

*Doing Business  
in Mexico*  
2011

Tax and Legal Services  
PwC Mexico



---

# ***Foreword***

This Guide has been prepared for the assistance of those interested in doing business in Mexico. It is not intended to cover exhaustively the subjects it highlights, but rather to answer some of the important, broad questions that may arise. When specific questions occur in practice, it will often be necessary to refer to the laws, regulations and decisions of the country and obtain appropriate business, accounting and legal advice.

**The material contained in this Guide was assembled in January 2011 and, unless otherwise indicated, is based on information available at that time.**

---

# ***Introduction***

PwC in Mexico

We trust that this latest printed edition of our Doing Business and Investing in Mexico Guide will be a useful tool to assist the business executive when seeking information from a general reference guide. The Guide has been structured in a way that we believe will make it easier for you to obtain the basic relevant information you require when considering a direct or indirect investment in Mexico.

Mexico is currently one of the countries with the largest network of tax and information exchange treaties and trade agreements, which brings it into the list of the largest and most open economies in the world, with only a handful of strategic sectors or industries closed to private investment.

Mexico has kept its fiscal and monetary policies under strict discipline, a situation that has maintained the country with an adequate macro-economic position and suitable for an investment from that perspective, as well as maintaining an “investment grade” from the international financial community. For 2011, Mexico is forecasting an economic growth rate from 4 to 5 %, following the global recovery trend. Nevertheless, the very significant cross-border commercial and investment interaction with the rest of the economies in the current globalized environment may also affect Mexico, as has been the case when other countries’ economies have experienced slowdowns or their financial sectors have entered into sudden crises, as all countries are now interdependent and Mexico is no exception.

Consistent with its fiscal and economic policies, Mexico has opened its doors to foreign investment, providing incentives for the creation of jobs and most of the 32 states offer local investment incentives in their jurisdictions.

PwC has presence in the most important cities of Mexico, covering the country’s entire geography. Our professionals from the 19 offices listed in this Guide will be more than happy to assist or refer you to the appropriate specialist who can help you navigate the complexities of doing business in Mexico, in the context of a best practices approach, using a single point of contact and service delivery, offered consistently through our wide range of services and specialist areas, as you have come to expect from the PwC Network throughout the world.

All of us in the Firm are committed to bringing you the PwC experience and values, as further discussed in the chapter entitled “Introduction to PwC”. So rest assured that in this Guide we have done our utmost to bring to you a truly valuable tool to plan your investment in Mexico.

Sincerely,



Javier Soni  
**Territory Senior Partner**



---

# **Table of Contents**

## Investment Climate

<b>Chapter 1 Mexico - A profile</b>	1
Investor considerations	1
Geography and climate	2
History	2
Political system	3
Legal system	3
Population and social patterns	4
The Economy	6
Hints for the business visitor	14
<b>Chapter 2 Business environment</b>	17
Investor considerations	17
Industrial climate	17
Framework of industry	17
Focus of government policy	18
Public/private sector cooperation	19
Labor/management relations	19
Overseas trade relations	20
<b>Chapter 3 Foreign investment and trade opportunities</b>	21
Investor considerations	21
Investment climate	22
Special investment opportunities	24
<b>Chapter 4 Investment incentives</b>	25
Investor considerations	25
Investment policy	25
Tax concessions	26
Regional incentives	26
Industry incentives	26
In-bond processing industry (Maquiladora industry)	27
Strategic Bonded Warehouse	28
Industrial parks	28
Free trade agreement	28
International financial center operations	28
Export incentives	28
Ministry of the Economy (SE) export programs are as follows	29
Incentives to invest in other countries	31
Incentives and foreign investment strategy	31

<b>Chapter 5 Restrictions on foreign investment and investors</b>	33
Investor considerations	33
Regulatory climate	33
Liberalization of foreign investment restrictions	34
Exchange controls	35
Restrictions on foreign investment	36
Policy trends	41
<b>Chapter 6 Regulatory environment</b>	43
Investor considerations	43
Regulation of business	43
Competition Policy	44
Price controls	44
Mergers and acquisitions	45
Securities markets (stock exchange)	45
Requirements for Securities Commission approval	45
Mexican Stock Exchange	45
Brokers and broker-dealers	46
Imports and exports	46
Consumer protection	46
Imports	46
Food and drugs	47
Environmental provisions	47
Electronic Contracting: Private use and Public trend; online consumer protection.	48
Special industries	48
Insurance and banking	48
Mining industry	49
Patents and trademarks	49
Patents	50
Trademarks	50
Copyright protection against video and audio piracy	50
<b>Chapter 7 Banking and finance</b>	51
Investor's considerations	51
General note	51
Banking system	52
Specialized financial institutions	53
Non-Bank Financial Entities	54
Investment institutions	54
Retirement fund managers (AFOREs)	55
Financial markets	56
International financial market	57
Sources of funds	58
Impact of the Foreign Investment Law and NAFTA on the financial services industry	59

<b>Chapter 8 Exporting to Mexico</b>	61
Tips for exporters	61
Import restrictions	62
Import duties	62
Other taxes	63
Documentation procedures	64
and technical barriers to trade	64
Customs and storage	65
Port of entry and inland transport	65
Reexports	66
Local representation	67
Sources of information	68
<b>Chapter 9 Business entities</b>	69
Guide to “doing business” entities	69
Forms of business enterprise	70
Stock Corporation	72
Stock Corporation with variable capital	77
Stock Corporation for the promotion of investment	77
Limited liability company	78
Partnership	79
Civil partnership	79
Joint venture contract	79
Branch of a foreign corporation	81
Sole proprietorship	81
Nonprofit organizations	81
<b>Chapter 10 Labor relations and social security</b>	83
Investor considerations	83
Labor relations	83
Working conditions	86
Social security	91
Housing	94
<b>Chapter 11 Audit requirements and practices</b>	97
Investor considerations	97
Statutory requirements	97
<b>Chapter 12 Accounting principles and practices</b>	101
Investor considerations	101
Form and content of financial statements	103
Book and tax differences	110
Foreign investors	110

<b>Chapter 13 Tax system</b>	113
Investor considerations	113
Principal taxes	113
Legislative framework	114
Income tax	115
Business Alternative Tax (Flat tax)	115
Classes of taxpayer	116
Taxable income	117
Tax year	117
Tax-free zones	117
Tax holidays	117
Capital taxation	118
International aspects	118
<b>Chapter 14 Tax administration</b>	119
Investor considerations	119
Administration of the tax system	119
Corporate taxpayers	120
Individual taxpayers	124
Partnerships and joint ventures	127
<b>Chapter 15 Taxation of corporations</b>	129
Investor considerations	129
Corporate tax system	130
Taxable entities	131
Gross income	131
Business profits	133
Capital gains	135
Deductions	141
Tax computation	151
Other taxes	154
Branch versus subsidiary	155
Special industries	156
<b>Chapter 16 Taxation of foreign corporations</b>	159
Investor considerations	159
Tax concepts	160
Imports	160
Branch operations	161
Income from subsidiaries	164
Fees paid to foreign corporations	168
Portfolio investments	169
Taxes other than income tax	169
Regional administrative offices	169

<b>Chapter 17 Taxation of shareholders</b>	171
Investor considerations	171
Domestic shareholders	172
Foreign shareholders	173
Reorganizations	173
<b>Chapter 18 Taxation of foreign operations</b>	177
Investor considerations	177
Taxation of foreign income	177
Double taxation relief	179
<b>Chapter 19 Partnerships and joint ventures</b>	181
Investor considerations	181
Partnerships	181
Joint ventures	182
<b>Chapter 20 Taxation of individuals</b>	183
Tax planning for expatriates	183
Territoriality and residence	184
Deductions	193
Double taxation relief	194
Tax computation	194
Other taxes	195
Alternative Business Tax	195
<b>Chapter 21 Taxation of trusts and estates</b>	197
Investor considerations	197
Trusts	198
Estate and Gift Taxes	200
<b>Chapter 22 Alternative business tax</b>	201
Flat tax	201
Corporate tax system	202
Taxable entities	202
Territoriality	202
Cash basis tax	203
Income	203
Exemptions	203
Authorized Deductions	205
Non-deductible items	206
Computation of flat tax	206
Flat tax credits	206
Consolidated entities	210

Non-profit entities' members	210
Trusts	211
Small taxpayers' regime	211
Financial system entities	212
Insurance companies	213
(financial intermediation margin)	213
Purchase and sales of currencies	214
Bankruptcy process	214
Asset tax paid in previous years	215
Presidential Decree addressing new Mexican Flat Tax may benefit certain taxpayers	215
Installment sales	216
Additional deduction for taxpayers who do business primarily with the general public	216
Inventory as of December 31, 2007	216
Additional benefit on advance payments	216
Maquila (see INMEX in Chapter 23)	216
General requirements for authorized deductions	217
<b>Chapter 23 Value-added tax</b>	219
Investor considerations	219
Taxable transactions	220
Sales of goods	221
Rate of tax	222
Payments of tax	223
Taxpayers subject to VAT withholding	223
VAT Refunds and overpayment certification process	223
<b>Chapter 24 Other indirect taxes</b>	225
Investor considerations	225
Tax on acquisition of real estate	225
Federal excise and vehicle taxes	225
State and municipal taxes	226
<b>Chapter 25 Tax treaties</b>	227
Investor considerations	227
Tax treaty policy	227
Treaty models	227
Treaty provisions	227
Exchange of information	227
<b>Chapter 26 Introduction to PwC</b>	229
PricewaterhouseCoopers worldwide organization	229
PricewaterhouseCoopers in Mexico	229

<b>Appendix I</b>	
Corporate tax rates	231
<b>Appendix II</b>	
Tax depreciation rates	232
<b>Appendix III</b>	
Corporate income tax and employee profit sharing calculations	233
<b>Appendix IV</b>	
Withholding taxes- Taxation of shareholders	234
<b>Appendix V</b>	
Withholding taxes-Payments to nonresidents	236
<b>Appendix VI</b>	
Tax treaties	244
<b>Appendix VII</b>	
Individual tax rates	245
<b>Appendix VIII</b>	
Monthly individual withholding tax rates	246
<b>Appendix IX</b>	
Personal allowances	248
<b>Appendix X</b>	
Individual income tax calculation	249
<b>Appendix XI</b>	
Social security contributions and benefits	251
<b>Appendix XII</b>	
Value-added tax – Items subject to zero rate	252
<b>Appendix XIII</b>	
Financial Statements	254
<b>Appendix XIV</b>	
Acquiring a business enterprise – A checklist	259
<b>Appendix XV</b>	
Structuring an investment – A checklist	263
<b>Appendix XVI</b>	
Major events/changes	266
<b>Appendix XVII</b>	
Business information services	268
<b>PwC Mexico Tax and Legal Experts</b>	<b>270</b>
<b>Our network</b>	<b>272</b>



# Chapter 1

## Mexico - A profile

### ***Investor considerations***

- Stable government.
- President elected every six years for a single term.
- Foreign investment rules in Mexico are fairly liberal.
- Strong government efforts to keep inflation low.
- Continuing trend toward reprivatizing government-owned enterprises. Certain areas of the electricity sector were opened up to private investment to facilitate the urgent need to expand Mexico's generating capacity.
- Trade barriers are substantially reduced.
- The North American Free Trade Agreement -NAFTA, with the United States and Canada effective since 1994, and Free Trade Agreement with the European Union since 2000. Free trade agreement with the European Free Trade Association (EFTA) signed on November 2000. Economic Agreement between Japan and Mexico is in place since April 2005.
- In-bond processing companies (maquiladoras) with high productivity are available.
- Long common border with the United States, providing a large market for exports.
- Some foreign banks have subsidiaries in Mexico or joint ventures as result of open foreign investment rules.
- Population is approximately 106,400,000 inhabitants, increasing at a rate of about 1.3 percent per year.
- Low-cost, easily trainable workforce.
- Climate is generally mild.
- Tourist attractions include archeological sites and extensive coastlines, with excellent beach resorts.

## ***Geography and climate***

Mexico (officially the United Mexican States) has an area of 760,000 square miles (1,970,000 square kilometers), the twelfth country in the world in size, and occupies the southern part of North America and part of Central America. It is the third-largest country in Latin America after Brazil and Argentina. The greater part of the country is a highland plateau bordered on the east, west and south by mountains. This plateau gradually rises to the south. The southern part of the plateau includes Mexico City, the political, economic and population center of the country, located at an altitude of about 7,500 feet (2,240 meters), one of the highest cities of the world.

Almost 50 percent of Mexico, including the entire northern part of the country, is arid or semiarid. Annual rainfall increases toward the south where there are zones with the highest levels of rainfall in the world; the rainy season usually runs from May to October, with very little rainfall during the rest of the year, except in the coastal area near the Gulf of Mexico. Nevertheless, the climate varies widely, in part because of the wide variation in altitudes in the country and the effect of the Pacific Ocean and the Gulf of Mexico on the coastal areas. Mexico City and many other regions in the central part of the country have a semitropical climate. There are very few regions, aside from the higher mountains, where it snows regularly in winter. Most of the coastal regions have a humid, tropical climate.

The Mexico City metropolitan area has an average mean temperature of 63°F (17°C), with occasional lows of around 32°F (0°C) in December and January and highs near 86°F (30°C) in April or May before the beginning of the rainy season.

## ***History***

For more than 300 years Mexico was ruled as a tightly controlled colony of Spain. Independence in 1821 was followed by decades of struggle for political power and slow economic development, until the 30 years of internal peace achieved under Porfirio Díaz around the end of the 19th century. During this period, the great haciendas, huge areas of land used for cattle raising and farming, reached their peak, although with little improvement in the economic condition of the great majority of the people. The Mexican revolution of 1910 was followed by more than ten years of civil war, which almost completely destroyed the agricultural economy of the country. Accordingly, although Mexican cultural, social and political life reflects the cumulative development of more than 10 centuries since the Spanish conquest and the earlier Aztec, Mayan and other civilizations, the economy of modern Mexico is only some 90 years old, originating in the 1920s.

## ***Political system***

Mexico is now a federal democratic republic divided into 31 states and the Federal District (Mexico City). The federal government has somewhat greater powers than its counterpart in the United States, particularly in one area: the principal types of tax revenues are reserved to the federal government, which distributes certain revenues to the states. The chief executive is the President, who is elected for a period of six years and may not be reelected. There is a bicameral legislature as well as a judicial branch.

The mayor of Mexico City is elected by popular vote for a single six year term since 1997. The Legislative Assembly (formerly the Assembly of Representatives) of the Federal District is elected every three years. This assembly is empowered to issue ordinances regarding the day-to-day administration of the District. All the officials of the Federal District are appointed to office and may serve for more than a single term, although this is unusual. In view of the size and economic importance of the District, its annual budget is considerably larger than that of any of the states. For the last ten years the Federal District has been governed by the PRD, a leftist political party.

The state governments are headed by popularly elected governors, who also serve for single six-year terms. The states have their own legislatures and judicial systems.

## ***Legal system***

In general, legislation follows the pattern of codified law originally based on the Napoleonic Code, with separate federal and state civil and other codes, in addition to separate laws and decrees covering specific subjects. Corporate law, as well as foreign investment, intellectual property protection, and income and value-added tax laws, among others, are federally created.

## ***Population and social patterns***

### ***Population***

The population of Mexico is estimated at approximately 106,400,000 inhabitants, reflecting a net annual increase in recent years of about 1.3 percent. Mexico is the most populous country in Latin America after Brazil. The total population of the country has more than tripled since 1940.

