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Mexico's tax reforms to date and what to expect next

By Prof Sergio Guerrero Rosas

President Peña Nieto's controversial "sugar tax" was brought into force a year ago, targeting high calorie foods to the tune of 8% of their value. While the jury is still out as to whether it has had the desired effect on the population and the various burdens, what has become an issue of far greater significance is the success or otherwise of the more substantial reform package to which the sugar tax belonged.

Rises in income tax and corporate tax sought to generate revenue in a new, forward-looking Mexico, focused on social responsibility, investment in infrastructure and economic growth. Furthermore, tightened loopholes and a simplified tax structure aimed to push Mexico towards increased productivity, while making it an altogether more attractive prospect for foreign investment – a key feature of Peña Nieto's vision for Mexico.

"Our goal is to play a more active role in the global economy," wrote the President in the UK's Financial Times recently, before emphasising that his reforms "intertwine in pursuit of a single goal: to increase Mexico's productivity and competitiveness". He also took time to highlight Mexico's significant international standing as an oil producer and its shale gas resources. It is Nieto's historic, highly controversial, reform of Mexico's energy sector that underpins his entire economic strategy, having swung open the door to private investment in Mexico which had previously remained closed.

The massive auctioning off of well over one hundred oil and gas blocks this year aims to create a bidding frenzy, generating USD 50 billion by the end of Peña Nieto's presidency in 2018. However, falling oil prices threaten to undermine this strategy, which could in turn have a significant impact on domestic policy at a time when Nieto's administration has been called into question following a series of political disasters.

The shocking disappearance of 43 student teachers in the state of Guerrero brought about widespread protest and international condemnation, just as revelations regarding Peña Nieto's wife, Angelica Rivera, seemed to force the President's hand in U-turning on a multi-billion dollar contract for Mexico's first high-speed rail link, to be built between the capital and the city of Santiago de Queretaro.

The contract, only recently won by a Chinese-led consortium, was suddenly cancelled when it emerged that a luxury property owned by Rivera had recently been built by a construction group, Grupo Higa, strongly connected with the contract-winning consortium. Further revelations showed other links between the group and the President himself, with Grupo Higa reportedly having benefitted from contracts to the tune of over USD 600 million in the State of Mexico during Peña Nieto's time as State Governor.

Needless to say, Chinese investors were stunned at the turn of events, which, for a time at least, threatened to have far-reaching implications for the business links between the two countries. However, fortunately for Mexico (not to mention President Peña Nieto), Chinese enthusiasm for investment in Mexico appears to be unabated, and plans for more than USD 7 billion of investments in Mexican infrastructure and energy pipeline projects have since been announced by Beijing.

Cera Cruz Port – Mexico remains committed to establishing itself in the global economy and encouraging foreign investment and trade

Moreover, there are further indications that Sino-Mexican relations are going strong, with the arrival of the Industrial and Commercial Bank of China (ICBC) being fast-tracked through what is an often laborious licensing process in Mexico, leading an ICBC spokesman to anticipate: "a boost in economic exchanges and trade between China and Mexico, contributing to bilateral co-operation in sectors such as energy, trade, projects contracting and equipment supplies."

Furthermore, trade and manufacturing relations between Mexico and the United States continue to strengthen: over USD 500 billion is generated in business between the two countries per annum, and the countries' presidents met in the White House at the start of the New Year to discuss, among other topics, the Trans-Pacific Partnership, as well as strategies for opening new markets to Mexico and the U.S. within and among its twelve Pacific Rim member countries.

Meanwhile, though, anxiety persists as to the success of that all-important energy sell-off. Despite the expectation that increases in tax revenue will continue for the duration of Peña Nieto's presidency, uncertainties in the global economy could rein in Mexico's anticipated economic growth, in the short term at least, and possibly even limit intended public spending in his budget plans for 2016, despite the political fallout that would inevitably ensue.

Nevertheless, despite what could prove to be a rocky road ahead for the big energy auction, no significant amendments have been made to the 2014 budget: corporate tax remains at 30% and income tax at up to 35%, all the while further reforms press ahead. The IEPS (the special tax on specific products and services, and which includes the sugar tax) also remains at a similar level.

Over the course of 2014, improvements in the efficiency of tax collection methods have been observed. The sugar tax has successfully raised tax revenue, but the tax authority has been very slow to make VAT returns to companies, which has caused some difficulties.

However, Mexico continues to maintain healthy debt levels, it has achieved its initial tax revenue targets, the country has made progress – despite notable setbacks – in transparency levels, and it has recently received rating upgrades from the three major credit ratings agencies.

In this context, irrespective of the immediate uncertainty under the current administration, Mexico remains committed to establishing itself in the global economy and encouraging foreign investment and trade. There is cause for optimism that the long-term reward will be well-programmed and administered investment in the country's infrastructure and people. As always, though, the success of public spending programmes will largely depend on Mexico's ability to combat corruption and its continued efforts to improve transparency.

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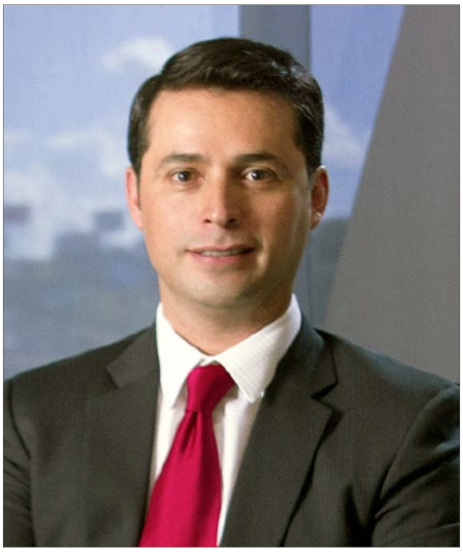

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