 10% and they do not intervene in the management of the same.
- b) Transparent entities or figures.- Mexican resident taxpayers that perform operations through foreign transparent entities or legal figures incorporated in countries which have executed a broad exchange of information agreement with Mexico, are relieved from the obligation of filing the mentioned tax return provided that they have a participation in the capital or patrimony of said entities or figures below 10% and they do not intervene in the management of the same.
- c) Investment in shares of Mexican companies.- Mexican resident taxpayers do not have to file the informative tax return as long as they participate in a foreign legal figure by which they invest in shares issued by companies resident in Mexico when a legal figure's tax transparency ruling has been obtained from the Mexican tax authorities, attributing to its members the income and goods held through the mentioned figure.

Should you have any comment, doubt, or suggestion related with the contents of this preliminary analysis, please contact us in the telephone number (55) 52513545 or in the mail address info@turanzas.com.mx.

Best regards,

TURANZAS, BRAVO & AMBROSI
Abogados tributarios

www.turanzas.com.mx

This document constitutes a preliminary analysis only for informative purposes which as been carefully prepared by the members of Turanzas, Bravo & Ambrosi. In no manner it intends to be an opinion or a definite position for particular cases, same that will have to be analyzed under their specific circumstances.

If you would not like to receive this Mexican Fiscal Update anymore, please send us an e-mail to info@turanzas.com.mx with the word "REMOVE" typed in the subject line.