There has been a substantial movement of people from rural areas to towns and larger cities. The urban population is now considered to represent well over 70.3 percent of the total. Although the average population density in the country as a whole is only about 53 inhabitants per square kilometer, that of the individual states of the republic varies widely, from about 13 inhabitants per square kilometer in the southeastern state of Campeche to more than 5,954 per square kilometer in the Federal District, consisting largely of the capital, Mexico City.

Mexico City and its environs continue to be the largest and most concentrated population center, with a disproportionate share of economic activity. However, some efforts have been made by both the federal and local governments to decentralize industry and foster the growth of other regional population and business centers.

### ***Language***

The national language of Mexico, understood and used by all but a very small number of indigenous tribes in the interior, is Spanish, although local languages are also spoken by fairly large numbers of the population in certain areas. English is also understood by many members of the business community in the capital and larger cities, as well as in the areas bordering the United States.

### ***Religion***

Mexico enjoys full religious freedom. Roman Catholicism was for a long time the state religion. However, the influence of the church has been greatly reduced since the separation of church and state in the 1860s. A majority of the population still consider themselves active members of the Roman Catholic Church.

### ***Education***

The Mexican federal and state governments provide universal free education through six years of primary school and three years of secondary school, as well as preprimary. The federal government also provides the funds for the three largest universities in Mexico City, which, however, operate as autonomous entities. These universities have established preparatory schools that provide another three years of education before the university level. Many state governments also finance schools and universities. Students are charged small fees at the preparatory schools and universities. A large number of private schools and colleges, as well as full-fledged private universities, some operated by religious orders, have also been licensed by the Ministry of Education.

The tremendous increase in population has resulted in an enormous demand for new school facilities at all levels. The federal government spends nearly 15 percent of its estimated expense budget to satisfy the demand. Illiteracy has been reduced substantially in recent decades, but 8% of the population over 15 years of age is still classified as illiterate. Particularly in rural areas, many children are still unable to attend school regularly.

### ***Living standards***

As in most developing countries, the distribution of wealth between different segments of the population is uneven. The standard of living of those in upper- and middle-management positions is more or less comparable to that of persons occupying similar positions in companies of comparable size in the industrialized countries. However, the earnings of office, skilled, semiskilled, and unskilled workers are considerably below those of their counterparts in the industrialized countries.

One of Mexico's biggest problems is to find gainful employment for its population. Government officials have estimated that more than 1,000,000 new jobs should be provided each year. Unemployment and underemployment are considerable and have increased in recent years, although no comprehensive statistical information is available. The unskilled labor pool is very large in many parts of the country, particularly outside Mexico City, where the labor force has proved to be easily trained for semiskilled and skilled jobs. The in-bond processing plants near the U.S. border often achieve productivity rates 20 to 30 percent higher than those in the United States.

### ***Cultural and social life***

Mexico City is considered the most important center of Mexico's very active cultural life, particularly as regards art, museums, theaters, musical organizations, book publishers, and libraries. Similar facilities, although less numerous, are also available in the other principal cities and state capitals.

There has been an increasing trend toward participation in many types of sports, and facilities for spectator sports are widespread. National tourism by automobile, bus and airline has become a major part of the overall travel industry, particularly during school vacation periods. The many resorts on the coastlines and in the interior, as well as Mexico's numerous colonial cities and archeological sites, are the preferred destinations. Foreign tourism has also been increasing, with Mexico becoming one of the world's preferred tourist destinations.

## ***The Economy***

### ***General description***

Mexico has a mixed economy, with the government, its agencies and government-owned or -controlled companies dominant in the areas of public utilities and petroleum. Private enterprise is the principal factor in manufacturing, mining, commerce, entertainment, and the service industries, including construction and tourism. During the 80's and 90's the government sold to private enterprise a number of its holdings in what are classified as nonstrategic industries. Foreign investment is found most frequently in the manufacturing, mining and financial sectors.

The economy is fairly broad-based and dedicated mainly to supplying the needs of the large and rapidly increasing population. However, proximity to the United States also provides a large market for the export of manufactured goods and semimanufactures, as well as substantial income from foreign tourists. Federal taxes on oil production and exports provide a substantial portion of the total resources of the federal government.

The foreign debt is quite significant, amounting to approximately US\$56 billion as of December 2008. The public portion of the debt has been renegotiated several times, and Mexico is current as regards payments of interest and principal on the debt. Moreover, Mexico has sufficient resources, in its international reserves, to cover its external debt due in future years.

Several steps have been taken to control inflation levels.

The contributions of the various sectors to GDP are shown in Table I.

### ***Inflation***

Since 1973 Mexico has had high rates of inflation with concurrent substantial devaluations of the Mexican currency. However, as a result of the measures then agreed on by the federal government and organized labor, farmers and private enterprise, inflation was brought down to approximately 9 percent for 1994. Although the 1994 devaluation resulted in inflation of 52 percent in 1995, in recent years, the inflation rate dropped to one digit and may be considered comparable with Mexico's commercial partners (i.e. US and Canada). For 2007, the inflation rate was 3.76% and in 2008 it was 6.53%. The estimated inflation rate for 2009 is 6.17%, due to international financial crisis.

### ***Mineral and energy resources***

Mexico has become the world's fifth or sixth most important exporter of crude oil. However, proven reserves have been decreasing in recent years, mainly because of the lack of exploration. Recent new discoveries have been announced that may convert Mexico again into one of the most important oil exporters in the world, although substantial investment will be required. Oil production and exports averaged about 2.6 million barrels per day and 1.2 million barrels per day, respectively, during 2009. These export levels are expected to continue, in part because of the rather unstable world market. Moreover, Petroleos Mexicanos (PEMEX), the government-owned oil company, has been obliged to reduce its rate of drilling new wells in line with the general reductions in government expenditures.

**I—GDP by Sectors, 2005- 2007**

(In Ps millions)

<b>Sector</b>	<b>2006</b>	<b>%</b>	<b>2007</b>	<b>%</b>	<b>2008</b>	<b>%</b>
Agriculture, fishing, livestock, forestry	436,450	4%	436,450	4%	506,594	4%
Mining	771,735	7%	966,837	8%	794,923	7%
Electricity, water and gas services	153,823	1%	180,055	2%	203,729	2%
Construction	730,380	7%	788,670	7%	854,190	7%
Manufacturing	1,928,472	18%	2,086,562	18%	2,230,941	18%
Commerce,	1,649,647	15%	1,794,390	15%	1,815,037	15%
Transportation, freight and storage	719,473	7%	771,109	7%	792,640	7%
Mass media	314,745	3%	356,314	3%	384,499	3%
Financial services and insurance	339,275	3%	403,055	3%	384,544	3%
Other	3,703,285	34%	4,009,698	34%	4,155,132	34%
<b>Total GDP</b>	<b>10,747,285</b>	<b>100%</b>	<b>11,793,142</b>	<b>100%</b>	<b>12,122,230</b>	<b>100%</b>

Source: INEGI

The principal benefits to the country from the oil industry are its export earnings and the very substantial amounts transferred to the federal government as tax payments, which account for a considerable portion of total tax collections from all sources.

Mexico is also endowed with other mineral resources, including substantial quantities of silver (one of the world's largest producers), copper, lead, zinc, sulfur and fluorite, as well as deposits of coal, iron ore and manganese. The mining industry is one of the oldest in Mexico, having become important in the Spanish colonial era, but local risk capital for this industry has been in short supply. Accordingly, exploration work is sometimes financed by foreign investors, who then seek local partners or make direct investment in the mine construction when an apparently commercial ore body is located. With the increase in prices of minerals investments have been growing in this sector.

The production and distribution of electric power in Mexico are controlled by the Federal Electricity Commission, which has been forced to increase its generating capacity in order to keep up with increasing demand. About 22 percent of its capacity comes from hydroelectric plants; the balance is largely from gas- or oil-burning plants.

### ***Agriculture, livestock, fisheries, forestry***

A relatively large segment (about 15 percent) of the total working population continues to be employed in agriculture, cattle raising, forestry, and fishing. Direct foreign investment in these areas has been very limited because of former constitutional and other restrictions. Only a small portion of the land can be considered first-class agricultural land, especially because of lack of rainfall in the northern part of the country. However, irrigation has considerably increased the amount of land under cultivation, and in a normal crop year Mexico is largely self-sufficient in food, except for deficiencies of wheat and corn. The principal agricultural exports have been coffee, tomatoes, cauliflower, artichokes, avocados, and other vegetables.

Efforts to improve productivity and standards of living in many agricultural areas have been hindered by a lack of modern agricultural equipment and know-how. Privately owned farms have usually been small because of former strict limitations in the Mexican Constitution on the maximum area that could be owned by a single individual (in the case of irrigated land, for example, 100 hectares). Much of the arable land has been expropriated for the establishment of cooperative farms (ejidos).

However, because of a sweeping amendment to the country's constitution and the enactment of a new agrarian law in February 1992, the legal framework governing land ownership has been significantly liberalized. The most important features of this legislation are the following.

- Ejidatarios, i.e., farmers who merely had the right to use cooperative farms (ejidos), may own the land outright, and it may be leased, sold or otherwise transferred.
- Ejidatarios may enter into any kind of business association with other ejidatarios or with third parties.
- Corporations may own farm, grazing or timber land with a maximum area of 2,500 hectares, subject to certain limitations.
- Foreign investment is permitted in these corporations up to 49 percent of series "T" shares, i.e., shares representing the contribution or acquisition of land.
- Expropriations to distribute land among the landless will no longer be decreed.

## ***Manufacturing***

The principal manufacturing industries include automobile and auto parts producers, steel manufacturers, textiles, food processing, breweries, glass, chemicals and petrochemicals, and cement and other materials for the construction industry.

Many companies are improving their products and quality control in order to be able to export. Competition from foreign manufacturers for consumer goods has increased because of the reduction in import duties and the elimination of requirements for prior import permits for most products currently prevailing in the Mexican open economy environment.

As a consequence of the above-mentioned lowering of import duties and the reduction of nontariff barriers since Mexico joined the General Agreement on Tariffs and Trade—GATT (now the World Trade Organization—WTO), manufactured goods have increased in significance and in some years surpassed oil as the principal export item.

### ***In-bond processing industry***

Mexico's in-bond processing industry, the maquila companies or maquiladoras, may have shown the highest growth rates of any industry in some recent past years. These companies, the majority of which are located near the U.S. border, are usually wholly owned by a foreign corporation with which the maquiladora contracts to produce subassemblies or semifinished or finished goods for shipment to the foreign company. The latter provides most of the necessary machinery and equipment and furnishes the principal raw materials or parts to be processed or assembled, all of which are usually imported duty-free under bond and remain the property of the foreign company.

The principal advantages of this method of operation, referred to as “production sharing,” arise from the favorable labor market in Mexico, with its lower wage rates (expressed in U.S. dollars), compared with those in the industrialized countries. These companies assemble or finish a wide range of different products, the most important of which are electric and electronic materials, equipment and apparatus and automotive equipment and supplies. The incentives available to these companies are discussed under “In-bond processing industry” in Chapter 4.

### ***Service industries***

The service industries form a major part of the economy, with the commercial sector alone (including hotels and restaurants) accounting for a large percentage of GDP. Financial and business services represent a much smaller proportion.

The commercial banking system was nationalized in 1982. However, it was reprivatized eight years later. Many foreign banks have established Mexican subsidiaries since the signature of NAFTA, some with limited activities. Currently most banks and all stock brokerages and insurance companies are privately owned.

Many major telephone companies have obtained concessions from the federal government to operate long-distance telephone and wireless communication services.

There is growing foreign ownership in the wholesale and retail trades. Although a few of the largest wholesale and resale trade companies are listed on the Mexican Stock Exchange, most are closely held family corporations.

### ***Tourism***

Largely because of the many lovely bays on its extensive coastlines, its numerous archeological sites and its tropical and semitropical climate, Mexico has developed a substantial tourist industry, handling more than 22 million foreign tourists per year, mainly from the United States, in addition to those who merely visit the border zone. Substantial foreign investments have been made in properties in the resort areas.

### ***Transport and communications***

The system of paved highways in Mexico has been expanded considerably. Concessions to private enterprise to build and operate modern toll roads greatly expanded the system, which connects all major cities in the country and most of the smaller urban areas, as well as several points on the borders with the United States and Guatemala.

Privately owned Mexican airlines offer numerous flights connecting most of the cities. These and many of the larger international airlines maintain regular service between Mexico City, some of the other large cities and principal resorts, and many cities in the United States and the rest of the world.

The national railroad network was operated by the federal government for many years and was the largest freight carrier in the country. In 2001 the privatization process started, and now the railroad network is operated by private companies. Considerable amounts of freight are carried by the many licensed truck lines, a business limited by law to Mexican nationals operating as individuals or cooperatives. Many intercity bus lines now carry a lot of passengers, and large modern bus terminals have been opened in Mexico City and other locations.

## Foreign trade and balance of payments

Foreign trade is very important to Mexico in order for it to service the large external debt and to obtain the machinery and equipment needed for industrial development. See Tables II and III for merchandise exports and imports, respectively.

### II—Merchandise Exports, 2006 to 2008

(In US\$ millions)

	2006	%	2007	%	2008	%
Total Exports	249,925	100	271,875	100	291,343	100
Petroleum products	39,022	16	43,018	16	50,656	17
Non-Petroleum Products	210,903	84	228,857	84	240,687	83
Non-Petroleum Products	210,903	84	228,857	84	240,687	83
Agriculture	6,853	3	7,435	3	7,916	3
Mining	1,317	1	1,737	1	1,931	1
Manufacturing	202,734	81	219,685	81	230,840	79

Source: Banco de México, INEGI, SAGARPA, Secretaría de Economía, Bancomext.

### III—Merchandise Imports, 2006-2008

(In US\$ millions)

	2006	%	2007	%	2008	%
Total Imports	256,058	100	281,949	100	308,603	100
Consumer goods	36,901	14	43,055	15	47,941	16
Raw materials	188,633	74	205,296	73	221,565	72
Capital goods	30,525	12	33,599	12	39,097	13

Source: Banco de México, INEGI, SAGARPA, Secretaría de Economía, Bancomext.

Revenue from exports of crude oil and natural gas increased substantially up to 2008 due to the rise in world prices for petroleum, since export volumes have not changed materially. On the contrary, volumes have decreased because of insufficient investment in new wells. Exports of nonpetroleum manufactures, particularly automobiles, motors and parts, also increased substantially.

From 1986 to 1994 imports increased substantially, in part because of favorable exchange rates but also because import duties were reduced as part of the government's efforts to open the economy. Imports were reduced after 1995 to some extent, because of the peso devaluation of December 1994. However, after 1996 imports increased substantially, surpassing exports.

Mexico's principal trading partner continues to be the United States, which normally receives between 70 and 85 percent of Mexican exports and is the source of a similar percentage of imports, as well as even larger percentages of border transactions, tourist expenditures and income from the in-bond processing industry. Other important trading partners include Japan, Germany, the United Kingdom, France, Canada, and the Netherlands. As a result of the opening up of the economy, unfavorable trade balances have resulted, as shown in Table IV.

