

## OECD Economic Survey: Mexico 2007 – ADDENDUM

The *Economic Survey of Mexico* was finalized in July 2007. The OECD Economic and Development Review Committee discussed a draft on 2 July 2007 and approved the final Survey, which was revised in the light of the discussion, on 18 July 2007.

The Survey has not been updated to reflect new developments that have occurred in Mexico since the finalization of the Survey in July. Prominent among these has been the approval by Congress of a tax reform bill on 14 September 2007.

The tax reform is a key element of the broader public finance reform which was presented by the government in June 2007. The public finance reform included four main pillars: i) strengthening of the tax administration; ii) improving the institutional framework for public spending; iii) reviewing the fiscal relations across levels of government; and iv) engaging in a tax reform that strengthens public finances and improves the stability of revenue. A detailed review of the proposed reform is provided in Chapter 2 of the Survey with an assessment and recommendations on its various components.

The major components of the approved tax reform are the following:

1. *The IETU (Impuesto Empresarial a Tasa Unica)* is introduced. It is an income tax on firms and professional activities to be applied on the firms' revenues from the sale of goods, the provision of services and the temporary grant for the use of goods, after deduction of capital spending. Similar to the originally proposed CETU (see Chapter 2, Box 2.2 in this Survey), the IETU acts as a minimum tax for the income tax. The tax will be compared with the firm's income tax and the income tax withheld by the firm for third parties, such as salaries, wages, and compulsory social contributions paid by the firm, and the higher of the two taxes will be paid. The Mexican asset tax is abolished. The rate for the IETU has been set at 17.5% (rising gradually from 16.5% in 2008 and 17% in 2009, to 17.5% in 2010). This is slightly below the rate which was proposed initially for the CETU (19%).
2. A 2% tax on cash deposits greater than US\$2 500 is introduced (this threshold is slightly higher than the original proposal of US\$2 000). Formal businesses and professionals can credit their payments of this tax against their other tax payments.
3. *The fiscal regime for the state oil company PEMEX is changed*: the change is aimed at reducing the taxes that PEMEX pays on extracted hydrocarbons from 79% to 74% in 2008 (this was not in the original proposal). The tax will be further reduced by an annual 0.5% in 2009-2011 and by 1% in 2012. In 2008, this change is estimated to provide around US\$2.8 billion in extra resources for PEMEX in 2008 and up to around US\$5 billion in 3 to 4 years. In addition, the company has to carry out a program to improve operating efficiency to international standards and funds must be spent on research and modernization rather than on current expenses.

4. A new tax on *petrol and diesel* of 5.5% is introduced to be phased in over 18 months (this was not in the original proposal). The revenue from this tax will be allocated in its entirety to state governments.

Coming after a long period of stalemate on tax reforms, this tax bill is to be welcomed. It helps to strengthen Mexico's public finances by reducing the dependence on oil revenue and providing more stable sources of revenue to support essential spending needs. The tax reform is expected to raise around 2.3% of GDP by 2012. This is a significant amount, even though somewhat below what was expected from the original proposal (around 2.9% of GDP).

As indicated in the Survey, additional tax measures should be considered in the longer run, notably on the consumption tax front, where VAT remains an area of concern because of the large number of exemptions and zero rated goods and services that introduce distortions and complicate tax administration.