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LADB Staff

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In mid-September, the Chamber of Deputies easily approved an initiative to overhaul Mexico's antiquated tax code, accomplishing a goal that eluded Congress for many years. The tax-reform initiative is the second major piece of legislation approved by the Congress in the course of a week. Legislators also passed a major election-reform initiative (see other article in this issue of SourceMex).

The legislation, which reduces reliance on oil-export revenues while imposing new corporate and gasoline taxes, received mixed reactions from members of the business community, but was generally opposed by the center-left Partido de la Revolucion Democratica (PRD). As with the election-reform legislation, political observers were amazed at the ability of Congress to finally pass a tax plan. However, the initiative was approved largely with support from the governing Partido Accion Nacional (PAN) and the opposition Partido Revolucionario Institucional (PRI).

Unlike with the election-reform plan, the PRD and its coalition allies in the Frente Amplio Progresista (FAP) voted against the legislation. The FAP opposed the initiative because of a proposal to boost taxes on gasoline.

Lacking the numbers to defeat the gasoline tax, some members of the coalition, acting on a request from former presidential candidate Andres Manuel Lopez Obrador, had threatened to take over the podium to protest the measure. But PRD Deputy Ruth Zavaleta, president of the Chamber of Deputies, prevented the takeover, which was to be led by Deputy Layda Sansores of the Partido Convergencia por la Democracia (PCD).

The approval of the tax-reform legislation is a major victory for Calderon, who had made an overhaul of Mexico's fiscal system one of the priorities of his six-year term. Analysts said the tax reform is a significant step forward because it reduces Mexico's reliance on oil-export revenues at a time when the country's oil reserves appear to be in a major decline (see SourceMex, 2006-03-22 and 2007-03-07).

The Secretaria de Hacienda y Credito Publico (SHCP) estimates that the tax overhaul could boost government revenues by about 115 billion pesos (US$10.5 billion) in 2008, the first year in which the changes would be in effect. Still, the legislation fell short of the administration's targets. When submitted to lawmakers in June, the bill aimed to bolster tax collection by an amount equal to 3% of GDP through 2012.

The bill approved by the Chamber of Deputies, and endorsed by the Senate, will probably boost collection by 1.1% of GDP in 2008 and as much as 2.7% through 2012, said PRI Deputy Jorge Estefan Chidiac, who chairs the finance committee (Comision de Hacienda) in the lower house.

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Bill closes corporate loopholes, boosts gasoline tax

The new law includes some of the proposals in the plan Calderon offered to Congress in June. These include closing loopholes to boost collections from corporations and a tax on bank deposits, which is partially intended as a mechanism to obtain taxes from people who operate businesses and make significant profit in the informal economy (see SourceMex, 2007-06-27).

PAN legislators, with support from the PRI, added a provision to tax gasoline sales at the retail level. Administration officials say the majority of the additional revenue will come from a new alternative minimum tax (Impuesto Empresarial a Tasa Unica, IETU) of 16.5%, which will be charged to businesses in 2008 and 2009. That tax would increase to 17.5% by 2010. The changes will force businesses to prepare their taxes more carefully to ensure compliance with the tax code, said Fernando Macias, vice president of Instituto Mexicano de Contadores Publicos (IMPC).

The provision to raise gasoline prices attracted some controversy. Opposition came not only from center-left legislators, but many members of the PAN and PRI were at first reluctant to back the proposal. In the end, proponents convinced fellow legislators to back the plan by announcing a phased-in timetable for the tax (impuesto Especial sobre Produccion y Servicios (IEPS), which would ease the impact on consumers. Beginning in January 2008, taxes for premium gasoline would increase by about 2.4 centavos (US$0.002) per liter each of the next 18 months. Diesel taxes would be raised about 1.6 centavos (US$0.001) monthly.

A large share of the money obtained from the gasoline taxes would be used to fund programs for states and municipalities. Another important element of the tax reform is the impact on PEMEX. As part of the legislation, Congress agreed to reduce "taxes" for the state-run oil company by about 30 billion pesos (US$2.7 billion) next year and by incrementally higher amounts in the ensuing years to about 55 billion pesos in 2012. The move frees PEMEX to use more of its revenues to invest in infrastructure, exploration, and other activities. Legislators expect to address further reforms to PEMEX later this session with measure regarding the energy sector.

Business organizations criticized both the IETU and the gasoline tax. The corporate tax, they said, could reduce competitiveness for Mexican businesses and discourage foreign investment. "We must take into account that the major economies of the world have reduced their taxes...to promote development and generate employment," said Armando Paredes, president of the Consejo Coordinador Empresarial (CCE).

The CCE and organizations like the Confederacion Patronal de la Republica Mexicana (COPARMEX) and the Confederacion de Camaras Industriales (CONCAMIN) also raised concerns about the effect that the gasoline tax would have on overall consumer prices. "We do not agree with this tax on gasoline because it could generate an inflationary bubble," CONCAMIN director Ismael Plascencia Nunez told the Mexico City daily newspaper Excelsior. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Sept. 19, reported at 10.99 pesos per US$1.00]

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