**IV— Balance of Trade, 2006-2008**

(In US\$ millions)

	2006	2007	2008
Export of goods	249,925	271,875	291,343
Export of services	16,224	17,464	18,051
	266,149	289,339	309,394
Imports of goods	256,058	281,949	308,603
Imports of services	21,953	23,781	25,141
	278,011	305,730	333,744
Net trade deficit	11,862	16,391	24,350

Source: Banco de México

The United States also provides the major portion of the income of the in-bond processing companies and net income from tourism. The annual balance of payments for 2006 to 2008 is shown in Table V.

As a result of recent administrations' policies of continuing to open up the Mexican economy to private investment, both domestic and foreign, and of reprivatizing certain sectors of the economy, coupled with the need to create jobs and the international prices for oil, the expected trends in the Mexican economy are as follows.

- Increased participation of private investment in new projects, including innovative approaches in such sectors as telecommunications, highways, air transportation, petrochemicals, railroads, auto parts and utilities.
- Constant increases in the export of semifinished and manufactured goods as a percentage of total exports.
- Consistent growth of the in-bond processing industry.
- Growing demand for skilled workers and for trained managerial and professional people.
- Control of inflation, keeping it at manageable levels.

## External debt

Mexico's external debt amounted to approximately US\$56.9 billion at December 2008. In the recent past, some restructurings of the public portion of the debt were agreed with the creditors, principally U.S. and other foreign banks, resulting in substantial reductions in the rates of interest and extensions in repayment schedules. Mexico is current in its payments, but debt service continues to take a very substantial percentage of the income from exports of goods and services.

### V—Balance of Payments, 2006-2008

(In US\$ millions)

	2006	2007	2008
<b>Liabilities</b>	<b>15,784.4</b>	<b>50,819.9</b>	<b>29,798.8</b>
External debt	- 9,833.6	15,081.3	7,986.3
Foreign investment	25,618.0	35,738.6	21,812.5
<b>Asseets</b>	<b>- 17,914.5</b>	<b>- 30,032.1</b>	<b>- 8,360.3</b>
External banks	- 6,148.3	- 17,045.6	- 2,667.9
Direct investment	- 5,758.5	- 8,256.3	- 437.8
Other	- 6,007.7	- 4,730.2	- 5,254.6
<b>Capital account</b>	<b>- 2,130.1</b>	<b>20,787.8</b>	<b>21,438.5</b>
<b>Income</b>	<b>298,760.0</b>	<b>323,882.4</b>	<b>342,706.8</b>
Export of goods	249,925.0	271,875.0	291,343.0
Export of services	22,798.5	25,484.9	25,774.5
Transfers	26,036.5	26,522.5	25,589.3
<b>Disbursements</b>	<b>303,134.6</b>	<b>332,061.2</b>	<b>358,663.3</b>
Imports of goods	256,058.0	281,949.0	308,603.0
Import of services	46,988.9	50,004.5	49,932.1
Transfers	87.7	107.7	128.2
<b>Current account</b>	<b>- 4,374.6</b>	<b>- 8,178.8</b>	<b>- 15,956.5</b>

## ***Hints for the business visitor***

### ***Visitors' visas***

Business visitors traveling to Mexico to plan, supervise or carry out business operations should enter the country with a nonimmigrant visa as a visitor employed by a foreign company or self-employed, prohibited from receiving remuneration from Mexican sources. Such visas can be readily obtained from Mexican consulates in foreign countries or at any Mexican Entry Port.

A simple tourist card or tourist visa in a valid passport does not authorize a foreign visitor to engage in business operations. Further information about immigration requirements for foreigners desiring to work in Mexico is given under "Foreign personnel working in Mexico" in Chapter 10.

### ***Currency Exchange***

Since 1991 transactions involving foreign currency have not been subject to any kind of exchange control, and all currencies may be freely held, transported or traded by anyone.

The peso exchange rates quoted in Mexico City on November 3, 2009 for transfers to and from Mexico's principal trading partners by check or other documents are shown below.

	<b>Buying Ps</b>	<b>Selling Ps</b>
USD	12.92	13.37
EUR	19.34	19.65
JFY	.1446	.1487
GBP	21.44	22.05
CHF	12.72	13.08
CAD	12.23	12.58

### ***International time***

Most of the country is on the equivalent of U.S. Central Time (U.S. Eastern Time minus one hour or Greenwich Mean Time minus six hours). The far northwest of Mexico is on U.S. Mountain Time and the peninsula of Baja California is on U.S. Pacific Time, one and two hours later, respectively. In the summer months Mexico is on daylight saving time. From April to October the clock is advanced one hour throughout the country.

### ***Business hours***

Business offices normally open at 8:30 a.m. or 9:00 a.m. for an eight-hour working day, with one or two hours for lunch. The two-hour lunch period is almost universal outside Mexico City. Some banks are open from 9:00 a.m. to 04:00 p.m. and others up to 7:00 p.m. The official working hours for government offices are 8:00 a.m. to 2:30 p.m. but have been extended to 7:00 p.m. in many departments. All these hours are for a five-day week.

Factories usually open at 7:00 a.m. or 8:00 a.m. and work eight-hour shifts, with a half-day's work on Saturday, although a five-day week is in use in some cases.

### ***Statutory holidays***

The federal labor law establishes the following obligatory holidays throughout the country: January 1, February 5, March 21, May 1, September 16, November 20, and December 25. December 1 is an obligatory holiday every six years for the inauguration of a new presidential period, Some of these dates are moved to the nearest Monday. Religious holidays are also observed by most business offices, banks and large stores, including the Thursday and Friday of Easter week, November 1 and 2, and December 12. These and other holidays are often agreed on in collective labor contracts.

### ***Weights and measures***

The use of the metric system is compulsory in Mexico.

### ***Dates and numbers***

In writing dates, the day is usually placed before the month, and Roman numerals are often used to indicate the month, i.e., 31/V/09 for May 31, 2009.

A decimal point is used to denote fractions of the monetary unit; commas indicate thousands, millions, etc., as in \$3,000.92.

### ***Business information services***

See Appendix XVI for a listing of the addresses of various agencies providing information services to persons interested in doing business in Mexico.

### ***Local customs***

Business relationships tend to be somewhat more formal than in the United States, and the use of first names, particularly outside the northern border zone, is not as widespread. Meetings with customers and advisers are often held at breakfast or luncheon; the latter can sometimes be quite lengthy.



# Chapter 2

## Business environment

### ***Investor considerations***

- Currently Mexico has a broad free-trade agreement network that includes North America, the European Union, Japan and some South American countries and has substantially reduced tariff and nontariff barriers to free trade between Mexico and those regions.
- Almost all non-strategic government assets have been privatized.
- Strong government efforts to reduce inflation have placed Mexico at a level comparable to the top economies in the world.
- Internal interest rates have been stable.
- Mexico has a common border with the United States, one of the largest markets in the world.
- Government policy encourages exports and establishment of in-bond processing operations.
- Young, skilled, low-cost labor force.
- Public/private sector cooperation.
- No exchange controls exist, exchange rates are determined by supply and demand and foreign currency is freely available.

### ***Industrial climate***

Private investment is dominant in the manufacturing, construction and hospitality industries, as in wholesale and retail trade operations.

The federal government has intensively promoted the establishment of manufacturing operations for export and labor-intensive industries, such as in-bond manufacturing and tourism, taking advantage of the relatively low wage costs expressed in U.S. dollars and the proximity to the US market.

### ***Framework of industry***

Most domestic small businesses are operated as unincorporated units, although many of the larger units are organized as family-owned corporations. A few of the larger businesses have gone public by listing in the Mexican Stock Exchange.

The main government investments are directed to utilities, water supply and irrigation, the electrical system, petroleum and basic petrochemical industries.

## ***Focus of government policy***

For many years the focus of Mexican government policy has been to raise the living standards of its people, promoting industrialization and creating jobs for the fast growing population to reduce under- and unemployment.

President Felipe Calderón's administration has similar goals, but has given priority to inflation control measures and the reduction of the government deficit. Great importance will continue to be given to industries able to attract the flow of foreign exchange, in part to offset the increase in imports.

## ***Economic development plans***

The Mexican government implemented an economic development plan to achieve industrial development and expansion and increase exports, in order to decrease dependence on oil revenues, at the same time reducing and maintaining inflation at competitive levels. To attain these goals, Mexico opened up its economy by joining the General Agreement on Tariffs and Trade (GATT) (now the World Trade Organization—WTO), eliminated trade barriers and reduced tariffs, adopted a reprivatization policy, and relaxed foreign investment restrictions.

In addition, Mexico has entered into several free-trade agreements such as the North American Free Trade Agreement (NAFTA), effective January 1, 1994. Also, Mexico and the European Union entered into a multilateral free-trade agreement effective as from July, 2000 and a free-trade agreement with Japan, as from April 1, 2005.

## ***Regional/special industry development***

Some State governments are willing to grant incentives to attract new industries to specific areas within their borders, often in the form of reduced prices for land for industrial use and reductions in property and payroll taxes.

## ***Free-trade zones***

There are no free-trade zones in Mexico. However, limited duty-free zones are maintained in the entire states of northern and southern Baja California, the city of Agua Prieta, a triangular area in the state of Sonora, and certain areas in the southern part of Mexico. Materials and goods, with certain exceptions, may enter the zones free of duty, unless they are to be shipped to other parts of Mexico.

## ***Financial services***

Previous government policies have not encouraged the establishment of financial service centers, especially since the banking industry was nationalized in 1982. However, this trend has changed since the banking system was re-privatized. Trade agreements and Foreign Investment Law reforms have significantly reduced limitations to foreign investment in the financial services industry. Thus the Mexican banking system is now operated mainly by international financial corporations, such as Citibank, HSBC, BBVA, Santander, etc.

## ***Public/private sector cooperation***

Cooperation between the public and private sectors is notable in the relationships between industry and government-owned and -operated development banks, such as Nacional Financiera, S.N.C. and Banco Nacional de Comercio Exterior, S.N.C., which provides financing for exports.

Foreign investors receive full cooperation from the National Commission on Foreign Investment, and those wishing to establish or expand in-bond processing companies can find support from the Division of In-Bond Industries and Regional Development, both of which form part of the Ministry of the Economy.

## ***Labor/management relations***

Because of the fast-growing population of the country in the last century, Mexico has a young labor force. Most companies find that, with adequate training programs, the skills of inexperienced workers can be readily upgraded and high-quality work is obtained, sometimes with somewhat more on-the-line supervision than is customary in more industrialized countries. In-house training is used at skilled and managerial level.

For many years Mexican labor law has clearly favored employees in their relations with management. National labor unions have become quite strong in a number of industries, particularly petroleum, telephones, electricity, mining, airlines and entertainment.

Labor law grants the right to form a union for collective-bargaining purposes to groups of 20 or more employees. Collective labor contracts are signed by almost all industrial companies. Nevertheless, satisfactory labor relations are maintained at most companies.

Fringe benefits, including mandatory profit sharing to employees and social security premiums to cover current medical expenses and retirement pensions, are usually a significant portion of labor costs, often about one-third of the total. See Chapter 10 for a more detailed discussion.

## ***Overseas trade relations***

### ***Membership in trade blocs***

Mexico joined the GATT (currently WTO) in 1986. This membership, as well as reductions in import duties and formalities adopted in 1988 as part of the effort to control internal inflation, has increased the volume of merchandise imports/exports to/from Mexico. Mexico is also a member of the Latin American Integration Association, which provides for reductions in duty rates on merchandise imports from members of the association. The North American Free-Trade Agreement (NAFTA) has been in effect since January 1, 1994. In addition, in July 2000, Mexico and the European Union entered into a multilateral free-trade agreement substantially reducing tariff and non-tariff barriers to free trade between the two regions.

Mexico has also entered into free-trade agreements with Colombia, Venezuela, Bolivia, Costa Rica, Chile, Nicaragua, Guatemala, Honduras, El Salvador, Israel, Uruguay and the European Free Trade Association (Iceland, Norway, Lichtenstein and Switzerland). In addition, an Economic Association Agreement with Japan has been in force since April 2005.

### ***Exports***

Mexico provides some incentives for exporters. The main tax incentive is the zero rate of value-added tax (VAT) applicable to exports and the consequent right to the refund of VAT charged by others on materials, supplies and services used in the production of exports or the credit of such charges against a company's VAT liability for its activities subject to the tax.

### ***Trade barriers***

In previous years, industrialization in Mexico was extensively promoted as a mean for eliminating imports, and considerable protection was granted to the new local industries in the form of high import duties on competing products, the requirement of prior import permits or outright prohibition of such imports. Mexico's entrance into GATT, its free-trade agreement network, its efforts to reduce inflation by facilitating imports since 1988 and the improvement in Mexico's balance of payments have all resulted in reductions or eliminations of trade barriers, and this trend is expected to continue.

The requirement of a prior import license or permit has been repealed, except in special cases, such as for strategic minerals, e.g., uranium. Import duties have been drastically reduced from an average of 100 percent to around 8 percent or even lower.

# Chapter 3

## Foreign investment and trade opportunities

### **Investor considerations**

- The government has a favorable attitude toward foreign investment.
- Foreign investment is restricted only in certain strategic activities reserved to the state or Mexican investors.
- Trade policy wide open. NAFTA has been in effect since January 1994; trade agreements are in place with Guatemala, El Salvador and Honduras (Northern triangle), Iceland, Norway Liechtenstein and Switzerland (EUFTA), Colombia (G2), Bolivia, Costa Rica, Chile, Israel, Nicaragua, Uruguay, Japan and the European Union.
- Mexico is a member of the Organization for Economic Cooperation and Development (OECD), the World Trade Organization and the Asian-Pacific Economic Cooperation Mechanism (APEC).
- Even in the midst of the global crisis, Mexico has been able to control inflation, keep a relatively steady exchange rate, stabilize the economy in general terms and, above all, maintain the investor's confidence. The inflation rate during 2008 was 6 percent.
- No exchange controls.
- The labor force is large.
- Antitrust law could impose investment restrictions for any investor, including foreigners.
- New laws were enacted in 2006, such as the navigation and maritime commerce law, for the purpose of modernizing methods of communication to increase international trade activities.
- The Telecommunications Law provides that in no case may foreign investment in any company engaged in telecommunications activities exceed 49 percent, with the exception of cellular phone service companies, which may exceed the 49 percent by obtaining written authorization from the Foreign Investment Commission.
- Regulations relating to natural gas allow private companies to engage in the transport, storage, distribution, importation, and exportation of natural gas.

- The Railroad Law allows foreign investors to participate with up to 49 percent of the capital stock in companies providing railway service. Railroad activity with more than 49 percent foreign participation requires prior authorization from the Foreign Investment Commission.
- The Airport Law allows 49 percent foreign ownership in the construction and operation of airports located in Mexico. This requires prior authorization from the Foreign Investment Commission.

## ***Investment climate***

### ***Government attitude toward foreign investment***

In general, the government's attitude is to encourage foreign investment, particularly when new skills or manufacturing techniques are brought in, except in certain fields reserved to the government or Mexican nationals as noted in Chapter 5. Foreign investors receive the same treatment under Mexican law as domestic investors.

Prior foreign investment law imposed performance commitments, including a requirement to maintain a positive balance of payments. These requirements generally no longer apply, and entities established under prior law can request a waiver of the commitments from the Foreign Investment Commission.

The foreign investment law in force (*Ley de Inversión Extranjera*) specifies which activities are reserved or restricted and, in the latter case, the maximum percentage of foreign investment allowed (see Appendix IV). It also specifies those activities that require prior authorization from the Foreign Investment Commission to increase foreign participation above the levels approved. Currently, the automotive and construction industries are not considered to be restricted activities; therefore, 100 percent foreign investment is permitted in companies engaged in such activities.

