2002 Tax Changes Applicable to Maquiladoras

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At the request of the Maquiladora Industry, the new income tax law (ITL) includes in its transitory articles, rules that allow foreign residents who's products are assembled and manufactured through companies with Maquila programs, not to be considered as permanent establishments so long that such Mexican companies comply with transfer pricing rules either by obtaining an advanced pricing agreement (APA) or by applying the " Safe Harbor Rule". Such rules apply for the 2002 and 2003 calendar years, and were previously only contained in the tax miscellaneous rules and only through the 2002 calendar year.

As a result of such inclusions in the ITL the Safe Harbor Rule will continue in effect during such years. The Safe Harbor consists in showing as a minimum tax profit the grater of 6.9% of the total assets used in the Maquila operation or 6.5% of the costs and expenses in accordance with Generally Accepted Accounting Practices. The option to obtain an advanced pricing agreement instead of the Safe Harbor remains in effect.

Although including such rules in the ITL may give more legal certainty to the Maquiladora Industry, Mexico's inability to reach long-term commitments, prevents companies in such industry from planning ahead with long-term commitments and investments in Mexico. Its also important to note that the old rules covered only through 2002 based on the agreement reached with United Stated of America, however under the new ITL, the rules extend through the end of 2003.

Another important change relates to the exemption of surcharges payable by Maquiladoras as a result of the APA's for the fiscal years 2000 and 2001, in which the APA's determine that Maquiladoras must pay additional income taxes. An extension of time from 5 days to 20 days following the issuance of the resolution was introduced under the new ITL to allow payment of such taxes. As most of you know, APA's take time, sometimes years to get approval. Unfortunately, the new ITL does nothing to shorten or speed up the approval process.

A new addition to the ITL includes companies operating under a Shelter Program and under the new rules they will not be considered as permanent establishments of foreign residents for who they manufacture products. Such foreign residents will also benefit from the exemption of the asset tax for the assets used in such activities that are owned by the same foreign residents.

It is important to note that those companies operating under a Shelter agreement must have obtained their program specifically as a "Shelter" and not as a Maquila Program otherwise the benefits may not apply.

The new ITL also allows certain breaks to Maquiladoras of new creation. Companies that are considered "Maquiladoras of New Creation" will only have to meet the minimum tax profit of 6.5% of cost for the tax years 2002 and 2003 (vs. the higher of such, or 6.9% of assets). In order to be considered a Maquiladora of New Creation the company must: (i) have been incorporated after December 31, 2001; (ii) obtained its Maquila

Program some time in 2002; (iii) its creation must not be a result of a merger or spin off; or (iv) more than 10% of the total assets must not have been acquired or used previously by another Maquiladora.

This article is designed to provide information regarding the subject matter covered and is not to be considered as legal advice by the authors. Each case should be reviewed on an individual basis. Should you have any questions please do not hesitate to contact Jorge A. Garcia from our San Antonio Office at (210) 227-7591.