Any company, regardless of the nationality of its owners, must obtain written permission from the Ministry of Foreign Affairs in order to use a specific corporate name. On the other hand, companies with foreign investment have the obligation to register with the National Investment Registry regardless of the foreign investment percentage.

The administration has recognized the need for substantial private capital investment to provide additional employment opportunities and to increase industrial production in Mexico for local consumption and for export, where possible.

In general, foreigners may operate in Mexico in many ways, including through licensing agreements, by exporting goods to Mexico or through local manufacturing. Joint venture contracts can also be used for minority investments in short-term projects. See Chapter 9 for a discussion of corporate vehicles available.

### ***Trade policy***

Previous administrations signed the GATT (now the World Trade Organization—WTO) protocols in 1986 and made substantial reductions in import duties and trade barriers. This trend has continued toward more-nearly free trade to facilitate the export of Mexican manufactured products, as evidenced by the signing of free-trade agreements with the United States and Canada, the European Union, Japan and certain other countries, and by ongoing negotiations to conclude free-trade agreements with other nations.

Mexico was a founding member of the Latin American Free Trade Association (LAFTA) and its successor organization, the Latin American Integration Association (LAIA), in accordance with which Mexican-source products can often be shipped to other member countries at reduced import duties.

### ***Taxation policy***

The Mexican tax system, based on the central idea that corporate earnings should be taxed only once at the rate of 28 percent (30% from 2010 to 2014), is competitive with respect to the developed countries with which Mexico does business and with the developing countries with which it competes. However, since 2008 the Flat Rate Business Tax (“IETU”) has also been in effect, acting as a minimum tax and based on net cash flow, with a 17% rate, and operating as an alternative tax. There are some tax incentives specifically designed to attract foreign investment, mainly around the in-bond manufacturing (maquiladora) industry.

### ***Local competitor attitude toward foreign investment***

Most local businessmen tend to favor foreign investment in Mexican industry as strengthening the private sector and react very favorably to opportunities to invest in joint venture companies with established foreign companies. Successful Mexican industrialists generally prefer joint investments with foreign companies that can make modern technology available and that will act as technical partners, with local marketing and administration to be supervised by the local industrialists.

### ***Labor attitude toward foreign investment***

Organized labor does not officially oppose foreign investment and, in fact, may actually prefer to deal with the management of companies having substantial foreign capital, on the grounds that such companies tend to be more amenable to the collective-bargaining process.

## ***Special investment opportunities***

Low labor costs (when expressed in U.S. dollars) have made the establishment of in-bond processing plants to handle labor-intensive operations increasingly attractive to foreign investors. Moreover, foreign investors are also finding it advantageous to utilize their knowledge of world markets to organize Mexican companies to export locally manufactured goods, not only to the United States but to customers in other parts of the world as well.

Nevertheless, Mexico's large and still increasing population has resulted in considerable demand for all types of consumer goods, including durable goods and, in particular, basic necessities. As the formerly high rates of inflation have been reduced, the volume of effective local demand has increased substantially. Reductions in customs duties and in other trade barriers offer an interesting market for exports to Mexico, as well as for local production.

The two largest unsatisfied local markets are probably those for agricultural equipment and housing, particularly low-cost units. There may also be an improved market for importing machinery and equipment to Mexico.

Most of the direct foreign investment in Mexico is allocated to four industrial sectors: automotive, petrochemical, apparel, and electronics. Wireless telephone service is one of the fastest-growing areas of the electronics industry.

Franchising is another industry showing marked growth. Franchise firms have contributed significantly to Mexico's economy by helping create more firms that provide goods and services.

Mexico is still one of the world's key sources of minerals. The mining industry has been one of the few to continue growing during the period of economic crisis. The industry is going through a modernization period, and foreign participation is allowed. Recently with the increase of demand, new investments have been made in the mining industry.

In accordance with the Mexican Constitution the petroleum and basic petrochemical industries may be operated only by the Mexican government and its agencies. Necessary investments have been constrained as part of the effort to hold down government expenditures. Growth in the oil and basic and secondary petrochemical industries, as well as in offshore drilling in the Gulf of Mexico and the Caribbean, provides opportunities for construction, supply and service companies, both foreign and Mexican. Foreign investors may participate in the drilling of oil and gas wells.

The consumption of natural gas by residential and industrial customers has increased significantly in recent years. In this respect, the Mexican government allows foreign and national companies to store, transport and distribute natural gas.

---

# Chapter 4

## Investment incentives

### ***Investor considerations***

- 100 percent foreign ownership is permitted in labor-intensive in-bond processing entities (so-called *Maquiladoras*, now termed *IMMEX companies* as from November 1, 2006) and in most other activities.
- No free-trade zones are designated.
- Some duty deferral programs are in place under which temporary imports are allowed (IMMEX), besides strategic bonded warehouses, which bring additional benefits.
- Incentives are not offered for establishing international financial center operations.
- Mexico is not a tax-haven country; its tax rates are comparable to those of both developed and developing countries.
- The government has a policy and procedures that aim to simplify the setting up of a company, including the reduction of formalities and of the time for issuance of resolutions.
- Accelerated depreciation is allowed with some requirements.

### ***Investment policy***

It has been the general policy of the Mexican government to eliminate tax incentives and to grant them only on a selective basis. These are mainly provided through a system of one-time deductions for the assets acquired in nonrestricted zones or activities, in lieu of an annual depreciation deduction.

## ***Tax concessions***

No special tax concessions are offered to encourage foreign businesses to locate in Mexico. Special tax reductions are applicable to the publishing industry and to taxpayers who are involved in the agriculture, livestock, fishing, or timber industries.

Moreover, a presidential decree issued in 2003 allows companies engaged in the in-bond manufacturing of goods for exports, previously referred to as Maquiladoras, to benefit from a reduced income tax rate on earnings from export operations. This rate reduction is a mechanical calculation, but can average between a 30% to 60% reduction in the normal income tax rate of 28%.

## ***Regional incentives***

### ***Regions affected***

Most regional incentives available have gradually been repealed.

### ***Tax incentives***

Regional tax incentives are very limited. A few states grant a reduction in real property or state payroll taxes to new industries established within the state.

### ***Nontax incentives***

No regional nontax incentives are granted at the federal level. Certain states donate land for plant sites or sell industrial sites at reduced prices, and guarantee the availability of public services, including electricity, water, transportation, etc.

### ***Earnings***

There are no state or local income taxes on corporate earnings.

## ***Industry incentives***

### ***Industries affected and eligibility***

The industries discussed below enjoy special incentives, regardless of size and with no restrictions as to their location or the foreign ownership of their capital.

### ***Tax incentives***

#### ***Publishing industry***

Book publishers enjoy an income tax reduction of 50 percent on income from books published.

#### ***Agriculture, livestock, fishing, and timber***

Taxpayers engaged exclusively in these industries are granted a reduction of 50 percent of their tax liability. If these taxpayers industrialize their products or are also engaged in commercial or industrial activities, the reduction is only 25 percent.

### ***Nontax incentives***

#### ***Tourism industry***

The government has undertaken to stimulate expansion in the tourism industry in Mexico. Foreigners purchasing residential real estate are now allowed to own all rights, except bare title to land in the coastal areas or along the country's borders. No restriction applies in the case of nonresidential real estate in these areas, provided the real estate is acquired by a Mexican legal entity (regardless of the nationality of the shareholders/partners), and provided notice is given to the Foreign Affairs Ministry within 60 (sixty) days after the acquisition takes place. A government trust, FONATUR, has made substantial investments in the infrastructure necessary for the development of a number of resorts. FONATUR sells beneficial rights to land in its resort areas for use for hotels, condominiums, shopping centers, etc., on relatively favorable terms and provides expert advice in planning such projects in these and other resort areas.

### ***Earnings***

Refer to Chapter 17 for information on the taxation of dividends and remittance of earnings.

## ***In-bond processing industry (Maquiladora industry)***

The Mexican government, in order to create more employment opportunities, has adopted certain policies that allow the establishment of 100 percent foreign-owned companies that process or assemble temporarily imported materials into finished goods for export. Such companies were first created in the border area between Mexico and the United States and may now be established anywhere within the country. As previously mentioned, these entities are currently entitled to a reduced income tax rate for profits attributed to exported goods complying with certain conditions.

These companies may sell or deliver part of their production to the domestic market, as long as customs duties are paid on the temporarily imported raw materials included within the finished goods sold in Mexico. The main regulations for the operation of the *Maquiladoras* are contained in the Law to promote Manufacturing, Maquila, and Export Service Companies (IMMEX).

Companies wishing to operate as *Maquiladoras* (now termed IMMEX companies) should be registered as such by the Ministry of the Economy (Secretaría de Economía), which will approve an operating program. The program will specify, among other things, the machinery and equipment that will be temporarily imported; the types of materials, components, etc., to be brought into the country for processing or assembly during specified periods; and the technical and other types of assistance to be provided by the foreign contractor.

In many cases, U.S. import duties are levied only on the value added in Mexico, but even without this advantage, substantial savings are achieved by carrying out labor-intensive processes in Mexico at substantially lower wage rates, while the initial and, possibly, the final operations are handled in the United States. These companies make extensive use of the procedures for temporary duty-free imports mentioned above, and their fees for assembly services charged to nonresidents are considered as subject to the zero rate tax under the value added tax (VAT) law.

These companies can process or assemble temporarily imported materials from several countries, not only the U.S.

## ***Strategic Bonded Warehouse***

The Strategic Bonded Warehouse regime consists of introducing for a limited period of time, foreign, national or imported goods into authorized warehouses, with the purpose of being stored for safekeeping, exhibition, distribution or transformation or to be repaired. Authorized warehouses must be established next to a customs facility.

*The main benefits of this regime are as follows:*

Neither import duties nor countervailing duties will be paid, except for those cases contemplated within the Free Trade Agreements Rules.

Non-tariff restrictions and regulations do not have to be complied with, except for those regarding animal and vegetable sanitation, public health, environmental and national security.

Sales carried out while the goods are under this customs regime will not be subject to VAT.<sup>1</sup>

## ***Industrial parks***

Industrial parks have been established in a number of areas all over the country to provide the needed infrastructure. Land is usually available in these areas on relatively favorable terms. Some states have donated land for new industry or sell it at relatively low prices.

## ***Free trade agreement***

The Mexican foreign investment legislation restrictions discussed elsewhere in this Guide (see in particular Chapter 5) are applicable to the entire country. Accordingly, no free-trade zones exist. Mexico, the United States and Canada signed a trilateral free-trade agreement commencing in 1994, and Mexico has entered into free-trade agreements with Colombia, Costa Rica, Bolivia, Nicaragua, Chile, the European Union, Israel, El Salvador, Guatemala, Honduras, Iceland, Norway, Liechtenstein, Switzerland, Uruguay and Japan.

## ***International financial center operations***

There are no tax concessions or treaties available to foreign corporations that establish regional, offshore or holding company activities in Mexico. Accordingly, Mexico should not be deemed a tax-haven country or a viable site for establishing an international financial center.

## ***Export incentives***

The most significant benefits under the Mexican economic development plan are precisely those provided to promote the export of manufactured goods. These export benefits apply to all entities, regardless of size and degree of foreign ownership, and are provided in both tax and non-tax forms.

---

<sup>1</sup> Removal of the goods from the Strategic Bonded Warehouse regime will be subject to import VAT.

A series of executive decrees, general application rulings and government communications have been issued both to constitute the entities entrusted with the task of promoting export activities and to grant the related incentives to exporters. A summary of the existing export incentives, as well as the official entities involved, is given below.

### **Ministry of the Economy (SE) export programs are as follows**

*Temporary imports of goods for subsequent export (IMMEX)  
Maquiladoras (mentioned in previous paragraphs).*

The SE created the Law to Promote Manufacturing, Maquila and Export Services Companies (IMMEX) which merged the Maquila and PITEX programs (the previous temporary import programs). Entities exporting at least US\$500,000 or 10 percent of their production may enter into an IMMEX program authorized by the SE and obtain the following benefits:

1. Temporary (duty-free) imports for up to 18 months for raw materials, supplies and packing materials used in the exported production.
2. Exemption from import duties on fuels, lubricants, spare parts, and other consumables used in the production of goods to be exported.
3. A portion of the production (with foreign content) covered under the program may be sold domestically upon the payment of the corresponding import duties on the foreign content thereof.
4. To enroll in this program, companies must be incorporated in Mexico and present a viable export project.
5. Companies may also be approved under a Sectorial Relief Program (SRP) to enable manufacturers to import raw materials regardless of their origin and with certain conditions.
6. VAT may be refunded within 20 days if there is a credit balance.

The life of an IMMEX program is indefinite as long as the company complies with the provisions, including:

1. Issuing an annual report covering foreign trade operations related to the program.
2. Keeping an automated inventory record to control the merchandise imported and exported during the life of the program.
3. Exporting merchandise or changing the customs regime of raw materials in 18 months, at the latest.

Zero rate of value-added tax (VAT) is applicable to exports, even when they are physically exported by a third party, provided they remain under the temporary importation regime.

IMMEX status is also granted to service companies, to perform repairing, cleaning, quality control testing, packing, painting, greasing activities and technological support services (back office, shared services centers).

### *High volume exporting companies*

The High Volume Exporting Companies Registry (*Empresas Altamente Exportadoras*—ALTEX) covers entities exporting at least US\$2 million annually or export sales that represent at least 40 percent of gross sales.

As for non-tax benefits, ALTEX entities are provided greater financial assistance, top priority in customs clearances and special promotional assistance in Mexico and overseas.

In addition, ALTEX entities are able to obtain value-added tax refunds within a 10 working day period, instead of the normal 90 working day period.

### *Import duty drawback*

Under import duty drawback (*devolución de impuestos de importación a los exportadores*), all exporters (including indirect exporter suppliers) are entitled to the refund of import duties paid up to one year before on imported merchandise integrated into exported goods or sold to other entities that physically export the related goods.

Exporters may also be able to recover import duties through the drawback system when they export products in the same condition in which they were imported.

### *Sectorial Relief Programs (SRP)*

The SRP benefit companies with preferential import tariff on goods intended for production, regardless of the country of origin. The rates vary from 0 to 5% depending on the type of industry.

The authorized industrial sectors in which companies are able to get the above benefit are the following:

- I. Electricity industry
- II. Electronic industry
- III. Furniture industry
- IV. Toy, recreational games and sporting goods industry
- V. Footwear industry
- VI. Mining and metallurgy industry
- VII. Capital goods industry
- VIII. Photographic industry
- IX. Agricultural machinery industry
- X. Sundry industry
- XI. Chemical industry
- XII. Rubber and plastic manufacturing industry
- XIII. Steel industry
- XIV. Pharmaceutical, medication and medical equipment industry
- XV. Transportation industry, except the automobile industrial sector
- XVI. Paper and cardboard industry
- XVII. Lumber industry
- XVIII. Leather and fur industry
- XIX. Automobile and autoparts industry
- XX. Textile and apparel industry
- XXI. Chocolate, sweets and candy industry
- XXII. Coffee industry

## ***Financial assistance***

### ***Foreign Trade Bank***

The Foreign Trade Bank (*Banco Nacional de Comercio Exterior, S.N.C.*— Bancomext) is the Mexican export development bank and is primarily engaged in all aspects of export support. The bank's authorized activities include the following.

1. Providing financial assistance to direct exporters.
2. Providing loan guarantees.
3. Providing promotional assistance domestically and overseas.
4. Providing financial assistance to indirect exporters (those selling to ultimate exporters).
5. Assisting in the development of export policies and programs.
6. Acting as fiduciary for trusts and funds engaged in export development activities.

### ***Nacional Financiera, S.N.C.***

Nacional Financiera, S.N.C., a large government-owned development bank, takes an active part in stimulating new industry in Mexico. In this connection it operates a number of services and trust funds that offer assistance, ranging from feasibility studies to direct investment in capital stock and long-term financing. The bank is particularly active in arranging joint ventures of foreign and Mexican investors in companies for the production of capital goods.

## ***Incentives to invest in other countries***

Mexico offers no incentives, tax or nontax, to invest in other countries. Additionally, it discourages the investment in tax-favored jurisdictions (i.e. tax havens) by requiring the immediate recognition of undistributed earnings in some cases.

## ***Incentives and foreign investment strategy***

The current trend of Mexican government policy with regard to incentives is not to grant them except in exceptional cases. With respect to foreign investment, the current trend is toward welcoming it, especially when it contributes to increasing Mexico's level of employment, exports and technological development.



---

# Chapter 5

## Restrictions on foreign investment and investors

### ***Investor considerations***

- There are no exchange controls.
- Capital and earnings can be freely remitted abroad.
- 100 percent foreign ownership is permitted in a majority of economic activities, including the commercial and services sectors.
- Banking industry is almost 100% private, and majority foreign ownership of banks is allowed. In addition, NAFTA permits 100 percent U.S. and Canadian participation in other financial activities, with special requirements.

### ***Regulatory climate***

#### ***Regulatory authorities***

The government-owned central bank, Banco de México, is charged with the responsibility of establishing monetary policies, although it is autonomous from the government. The Foreign Investment Commission (Comisión Nacional de Inversión Extranjera) and its Executive Secretary are responsible for administering the controls on foreign investment and authorizing specific investments where required.

#### ***Foreign Investment Commission***

The Foreign Investment Commission is the central authority that approves foreign investment in new or existing companies where required under the law. The Commission operates through an Executive Secretary and the necessary staff.

### ***National Register of Foreign Investment***

The Foreign Investment Law (*Ley de Inversión Extranjera*) establishes a National Register of Foreign Investment (*Registro Nacional de Inversiones Extranjeras*), which is maintained by the Ministry of Economy (*Secretaría de Economía “SE”*). Under the applicable provisions, the following information must be included in the Register:

- Mexican companies with foreign shareholders.
- Foreign individuals or legal entities that regularly carry out acts of commerce in Mexico, and branches of foreign investors or entities established in Mexico,
- Trusts owning shares (or other equity) of Mexican companies or real estate in Mexico, and “neutral” investment trusts with foreign beneficiaries.

When SE is provided with the necessary information, it will issue the corresponding registration certificate, which must be renewed on an annual basis. For this purpose, it is necessary to complete and submit an economic-financial questionnaire.

The parties referred to in the first and second categories above and the trustees of the trusts referred to in the third category above are responsible for registering with SE within 40 working days following the occurrence of any of the following:

1. Incorporation of the corresponding company.
2. Participation of the foreign investment in and the formalization or notarization of the documents relative to Mexican branches of foreign companies, or
3. Formation of a trust or the granting of trust rights to foreign investors as set forth above.

### ***Regulatory legislation***

The Foreign Investment Law reserves certain activities to the Mexican government or to Mexican nationals, and limits foreign ownership to a specified maximum minority percentage of Mexican company shares in certain cases, as detailed at the end of this Chapter.

### ***Liberalization of foreign investment restrictions***

Over the last three decades the rules governing foreign investment in Mexico, once somewhat restrictive, have been substantially liberalized.

In line with the signing of the free-trade agreement with the United States and Canada and the general opening of the Mexican economy, a new foreign investment law was published in December 1993. Under this legislation, the rules governing foreign investment were further liberalized, especially in the following areas:

- Elimination of the requirement to secure prior authorization to exceed 49 percent ownership in most areas, except those specifically restricted by the Constitution or specific legislation.
- Elimination of certain commitments or performance requirements, such as the need to maintain a positive balance of foreign exchange, the requirement to make additional investments in fixed assets or export a certain volume of products.

### ***Expeditious application processing procedures***

The Foreign Investment Law and its regulations provide expeditious application processing procedures by requiring that an application for authorization by the Foreign Investment Commission must be approved or rejected within 45 working days after it is filed. If no reply is received within this period, the application will be considered as automatically approved.

### ***Penalties and foreign investment***

Violations of the Foreign Investment Law and its regulations are penalized with fines ranging from 30 to 5,000 times the general minimum salary in effect in Mexico City at the time the violation takes place. In cases of violations relating to the use of real estate in the restricted zones, the fine could be up to the amount of the transaction involved. In certain cases the SE is empowered to declare null and void any transactions made in violation of the foreign investment law.

In the case of fines, the authorities take into consideration the nature of the violation, the economic capacity of the offender, the time elapsed between the time when the obligation should have been complied with and the time of compliance or regularization, and the total value of the transaction.

### ***Exchange controls***

The Mexican peso is freely convertible into all other currencies, and there are no restrictions on the remittance of profits abroad or the repatriation of capital.

### ***Foreign currency liabilities payable in Mexico***

Obligations specified in foreign currency but payable within Mexico, whether contracted in a foreign country or in Mexico, may be repaid in pesos at the exchange rate on the date of payment.

### ***Registration of foreign capital***

There are no requirements for registering direct investment in Mexico when made with foreign currency. Accordingly, no proof of registration or of having brought foreign currency to Mexico is necessary at the time of purchasing foreign currency with pesos for repatriation purposes.

### ***Currency accounts***

No special currency accounts are required for foreign investors or traders.

### ***Repatriation of capital and earnings***

There are no exchange control limitations on remittances in foreign currency for repatriation of capital investments and repayments of intercompany loans or for remittance of dividends, intercompany interest or branch profits. However, all corporations are required to set aside from their profits a legal reserve amounting to 5 percent of yearly earnings until an amount equal to 20 percent of the capital stock of the entity is reached.

Foreign currency for remittances of royalties and technical assistance fees, as well as for payments of imported merchandise, may be freely obtained in the exchange market.

### ***Guarantees against inconvertibility***

There are no guarantees against inconvertibility, and all transactions in the exchange market depend on the availability of foreign currency funds.

### ***Restrictions on foreign investment***

#### ***Definition of foreign investment***

The following activities are considered as foreign investment for purposes of the foreign investment law:

- Participation by foreign investors, in any percentage, in the capital stock of Mexican companies.
- Investments by Mexican companies in which foreign investors have a majority interest and,
- Participation by foreign investors in activities and acts described in the foreign investment law.

This law provides that foreign individuals residing in Mexico with the status of permanent immigrants (*inmigrados*) will be considered domestic investors for purposes of this law, except in regard to those activities reserved to Mexicans or to Mexican companies that prohibit ownership of shares by foreigners, or in the cases of investments involving ownership of residential real estate in the border or coastal areas.

#### ***Industries closed to private enterprise and foreign investors***

In accordance with the Foreign Investment Law, foreign investors may as a general rule invest in Mexico without any prior authorization or restriction, except as specifically provided in the law. Specifically, the law establishes that foreign investors may do the following:

1. Participate in any proportion in the capital stock of Mexican companies.
2. Acquire fixed assets.
3. Participate in new fields of economic activity or manufacture new product lines and,
4. Open, operate, expand, and relocate existing establishments, except in the cases described in this chapter.

In general, there are five categories of restrictions, as follows:

Category 1—Activities exclusively reserved to the Mexican state:

- I. Petroleum and other hydrocarbons;
- II. Basic petrochemicals;
- III. Electricity;
- IV. Generation of nuclear energy;
- V. Radioactive minerals;
- VI. Telegraph;
- VII. Radiotelegraphy;
- VIII. Postal service;
- IX. Bank note issuing;
- X. Minting of coins;
- XI. Control, supervision and surveillance of ports, airports and heliports
- XII. Any other activity set forth expressly by applicable legal provisions.

Category 2—Activities exclusively reserved to Mexican nationals and to Mexican companies in which foreign investment cannot participate:

- I. Land domestic passenger, tourism and freight transport, without including courier or packaging services.
- II. Gasoline retail sales and distribution of liquefied petroleum gas;
- III. Radio broadcasting services and other radio and television services, other than cable television;
- IV. Credit unions;
- V. Development banks, under the terms of the law governing these entities; and
- VI. Rendering of certain professional and technical services reserved expressly by applicable legal provisions.

Foreign investment may not participate directly in the activities and companies mentioned or through trusts, contracts, partnerships or by-law agreements, pyramiding schemes, or other mechanisms granting any control or participation.

Category 3—Activities in which foreign investment is limited to specified percentages, ranging from 10 to 49 percent:

- I. Up to 10% in: Cooperative companies for production;
- II. Up to 25% in:
  - a) Domestic air transportation;
  - b) Air taxi transportation; and
  - c) Specialized air transportation;
- III. Up to 49% in:
  - a) Insurance companies.
  - b) Bonding companies.
  - c) Currency exchange houses;
  - d) Bonded warehouses;
  - e) Companies that promote investments;
  - f) Retirement fund management companies;
  - g) Manufacture and commercialization of explosives, firearms, cartridges, ammunitions and fireworks, not including acquisition and use of explosives for industrial and extraction activities nor the preparation of explosive compounds for use in said activities;
  - h) Printing and publication of newspapers for circulation solely throughout Mexico;
  - i) Series “T” shares in companies owning agricultural, ranching, and forestry land;
  - j) Fresh water, coastal, and exclusive economic zone fishing, not including fisheries;
  - k) Integral port administration;
  - l) Port pilot services for inland navigation under the terms of the law governing this activity;

- m) Shipping companies engaged in commercial exploitation of ships for inland and coastal navigation, excluding tourism cruises and exploitation of marine dredges and devices for port construction, conservation and operation;
- n) Supply of fuel and lubricants for ships, airplanes, and railway equipment; and
- o) Telecommunications concessionaire companies as provided by Articles 11 and 12 of the Federal Telecommunications Law.

Foreign investment participation limits in the activities and companies mentioned above may not be exceeded directly or through trusts, contracts, partnerships or by-law agreements, pyramiding schemes or other mechanisms granting any control or a higher participation in excess of the established limit.

Category 4—Activities requiring permission to have more than 49 percent foreign participation:

- I. Port services allowing ships to conduct inland navigation operations, such as towing, mooring and barging.
- II. Shipping companies engaged in the exploitation of ships solely for high-seas traffic;
- III. Concessionaire or permissionaire companies of air fields for public service;
- IV. Private education services of pre-school, elementary, middle school, high school, college or any combination;
- V. Legal services;
- VI. Credit information companies;
- VII. Securities rating institutions;
- VIII. Insurance agents;
- IX. Cellular telephony;
- X. Construction of pipelines for the transportation of petroleum and products derived therefrom;
- XI. Oil and gas well drilling; and
- XII. Construction, operation and exploitation of general railways, and public services of railway transportation.

Category 5- A favorable resolution from the Foreign Investment Commission is required for foreign investment to participate, directly or indirectly, in a percentage higher than 49% of the capital stock of Mexican companies when the aggregate value of the assets of such companies at the date of acquisition exceeds the amount determined annually by the Commission.

### ***Real estate in restricted zones***

The foreign investment law provides that Mexican companies with majority foreign investment may directly acquire real estate located within the restricted zones without the need of having a trust, as long as such real estate is not intended to be used for residential purposes, but rather for industrial, commercial and/or tourism activities in general, and provided the acquisition is registered with the Ministry of Foreign Affairs (Secretaría de Relaciones Exteriores) within the 60 natural days following after the day the acquisition took place.

The acquisition by foreigners or Mexican companies with foreign owners of residential real estate located within the restricted zones must be handled through a trust, subject to the following rules:

1. A permit is required from the Ministry of Foreign Affairs for Mexican banks to acquire, as trustees, real estate in the restricted zones.
2. The beneficiaries of the trust can be Mexican companies with foreign owners, including individuals or entities, or foreign entities and individuals.
3. The trusts have a maximum duration of 50 years, renewable at the request of the interested party. In the case of such a request, the Ministry of Foreign Affairs reserves the right to verify compliance with the conditions under which the trust was authorized or registered.
4. The Ministry of Foreign Affairs has the right to decide whether it will grant permission to form the trust, taking into consideration the economic and social benefits that the trust in question may bring to Mexico.
5. All applications to form trusts submitted to the Ministry of Foreign Affairs must be acted on by the Ministry within the 30 working days following the filing date of the application, provided the application is properly prepared, executed and filed. If this ministry does not respond within the 30-day period, the application will be considered to be approved.

### ***Branches of foreign companies***

Foreign companies wishing to engage in commerce in Mexico on a regular basis, in activities in which there are no foreign investment restrictions, must obtain prior authorization from the SE to register a Mexican branch in the Public Register of Commerce (Registro Público de la Propiedad y del Comercio). Proper applications filed with the Ministry are required to be granted within 15 working days following their filing date.

### ***Neutral investment***

In order to permit the participation of foreign investment in those activities which, in principle, are exclusively reserved to Mexican nationals or to Mexican companies in which foreign investment is not allowed, the foreign investment law permits a “neutral investment,” which is defined as an investment made in Mexican companies or in authorized trusts and which does not represent a percentage of foreign investment in the capital stock of Mexican companies.

### *Neutral investment instruments*

SE may authorize Mexican banking institutions (trustees) to issue neutral investment instruments, such as participation certificates, which will confer on the holder only certain economic rights. These instruments must also have limited voting rights in Mexican companies, i.e., the neutral instrument cannot provide the right to vote in the ordinary general stockholders' meetings of Mexican companies.

### *Neutral investment represented by special series of shares*

The Foreign Investment Law considers an investment to be neutral when the foreign investment is made in nonvoting shares or in shares with limited voting rights issued with SE's prior authorization. In the cases of companies whose shares are publicly traded, permission is required from the Securities and Exchange Commission (Comisión Nacional Bancaria y de Valores).

### *Neutral investments by international financial development companies*

The Foreign Investment Commission may authorize neutral investments that international financial development companies intend to make in the capital stock of Mexican companies, in accordance with the terms and conditions to be set forth in its regulations.

### **Maquiladoras**

The policy of allowing the establishment of wholly owned *maquiladoras* (in-bond processing companies), now IMMEX companies, by foreign investors without prior authorization and under virtually no restrictions is continued and is extended to certain other export-oriented activities.

### **Joint venture agreements**

Joint venture agreements or contracts (*Asociación en Participación*—A. en P.), as opposed to joint venture corporations, are not subject to the restrictions or requirements as regards percentage of ownership, registration, etc., since they do not constitute separate entities but instead are considered to be the activities of the managing joint venturer (*asociante*). However, some attorneys are of the opinion that if an A. en P. agreement results in a foreign participation of more than 49 percent of the total profits of the venture or if the foreigners have the right to manage or control its general activities, then the A. en P. agreement should be submitted for approval or, at a minimum, the Foreign Investment Commission should be informed of its contents.

Given the flexibility and ease of entering into A. en P. agreements, their use has been somewhat common for short-term ventures. For details on the characteristics and tax treatment of joint venture agreements under Mexican law, refer to the relevant sections of Chapters 9 and 19.

### ***Other restrictions***

Depending on the potential investor's activity and desired location, other restrictions beyond the scope of this Guide may apply. Accordingly, competent counsel should always be sought during the planning stage for any investment.

### ***Bilateral investment treaties***

Mexico has signed agreements with several countries to protect and promote investments of their investors in Mexico and vice versa. These agreements have been signed with Argentina, Austria, Australia, Belarus, Belgium, the Czech Republic, China, Cuba, Denmark, Finland, France, Germany, Greece, Iceland, India, Italy, Korea, Luxemburg, the Netherlands, Panama, Portugal, Slovakia, Spain, Sweden, Switzerland, Trinidad & Tobago, the United Kingdom and Uruguay.

Mexico has entered into free-trade agreements with the United States and Canada (NAFTA), Guatemala, El Salvador and Honduras (Northern Triangle), Iceland, Norway, Liechtenstein and Switzerland (EFTA), Colombia (G2), Bolivia, Costa Rica, Chile, Israel, Nicaragua, Uruguay, Japan and the European Union. Some of these agreements also refer to investments between the signing countries, requiring non discriminatory practices and most favourable nation treatment.

### ***Policy trends***

#### ***Effect on foreign investment***

The current trend in Mexico is definitely toward the acceptance of new foreign investment. This attitude is evident in the foreign investment law issued in 1993. In any event, the foreign business executive considering doing business in Mexico will be in a better position to secure approval, if required, if the proposal involves exporting goods or services from Mexico, providing employment opportunities and developing or improving local technology. Additionally, the location of plant sites in development areas and the degree of ecological protection offered would also be considered in an application.



---

# Chapter 6

## Regulatory environment

### ***Investor considerations***

- Mexican Government trend is toward deregulation in the foreign investment, foreign trade, and financial sectors and toward stricter regulation in ecological protection, urban development, consumer protection, and intellectual property rights.
- Monopolies viewed as in the national interest still exist in the petroleum sector and in the postal services.
- A new Securities Market Law was enacted in June 2006.
- Patent protection is available for a nonextendable term of 20 years.
- Trademark protection is available for a ten-year period, renewable every 10 years.
- Copyright piracy is severely punished through criminal prosecution.

### ***Regulation of business***

The regulation of business enterprises is distributed among a number of government agencies operating under various cabinet ministries, the more important of which are referred to below. The states do not have the authority to incorporate corporations. In some cases where foreign investment is involved, approval is granted only after authorization by the Foreign Investment Commission, a part of the Ministry of Economy (SE) as described in Chapter 5.

## ***Competition Policy***

An antitrust law (Ley Federal de Competencia Económica or Federal Law of Economic Competition) prohibits monopolies, monopolistic activities and unlawful business concentrations. One of its main objectives is preventing such monopolistic activities as price-fixing, selective distribution, anticompetitive concerted practices and the elimination of competition.

Severe penalties are imposed on violations. A Federal Competition Commission (Commission) imposes penalties or conditions or subjects “concentrations” to total or partial divestiture. Its mission is to protect the process of competition and market access by eliminating monopolies, monopolistic practices and other restrictions on the efficient functioning of markets.

This legislation is consistent with U.S., Canadian and European antitrust principles.

## ***Price controls***

Article 28 of the Political Constitution of the United Mexican States (Constitución Política de los Estados Unidos Mexicanos) provides that Mexican Laws will establish the basis for fixing maximum prices for items, materials or products considered as necessary either for the national economy or for popular consumption. The Law shall protect consumers and legally organize them to take better care of their interests.

The Federal Law of Economic Competition sets forth the rules for determining prices for products and services necessary for the national economy or for popular consumption in terms of said Article 28.

A considerable number of products are still subject to what is considered variable price “controls”. These include basic petrochemicals, certain chemical products for industrial use and the products of a number of basic industries, including, among others, cellulose and fertilizers. The prices of these products may be varied upon authorization of the SE or the Ministry of Energy.

## ***Pharmaceutical products***

All pharmaceutical products must be authorized for production and sale by the Ministry of Health (SS), maximum selling prices must be approved by the SE. Such prices have, in most cases, allowed for reasonable profit margins on products sold in what is considered the private market and to a lesser degree on the products included in the basic list of medicines for the public sector. A third market for generic products for the lowest income groups is supplied at the lowest possible prices.

The Mexican Government is interested in promoting the consolidation of companies in the industry, with a view to increasing the participation of Mexican investors and reducing costs, for both export and local market purposes. Increased production of raw materials for the industry is also desired. It is advisable to seek the advice of a competent specialist when considering a possible investment.

## ***Mergers and acquisitions***

In the past, many foreign investors in Mexico preferred to purchase an interest in an established local concern rather than to form a new company that might enter the market at a competitive disadvantage. In any event, it is advisable to contact our Corporate Legal Area for competent legal advice when considering an acquisition or a merger. For a discussion of the tax consequences of mergers and acquisitions, see Chapter 17.

## ***Securities markets (stock exchange)***

Public offerings of securities, the stock exchange, brokers, and dealers are regulated under the Securities Market Law, which governs the operations of the National Securities Commission. Only securities approved by the Securities Commission and included in its National Register of Securities and Intermediaries may be offered to the public.

The New Securities Market Law (NSML) was enacted on June 28, 2006. This new securities market legislation establishes regulations in accordance with modern international standards governing the fundamental principles of the securities market. Among other objectives, the new law aims to incorporate medium-size corporations in the securities market, establishes minority shareholders' rights and corporate governance standards, as well as the regulation of the conduct of the participants in the securities market, with the final purpose of reducing the cost for the issuer.

## ***Requirements for Securities Commission approval***

In addition to details and documentation of the organization of a company, information as to its officers and a description of its business, a company desiring to have its equity or debt securities approved by the Securities Commission is required to furnish to the Commission, among other documentation, audited financial statements. Final approval can be expected to take from one to four months under normal conditions. Subsequently, audited annual financial statements must be published and furnished to the Commission.

## ***Mexican Stock Exchange***

The Mexican Stock Exchange is operated by a corporation whose shareholders used to be the brokers and broker-dealers registered to do business through the Mexican Stock Exchange, but which went public in 2008.

The principal requirement for listing a company's securities is the prior approval of the Securities Commission. Each listed company is required to provide annual audited financial statements as well as unaudited interim statements on a quarterly basis. No special rules exist for a foreign acquisition of an interest in a local publicly held enterprise, other than the restrictions that may still apply with respect to corporations engaged in certain activities where foreign ownership is limited or not permitted. See Chapter 5 for details.

## ***Brokers and broker-dealers***

The Securities Market Law establishes stringent rules for companies acting as broker-dealers and for individual securities brokers, who may not act as dealers or own shares in the companies registered as broker-dealers.

Broker-dealers must be Mexican corporations whose shares may not be owned by individual registered brokers, foreigners who are not permanent immigrants or corporations other than Mexican banks and finance companies. The managers and officials of such corporations who deal with the public must be registered brokers. All brokers and broker-dealers must be registered with the National Register of Securities and Intermediaries maintained by the Securities Commission.

## ***Imports and exports***

In the 1990's Mexico liberalized most import restrictions previously existing and considered internationally as trade restrictions. These actions included significant reductions of import duties and elimination of prior import permits for most merchandise listed in the General Import Duty Tariffs.

With respect to exports, Mexico has made significant efforts to encourage companies to export manufactured goods by developing certain Government programs, including temporary duty-free imports to be integrated into exported goods, financing programs and simplifications of official export procedures. Trade agreements are in effect with the United States and Canada (NAFTA), the European Union, EFTA countries (Switzerland, Iceland, Liechtenstein and Norway), Colombia, the Northern Triangle (Guatemala, Honduras and El Salvador), Nicaragua, Costa Rica, Chile, Bolivia, Uruguay, Israel and Japan.

Mexico is a member of the World Trade Organization (WTO) and, as such, is streamlining or eliminating trade barriers.

## ***Consumer protection***

All entities (including state-owned corporations) and individuals that manufacture, distribute or sell goods or render services are subject to the Federal Consumer Protection Law. This law was passed to provide consumers with adequate protection against merchants and service providers that do not comply with the minimum standards or specifications for products and services, including e-business. SE is empowered to impose fines and use other coercive measures to protect the consumer.

## ***Imports***

In the case of imports, SE requires the importer to re-label the products to include, in Spanish, the relevant information about the contents of the product, name and country of origin of the producer, and information about the importer, port of entry, etc. Additionally, all imported merchandise should meet minimum standards for sanitation and safety. Finally, a wide variety of products must comply with the Mexican Standards of Quality, referred to as Mexican Official Norms (NOM).

The regulations applicable to labels contemplate that the minimum required information to be included on the labels is as follows:

1. Description of the goods.
2. Importer's name and address.
3. Warnings or precautionary information in the case of hazardous products.
4. Instructions for use and storage.
5. Expiration date (if applicable).

Also, certain imports and exports are subject to regulations by the Ministry of the Environment and Natural Resources (SEMARNAT).

Some imported products must receive sanitary or phytosanitary authorizations issued by the Ministry of Health (MH). There are also rules establishing the classification of goods whose importation is subject to regulation by the Commission for the Control of Pesticides, Fertilizers and Toxic Substances.

### ***Food and drugs***

In accordance with the General Law on Health and numerous specific regulatory decrees, all types of prepared or packaged foods, meat, beverages, medicines, and related products must be approved and registered with the MH, which is authorized to make continuing follow-up inspections and laboratory tests at its discretion. Products of the types requiring approval and registration may not be imported unless they were previously registered with the MH. In some cases imports require specific authorization.

### ***Environmental provisions***

For many years, the Mexican government, through various ministries, exercised authority to control certain types of industrial pollution, now through SEMARNAT. The General Law of Ecological Balance and Environmental Protection, which was amended in 2006, provides for the imposition of substantial fines and even closure of the offending establishment in the event of non-compliance with the applicable rules and regulations. The law and regulations have been enforced on a broad scale by the National Institute of Ecology (INE) and by the Federal Public Attorney's Office for the Protection of the Environment (PROFEPA), both dependencies of SEMARNAT.

The Criminal Code introduced a chapter that regulates Environmental Crimes; the punishment for this type of crimes goes from six months to 10 years of imprisonment, plus a substantial fine.

Furthermore, local and state environmental legislation exists, including in the Federal District. Although very similar, they regulate activities not contemplated under the Federal law.

## ***Electronic Contracting: Private use and public trend; online consumer protection.***

In general, electronic contracts and web contracts are valid in Mexico under legal reforms made to the Commercial Code and the Federal Civil Code in 2000. Furthermore, legislation on advanced electronic signatures for commercial transactions was approved in 2003.

While Civil and Commercial Courts are obliged to acknowledge the validity of electronic evidence, certain Courts (e.g. labour Courts) are not specifically forced to accept such evidence; it should be noted also that certain documents must be presented in hard copy and with handwritten signatures in order to be valid in court (i.e. promissory notes). On the other hand, electronic signatures and advanced electronic signatures are widely used at government level.

There is a clear trend toward using electronic signatures both in government-to-government communications and government-citizen communications (such as public bids, foreign investment reporting obligations, tax reporting/payment obligations, among others). Public Administration expects these technologies to improve government transparency, efficiency and accountability. The Consumer Protection Law offers considerable protection to online consumers (including advertising and data processing rules, through minority or vulnerable protection rights, among others).

## ***Special industries***

Special regulations govern the operation of certain industries, some of which have already been covered. Others are discussed below. However, this section discusses these restrictions only in broad terms. Accordingly, those interested in more specific information about a certain industry or activity should consult with competent advisers.

## ***Insurance and banking***

The foreign investment law authorizes foreign ownership of insurance companies of up to 49 percent of their capital; NAFTA permits 100 percent ownership with certain investment caps in the case of Canadian and U.S. investments. The National Insurance and Bonding Commission regulate insurance activity in Mexico. Where the insured asset is situated in Mexico, the law provides that all insurance must be written with insurance companies authorized to do business in Mexico. Any person involved in the placing of insurance with companies not so authorized (entries in the Mexican company's books, among other things, being deemed to be involvement) is liable to criminal prosecution. Similar provisions exist with respect to fidelity and other types of bonds.

It should be noted, however, that substantial deregulation of both the banking and the insurance industries has been accomplished during recent administrations.

The foreign investment law establishes maximum foreign investment participation percentages of up to 49 percent for the following financial service activities:

- Insurance companies.
- Bonding institutions.
- Foreign currency exchange offices.
- General deposit warehouses.
- Corporations that promote investments (Article 12 of the Securities Market Law).
- Retirement fund management companies.

## ***Mining industry***

### ***Subsoil and mineral rights***

In accordance with the Mexican Constitution, the subsoil and any minerals found therein are the inalienable property of the nation. All mining activity requires a concession from the federal government. The mining law establishes the following:

1. Foreign ownership of Mexican corporations must conform to the restrictions imposed by the foreign investment law and is not specifically restricted by this law.
2. Exploration concessions will be granted for a non-renewable six-year period.
3. Exploitation concessions will be granted for a 50-year period, which can be extended for an additional 50 years.
4. Concessions will not be granted within areas that have been incorporated into the National Mining Reserves.

### ***Labor matters***

Labor unions are usually quite strong in the mining industry, and the corresponding collective labor contracts tend to grant fringe benefits more substantial than the minimums required by the Federal Labor Law. Most mining labor contracts provide for substantial severance compensation upon voluntary retirement after a specified number of years. Mining companies (as all entities) are required to provide social security to their employees; however, if no public health services are available in the area where the mine is located, the mining entity will have to finance (and provide) medical services on its own.

### ***Patents and trademarks***

Industrial property is regulated by the Industry Property Law enacted in June 1991. This law regulates, among others things, patents, trademarks, industrial designs, licenses, slogans, franchises, etc. It is not necessary to submit for prior approval and registration contracts for the use of patents, trademarks or trade names or for providing technical assistance or know-how. However, for due protection of patents, trademarks and copyrights, license agreements for these should be registered with the proper Mexican Authorities, particularly to ensure their enforceability vis-a-vis third parties.

## ***Patents***

In general, patents are issued for a non-extendable term of 20 years from date of issue, considering that the legal date of the patent will be the date on which the application was filed. Holders of Mexican patents are required to commence exploitation of their patents within three years after they are issued, except when the holder of the patent has been importing the patented product or a product obtained through the use of a patented process. Otherwise, unless technical or financial just cause can be proved, an obligatory non-exclusive license to use the patent may be authorized by the Mexican Institute of Industrial Property upon request. In this case, the amount of royalties payable and other terms for such a license will be specified by the authorities. This license will expire if two years have elapsed since it was granted and the holder does not exploit it or prove reasonable cause for not exploiting it.

## ***Trademarks***

Under the law, trademarks may be registered for a period of ten years, renewable every ten years. Proof of actual use of a trademark within at least three years after it was registered must be furnished to the Mexican Institute of Industrial Property, or the registration will be considered to have lapsed.

It is suggested that in any situations dealing with the protection, licensing or sale of intellectual property rights our Corporate Legal Area be contacted for competent legal advice.

## ***Copyright protection against video and audio piracy***

In order to protect authors or owners of exclusive rights to software programs, video and audio recordings, books and other intellectual or artistic properties, registration of these properties with the National Copyright Institute (Instituto Nacional del Derecho de Autor) must be made in Mexico. The protection of Copyrights lasts during the life of the author and 100 years after his death. To exploit them commercially, those reproducing or exploiting the copyrighted material must demonstrate their legal right to do so, and the reproductions themselves should clearly state the entity's corresponding authorization through a copyright license. Piracy of these restricted-use properties duly registered in Mexico is severely punished through criminal prosecution and confiscation of both the unauthorized copies and the equipment used to carry out this activity.

# Chapter 7

## Banking and finance

### **Investor's considerations**

- Local credit has increased and diversified in recent years.
- Commercial credit provided by banks for long-term loans, credit cards and real estate mortgage loans, as well as for financing inventories and receivables, have grown substantially.
- Brokerage houses have a significant participation in the financial markets.
- Banco de México, the central bank, operates as an autonomous entity within the federal government, including autonomy in monetary policy issues.
- The Mexican Derivatives Market (*Mercado de Productos Derivados*—MEXDER) has been in place for over 10 years.
- A new Securities Market Law (*Ley de Mercado de Valores*) is in force since June 2006.
- New niche banks and financial entities have been participating in the local credit market.
- Over 10 new banks have been incorporated since 2002.

### **General note**

The Mexican banking system is privately owned and managed. Foreign investment is allowed.

In order to reduce the risk of a banking crisis and to protect investors' savings in financial institutions, the Banking Savings Protection Law (*Ley de Protección al Ahorro Bancario*) has been in place in the aim of resolving the banks' bad debts problem, protecting depositors.

There are commissions that supervise and regulate the different segments of the financial sector. These commissions (agencies of the Ministry of Finance) include: The National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*-CNBV), the National Commission for Retirement Savings Systems (*Comisión Nacional del Sistema de Ahorro para el Retiro*-CONSAR) and the National Insurance and Bonding Commission (*Comisión Nacional de Seguros y Fianzas*-CNSF).

## **Banking system**

### **Central bank**

The Mexican banking system is regulated by Banco de México (BM, the central bank), which is operationally autonomous in setting monetary policy. The central bank is in charge of supervising the operation of the Mexican banking system in order to have an efficient payment system.

The National Banking and Securities Commission is a government commission under the Ministry of Finance. Its main activities are to supervise and to regulate financial entities in order to maintain stability and good performance and to protect companies' and individuals' interests. It has the authority to penalize financial institutions when they violate provisions of the laws regulating their activities. The Commission has adjusted accounting standards for banks, stock brokerage firms and other intermediaries in order to match internationally accepted accounting principles and standards.

### **Banking market**

The banks are divided into three groups: development banks, commercial banks and niche banks.

#### *Development banks*

The development banks include those established by the government to develop specific industries based on the National Development Plan (*Plan Nacional de Desarrollo*), such as the export trade. Currently there are seven development banks:

*Nacional Financiera* - Focused on the development of small and medium-size businesses through financing, training and technical assistance.

*Banco del Ejército* - Its main activity is to provide banking services to the military population and to support the Federal Government and the Navy.

*Banca Nacional de Comercio Exterior*- Focused on increasing the number of Mexican companies, specially small and medium-size businesses, that participate in global markets (export activities).

*Banco Nacional de Obras y Servicios Públicos*- Its function is to finance or refinance public or private projects focused on public services.

*Banco de Ahorro Nacional y Servicios Financieros*- Focused on providing financial opportunities to all the population, especially to low-income sectors.

*Sociedad Hipotecaria Federal* - Promotes the construction of houses for low-income sectors and provides mortgages.

*Financiera Rural* - Focused on providing financial resources, technical assistance, training and consulting to the rural sector.

### *Commercial banks*

The commercial banks receive the majority of checking and savings deposits and provide most of the short-term credit. The largest banks (Banamex – owned by Citigroup, BBVA-Bancomer, Santander, Banorte, HSBC and Scotiabank) operate throughout the entire country. The commercial banks also provide long-term loans for capital goods and real estate mortgage loans, as well as for financing inventories and receivables.

Individuals and companies resident in border zones are authorized to maintain checking accounts denominated in U.S. currency.

### *Niche banks*

In February 2008, the Mexican Congress enacted several reforms to the banking law to allow the creation of “niche banks” within the banking system. Niche banks undertake limited operations without the burden of carrying out the whole set of operations covered by the banking law. With these modifications, for instance, it would be possible to have institutions focused only on trading or trust activities without performing credit activities.

### *Bank reserves*

In 1999 the Bank Savings Protection Law was promulgated. The objective of this law is to protect the population’s savings. For this purpose, commercial banks are obligated to pay 0.04% of the total amount of their liability operations annually to the Bank Savings Protection Institute (*IPAB*).

The percentage of its credit operation reserves is determined based on the client credit scores of each particular bank.

### *Investment availability*

The Ministry of Finance authorizes private and public companies to issue both private and public debt instruments placed with the general investing public through the Mexican Stock Exchange, which provide interest rates or discounts yielding higher returns to investors than returns offered by commercial banks. Additionally, exchange coverage protection may be purchased, and peso futures are currently traded on the Chicago Mercantile Exchange, the Chicago Board of Options Exchange and the Mexican Derivatives Market (*MexDer*).

### *Specialized financial institutions*

Financial holding companies are usually formed to hold interests in banking, stock brokerage, insurance, bonding, financial leasing, and factoring companies. Separate legislation regulates each of these activities, including holding companies.

## ***Non-Bank financial entities***

A new form of entity called Sociedad Financiera de Objeto Multiple or SOFOM was created as a result of amendments to certain mercantile laws. These entities are basically devoted to providing financing through direct loans, financial leasing and factoring, and do not need to obtain an authorization from the Ministry of Finance to carry out business operations; however, they are not allowed to obtain funds (deposits) from the general public.

There are two types of SOFOMs:

- a) Regulated SOFOMs: In order to be a Regulated SOFOM it is necessary that a Mexican financial group holding company that owns a bank participate in the capital stock of the SOFOM. Also, a SOFOM would be a Regulated SOFOM if either its capital stock is owned 20% or more by a bank or if the bank effectively controls the SOFOM by any means, or the SOFOM and a bank have common shareholders. These types of entities are regulated by the Banking Commission.
- b) Non-Regulated SOFOMs are those that do not have any capital link with a financial entity regulated in Mexico.

SOFOMs are considered for tax purposes as part of the Mexican financial system and are subject to the same tax treatment. This, provided that (i) at least seventy percent (70%) of its assets derive from portfolio or accounts receivable resulting from the main corporate purposes of the SOFOM (i.e. credit, factoring or financial leasing), or (ii) that the company has income derived from such main corporate purpose activities and the sale or administration of loan portfolio granted by the company representing at least seventy (70%) of its total income.

## ***Investment institutions***

Mexican mutual fund investment companies have been growing significantly in number of funds, their size and the volume of transactions. Three main types of funds are available:

1. Fixed-income funds, which direct their investments mainly to high-yield, fixed-income securities denominated in pesos, such as Mexican governmental treasury certificates (CETES) and corporate debentures or commercial paper.
2. Variable-income funds, which are authorized to invest a large proportion of their assets in shares of companies listed on the stock exchange.
3. Risk-equity capital funds.

Investment and mutual funds are authorized by the Ministry of Finance and are usually operated by brokerage houses and banks. The Ministry authorization also contemplates the type of investor that may participate in the fund, e.g., individuals, corporate treasuries, nationals, foreigners, and employee savings and retirement funds. The investment institutions are regulated by the Investment Company Law (*Ley de Sociedades de Inversión*).

Insurance and bonding companies are authorized by the National Insurance and Bonding Commission to invest their technical reserves in certain instruments. These entities commonly invest in the money market.

## **Retirement fund managers (AFOREs)**

The Law for Retirement Savings Systems regulates retirement savings systems and their participants by means of retirement fund managers. These organizations, known as AFOREs (*Administradoras de Fondos para el Retiro*), are financial entities that as from July 1, 1997 are exclusively and continuously engaged in the management of individual savings accounts and channel the resources of the retirement subaccounts of which they are composed under the terms of the Social Security laws through companies specializing in the investment of retirement funds (SIEFOREs) (*Sociedades de Inversión Especializadas de Fondos para el Retiro*). The exclusive purpose of these SIEFOREs is to invest the resources of individual accounts entrusted to them, in accordance with the terms of the Social Security laws.

Authorization is required from the National Commission for Retirement Savings Systems (*Comisión Nacional del Sistema de Ahorro para el Retiro*) to operate as an AFORE or as a SIEFORE.

The capital of AFOREs is controlled to reduce potential conflicts of interest, to assure the security of the operation of the system and to have a better control over the investment of pension funds. It should be composed of Series “A” shares, which must account for at least 51 percent of the capital. The remaining 49 percent can be composed of Series “A” and Series “B” shares. Series “A” shares may be acquired only by Mexican nationals and Mexican entities majority-owned by Mexicans and actually controlled by Mexicans. Series “B” shares are unrestricted.

Foreign entities other than foreign government agencies may hold capital in AFOREs or participate in their management. Direct or indirect foreign participation of foreign financial institutions in the capital stock of AFOREs is regulated by the applicable international treaties and agreements, and will be subject to the regulations issued by the Ministry of Finance concerning compliance with such treaties and agreements.

The only party permitted to participate in the fixed capital portion of a SIEFORE’s capital stock is the AFORE that requests its creation and its members. In no case may the participation of an AFORE in the capital stock of the SIEFORE it operates be less than 99 percent of the fixed portion of the capital stock of the SIEFORE.

In addition to AFOREs, only workers investing in the resources of the individual accounts contemplated in the Social Security laws may participate in the variable portion of the capital stock of SIEFOREs.

## **Financial markets**

### **Securities market**

The amount of local capital available for investment in new or expanding industrial enterprises has increased considerably in recent years. This trend is expected to continue in 2010 once the worldwide financial crisis is over. A number of factors, including, principally, the rapid expansion of mutual funds (see above), which opened the market to small investors, created interest in equity shares traded on the Mexican Stock Exchange. In addition, the Intermediate Securities Market (*Mercado Intermedio*) was created to trade the capital stock of smaller and medium-size businesses.

Foreigners are authorized to participate (buy and sell) in the Mexican Stock Exchange or in special funds created specifically for this purpose.

A new securities market law (*Ley de Mercado de Valores*) was enacted on June 28, 2006. This new law establishes international standard regulations covering stock market activities.

See Chapter 6 for further discussion of the securities market and the Mexican Stock Exchange.

### **Specialized financial markets**

Investment interest in Mexico has soared in the past several years and Mexican equities have been some of the most actively traded in the world. Once the global financial crisis is over this situation should continue. Mexican peso futures and options are traded on the Chicago Mercantile Exchange, providing the means for investors to make the most of the opportunities in Mexico today. The addition of futures and options on the Mexican peso represents a significant advance in risk management for all investors in Mexico, because they provide nearly limitless possibilities and combinations for trading and hedging in the Mexican peso.

Some of the advantages are: Investors can trade forward foreign exchange on the Mexican peso, profits and losses are denominated in U.S. dollars, and there is an exchange of Mexican pesos for U.S. dollars at delivery.

The Mexican Derivatives Exchange (*Mercado de Productos Derivados MEXDER*) and the Mexican Clearing House (*ASIGNA*), are the result of the collaborative efforts of Mexico's Ministry of Finance (*SHCP*), the *CNBV* and the Mexican Stock Exchange (*BMV*). *MEXDER* and *ASIGNA* were designed to facilitate the modernization of the Mexican financial system and to ultimately turn Mexico into the major financial center of Latin America. *MEXDER* and *ASIGNA*, pursuant to regulations promulgated by the *SHCP*, *CNBV* and the *BMV*, are established as for-profit corporations with self-regulatory mechanisms to permit supervision of the operation and financial situation of their respective participants. These self-regulatory functions govern contract

execution, regulation of members, enforcement and compliance issues, and dispute resolution and disciplinary measures. The specific role of ASIGNA is to liquidate futures and options contracts executed on the MEXDER and to act as counterparty in the context of these operations. Banks and investment banking firms are the only operating partners authorized to conduct operations on behalf of clients on the MEXDER.

Initially, the MEXDER offered futures and eventually options with respect to a specific index, and dollar and interest rate futures. The intention is to permit trading in both dollar and interest rate options. The BMV developed the MEXDER after consulting with the world's largest stock exchanges in an effort to ensure a solvent and competitive market that would facilitate broad participation, reduce transaction costs, increase liquidity and provide better risk coverage in the management of portfolios.

### ***International financial market***

Mexico provides the full range of international financial services to both residents and nonresidents. Most major banks have full-service bank branches in the major international financial centers (including New York, Los Angeles, London, and Tokyo).

#### ***Some foreign banks (mainly U.S., Spanish, British and Canadian), have opened subsidiaries in Mexico.***

There is an active foreign exchange market. However, because of Mexico's proximity to the United States and because it is Mexico's principal trading partner, most foreign currency transactions (purchases, sales, remittances, and futures) are carried out in U.S. dollars. Additionally, other foreign currencies (which are traded in very low volumes), including the euro, , have fluctuated against the Mexican peso in similar proportions to the U.S. currency, as the Mexican peso is seen as pegged to the U.S. dollar in the European market. Eurobonds are not traded in Mexico, but Mexican corporations and individuals may invest in such instruments in foreign markets.

#### ***Offshore financial services***

Mexican companies are free to carry out offshore activities, including banking transactions (deposits, borrowings, remittances and transfers). As mentioned above under "International financial market," Mexican banks are authorized to open branches overseas and to carry out banking activities with both residents and nonresidents of Mexico.

Mexican taxpayers are required to file an annual information return when their source of income is located in a country deemed to be a tax haven or preferential tax regime by Mexican law or in a country with a territorial tax system.

## ***Sources of funds***

### ***Short-term credit***

Commercial banks provide most local-source financing. Short-term credit is furnished on a line-of-credit basis and may be supported by a pledge of inventories or by discounting customer paper.

Short-term commercial credit is available only at interest rates that would probably range from 11 to 36 percent per annum for a bank loan in pesos to a Mexican subsidiary, even if repayment of the loan were guaranteed by a parent company having the highest credit rating abroad. Borrowers are also encouraged to maintain substantial compensatory balances on deposit with lenders.

Banks generally charge rates similar to those for short-term peso credits on discounts of customer paper of manufacturing and wholesale enterprises, although somewhat lower rates are available for loans secured by inventory or fixed assets and for industrial mortgages.

Nowadays there are entities called Savings and Popular Credit Entities whose main function is to provide short-term credit to its members. The advantage of these entities is that their interest rate is lower than the market interest rate.

### ***Local capital market***

Obtaining long-term capital is expensive in Mexico. Debentures of industrial and large commercial corporations may be listed on the Mexican Stock Exchange for sale to the public, and 30- to 90-day commercial paper is also being issued through the market by listed companies.

Local private capital can usually be found to provide the majority ownership of Mexican companies, the minority shareholders of which are recognized foreign companies providing technical assistance and know-how.

With the liberalization of passive interest rates and operational flexibility and the reprivatization of the banking industry, the availability of lendable funds, together with the related interest rates, is determined by each major bank individually. Accordingly, company treasury officials should consult and possibly negotiate the terms and conditions of each entity's financing needs with several banks before deciding on the most favorable source of funds.

### ***Availability to foreign investors***

There are no restrictions on foreign investors' access to local sources of finance. However, foreign investors do not usually consider local sources of finance, since the cost of financing is high.

Some restrictions apply to the ability to invest in government securities and in local quoted companies. Those interested in investing in Mexico are encouraged to consult with the international divisions of the Mexican banks and brokerage houses located in the major international financial centers and in Mexico.

## ***Impact of the Foreign Investment Law and NAFTA on the financial services industry***

Because of Mexico's commercial opening, some years ago, modifications were made to legislation applicable to the Mexican financial system. The aim of these modifications was principally to allow and regulate the participation of foreigners in the capital of financial entities in Mexico and the establishment in Mexican territory of subsidiaries or subsidiary holding companies of foreign financial institutions resident in countries with which an international agreement or treaty had been executed for this purpose.

### ***Participation in the financial system***

The limit on foreign participation in the financial system is 49 percent for general deposit warehouses, financial leasing companies, financial factoring companies, mutual insurance companies and institutions, bonding companies, brokerage firms, and retirement fund managers (AFOREs).

However, Mexico has entered into commercial treaties with many countries; for example, NAFTA establishes conditions for 100 percent foreign investment participation in financial operations in Mexico, limiting the U.S. and Canadian resident investment amount to a percentage of the overall capital of the Mexican entities. We recommend that in each specific case, PricewaterhouseCoopers Mexico should be consulted to determine whether at such time Mexico has a commercial treaty with special provisions allowing a higher percentage of foreign participation in the financial services industry.

With the entry into force of NAFTA, companies providing auxiliary and insurance broker services may establish subsidiaries with no limits on participation.

Regarding non-bank financial companies, Mexico allows the establishment of subsidiaries of such companies for the purpose of providing consumer credit, commercial credit, mortgage loans or credit card services on the same terms as Mexican institutions.



# Chapter 8

## Exporting to Mexico

### ***Tips for exporters***

Mexico's commercial conditions provide an excellent business and investment opportunity:

Mexico is a member of the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation Mechanism (APEC) and the Organization for Economic Cooperation and Development (OECD).

Mexico constitutes an excellent potential customer for exporters, with its developing economy and a population of over 105 million.

Mexico lies in a strategic geographical location for international trade, sharing borders with the United States of America, while facing Europe and Asia, and representing an easy entry to the rest of Latin America.

Mexico has signed twelve Free Trade Agreements (FTAs), which provide for preferential duty rates on foreign trade operations with 43 countries.

FTAs signed by Mexico include NAFTA<sup>1</sup>; Colombia; Costa Rica; Bolivia; Nicaragua; Chile; the European Union<sup>2</sup>; Israel; Honduras, Guatemala and El Salvador (the Northern Triangle FTA); the European Free Trade Association<sup>3</sup>, and most recently Uruguay and Japan<sup>4</sup>.

General Import Duty rates range from 0 to 35 percent, but most imports fall within the range of 3 to 20 percent (exceptionally, certain food products, shoes and textiles pay higher duties).

Temporary imports are exempt from customs duties (except for fixed assets) and value-added tax payments.

Mexico offers information through official and private commercial delegates worldwide.

---

1 North America Free Trade Agreement.

2 Austria, Belgium, Bulgaria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Romania, Spain, Sweden, the United Kingdom, Cyprus the, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

3 Iceland, Norway, Liechtenstein and Switzerland.

4 In effect as from April 1, 2005.

## ***Import restrictions***

The Mexican government has continued its policy of progressive reduction of trade barriers to imports. Prior import licenses from the Ministry of Economy (SE) are required only for less than 1% of items or classifications in the customs tariff.

Special requirements currently apply for importing products into Mexico in respect of health, ecology, quality, and consumer protection issues. These requirements have different specific formalities to comply with, depending on the product to be imported, and are usually identified by the subheadings included in the Harmonized Tariff System for Merchandise Classification and Codification.

The special requirements are administered by government ministries such as the Ministry of Economy, the Ministry of Health (MH), the Ministry of Defense (SEDENA), the Ministry of the Environment, Natural Resources and Fisheries (SEMARNAP), and the Ministry of Agriculture and Livestock (SAGARPA).

The importation of drug products or substances containing illegal drugs (acetylmorphine, pseudoephedrine, coca leaf, corn poppy, cannabis indica, etc.) is definitely banned.

## ***Import duties***

### ***Customs duties***

#### *Tariff Classification*

Since the late 1980's Mexico adopted the Harmonized Tariff System (HTS) for Merchandise Classification and Codification, making its import/export classification system compatible with those of most countries with which it commonly trades.

A new General Import and Export Tariff Law became effective in Mexico as from June 18, 2007. The most significant change refers to some tariff code reclassifications and a general reduction in the duties.

#### *Customs Law*

Customs Law in effect as from April 1, 1996, was designed to provide legal certainty, promote investment and exports and to comply with the international commitments undertaken by Mexico. This law incorporates a number of tax rules and operational authorizations on specific international operations.

#### *Customs Valuation*

The customs valuation of merchandise to determine its taxable base is generally the transaction value of the goods, which is the value actually paid for the goods. In this sense, Mexico has adopted the valuation agreement approved by the WTO.

Consequently, if a financial, commercial or other type of relationship exists between the foreign supplier and the Mexican importer (related parties), free competitive conditions must be complied with.

## *Rates*

Import duty rates range from 0 to 35 percent; however, most taxable merchandise falls within the range of 3 to 20 percent. Higher rates apply to different types of goods and to imports from certain countries, ranging from 30 to 260 percent. Examples of these goods include fabrics, leather, malt, beans, crabs, live chickens and hens, coffee-based extracts and extracts for juices.

Compensatory quotas can raise duties up to 500 percent.

## *Special rates and customs associations*

Mexico has signed twelve FTAs, such as the NAFTA, European Free Trade Agreement, European Free Trade Association, Colombia, Costa Rica, Bolivia, Nicaragua, Chile, Israel, Honduras, Guatemala, El Salvador, Uruguay, and most recently, Japan. These FTAs require Mexico to apply preferential duty rates to the importation of goods from 43 countries.

Additionally, some preferences are provided in the form of import duty reductions pursuant to per-country bilateral trade agreements signed under the Latin American Integration Association (LAIA).<sup>5</sup>

Furthermore, Mexico signed economic cooperation agreements with Brazil, Argentina, Uruguay and Paraguay under MERCOSUR (South America Common Market).

All preferential customs rates may be requested by the importer if the certificate of origin is submitted to customs.

In addition, the Ministry of Economy created the Sectorial Relief Programs (SRPs), which came into force on January 1, 2001.

SRPs are designed to support domestic manufacturers by allowing them to import components, raw materials, and equipment under a preferential import duty rate, regardless of their origin, provided that such items are used in the production of goods authorized by the corresponding SRP (most duty rates granted under these programs range from 0% to 5%).

## **Other taxes**

Merchandise whose sale or production within Mexico is subject to excise, production or other indirect taxes is also subject to these taxes on import. Usually, the taxable base for the calculation of these taxes is the customs value (transaction value plus related expenses), plus import duties. The expenses refer to those expenses paid abroad and related to the importation (i. e. freight, insurance).

Additionally, most imports of tangible goods are subject to value-added tax (VAT) at the same rate that applies to domestic sales (16%). Refer to Chapters 23 and 24 for more information on VAT and other indirect taxes.

<sup>5</sup> Within LAIA, Mexico has signed agreements with Brazil, Cuba, Ecuador, Paraguay, Peru, Panama and Argentina.

## ***Documentation procedures and technical barriers to trade***

Any special import license, when required, should always be obtained before the arrival of merchandise at a Mexican customs office, and presented at the time of the customs clearance.

Aside from the import pedimento (entry summary), that is always required for the customs clearance of goods and that must be filed by a customs broker, other documents that should be attached are the commercial invoice; a detailed packing list, if necessary; the corresponding bill of lading, which should show all charges to be made by the seller in connection with the sale and in the case of shipments by land or sea, it should be stamped by a Mexican consul in the country from which shipment is made; and any permits where applicable.

If the goods are imported from a country with which Mexico has an FTA, a certificate of origin of the goods is also required in order to apply the corresponding preferential customs rates.

In addition, the importer must comply with the applicable customs requirements for declaring the value of the merchandise. The importer must also be duly registered as a taxpayer, as well as in the Importers Register kept by the Ministry of Finance (SHCP).

### ***Other charges***

In addition to import duties, the special production or excise taxes, payable on imports, VAT and any countervailing duties as mandated for certain imports by the Ministry of Economy, a customs processing fee is payable with the import declaration. This fee is calculated depending on the type of import. In the case of permanent imports the fee is 0.008 of the customs value of the goods.

### ***Review procedures***

The customs authorities are empowered to review entry summaries and to carry out physical inspections of merchandise, wherever located, and to request information or documentary support of the legal status of any foreign merchandise (including machinery and equipment) in the taxpayer's inventory or premises.

### ***Fines and other penalties***

Non-compliance with customs rules is severely punished in Mexico. Penalties include confiscation of the merchandise without possibility of recovery in extreme situations, late-payment penalties and assessment of omitted duties and fines of up to 100 percent of the value of the confiscated merchandise. Criminal prosecution could also apply.

## ***Customs and storage***

The customs handling system uses a computerized tracking and traffic control system, including warehousing. Customs and storage facilities are adequate and secure. Customs clearances should be made by the importer within two months and one day after the day of arrival, except in the case of explosives, flammable materials, contaminating, radioactive or corrosive products, perishable goods, and live animals, in which case the goods must clear customs during the three days commencing one day after the date of arrival.

In the case of abandoned merchandise, after the deadline stated above, the customs authorities grant a 15-working-day period for customs clearance. Once this period expires, the property is automatically transferred to the authorities.

## ***Port of entry and inland transport***

### ***Ports of entry***

The most important ports of entry, based on volume of merchandise handled, are as follows.

1. Gulf of Mexico: Veracruz and Tampico-Altamira.
2. Pacific coast: Manzanillo, Acapulco and Lázaro Cárdenas.
3. Northern border: Tijuana in the northwest and Nuevo Laredo in the northeast.
4. Air shipments: Mexico City, Guadalajara, Monterrey, and other international airports.

### ***Inland transport***

The Mexican railroad system serves the following ports of entry: Nuevo Laredo, Matamoros, Piedras Negras, Ojinaga, Ciudad Juárez, Nogales, Mexicali, and Tijuana, all along the northern border; Matamoros, Tampico-Altamira, Veracruz and Poza Rica on the Gulf coast; and Mazatlán, Topolobampo and Salina Cruz on the Pacific coast.

Additionally, all major cities/destinations are served by privately owned trucking companies. Exporters should consult with their importer/customer ahead of time to determine the optimal logistics applicable, depending on type, volume and final destination of the merchandise.

### ***Bonded warehouses***

Imported merchandise may also be held in bonded warehouses operated by private companies under government regulations. Import duties, adjusted for changes in currency valuation, become payable at the time when the importer (i.e., Mexican purchaser) withdraws the goods from the warehouse.

The foreign exporter is allowed to maintain inventories in bonded warehouses for local delivery and to be deemed as not having a taxable “permanent establishment (See Chapter 16).

## ***Reexports***

### ***Temporary imports***

Mexican customs regulations contain special provisions on the temporary importation of goods. This treatment allows the deferral of import duties for a period of between six and eighteen months (and in certain cases for longer periods). The main types of temporary imports allowed are as follows.

1. Temporary import of goods to be returned abroad in the same condition as imported, such as in the case of containers, exhibit merchandise, aircraft, ships, and trailers.
2. Temporary imports for transformation, processing or repairs by the in-bond processing or export industries. See Chapter 4 for a description of the incentive programs under which temporary imports are allowed.

### ***Sales to the Mexican government***

The government procurement law establishes the rules with which companies must comply if they want to sell their products or services to government entities. NAFTA provides less stringent rules for suppliers domiciled in the United States and Canada.

### ***Free trade zones within Mexico***

The free-trade-zone concept has been replaced by the border region concept. The border region consists of the 20-kilometer stretch lying on both the northern and southern Mexican borders, Baja California Norte, Baja California Sur and Quintana Roo states, and the Cananea district in Sonora, as well as a part of the same state.

Within this region, companies may import non-NAFTA originating products at an exempt or maximum import duty rate of 5 percent, as well as an 11 percent VAT, depending on the product, as long as the products do not enter parts of Mexico.

In any case, further research is required to determine whether the incentives provided within the border region may apply to a specific company.

## ***Local representation***

### ***Market surveys***

Before starting any export sales to Mexico it is essential to survey existing and potential markets. For this purpose PricewaterhouseCoopers maintains a fully integrated international trade practice staffed with customs and trade specialists (Worldtrade Management Services).

### ***Local agent***

A foreign supplier cannot withdraw merchandise from a Mexican customs office without the services of a local agent, in addition to a customs broker. If delivery of goods is made to a customer within Mexico, the supplier is subject to Mexican VAT and may be subject to income tax. However, see “Bonded warehouses” above and Chapter 16 for the tax treatment of local sales through the use of a bonded warehouse.

### ***Employee/salesperson***

The definition of what constitutes a “permanent establishment” for Mexican income tax purposes (i.e., whether a foreign corporation is deemed to be engaged in a trade or business in Mexico) should be considered. See “Permanent establishment for income tax purposes” in Chapter 16.

A permanent establishment of a foreign corporation is deemed to exist if the corporation carries out activities through a representative who acts under detailed instructions or receives guaranteed remuneration, as well as when the representative has the authority to execute contracts or deliver merchandise within Mexico on behalf of the foreign entity. Consequently, if a foreign corporation desires to appoint a sales representative, care should be exercised to ascertain that the relationship is that of an independent contractor and not that of an employee in order to avoid being deemed a permanent establishment.

However, if there is a tax treaty in effect between the country of the foreign corporation and Mexico, the definition of permanent establishment should be analyzed on a case-by-case basis. Under the definition of most treaties, merely having a limited activity sales representative who does not have the power to negotiate contracts may not give rise to a taxable permanent establishment in certain cases, although certain employee taxes and labor obligations may still apply.

## ***Sources of information***

### ***Overseas***

Parties interested in exporting to Mexico may consult with the commercial attachés of Mexican embassies around the world or the international trade specialists assigned to foreign branches of Mexican banking institutions in most major financial centers worldwide.

### ***In Mexico***

For general information on Mexico's trade potential, you may approach the commercial attaché of your country's embassy as a preliminary contact. Additionally, most of Mexico's major trading partners have a specialized Mexico-related chamber of commerce (the United States, the United Kingdom, France, and Germany, among others). For more detailed information see Appendix XVI. You may also contact the following.

1. Ministry of Economy (SE). [www.economia.gob.mx](http://www.economia.gob.mx)
2. Mexican Foreign Trade Bank (BANCOMEXT). [www.bancomext.com](http://www.bancomext.com)
3. Mexican Industrial Information Fund (Fondo de Información y Documentación para la Industria - INFOTEC). [www.infotec.com.mx](http://www.infotec.com.mx)
4. National Association of Importers and Exporters of the Mexican Republic (ANIERM). [www.anierm.org.mx](http://www.anierm.org.mx)

And, of course, you may also contact the PricewaterhouseCoopers specialists in our Mexico City, Monterrey, Tijuana, Guadalajara, San Luis Potosi, Puebla and Juarez City offices.

# Chapter 9

## Business entities

### **Guide to “doing business” entities**

#### ***Choice of entity***

A potential investor, domestic or foreign, has free choice to operate through any form of entity. A stock corporation (S.A., S.A. de C.V. or S.A.P.I.) is the most commonly used entity for a subsidiary of a foreign corporation, although sometimes a general partnership with unlimited liability (Sociedad en Nombre Colectivo), a limited partnership (Sociedad en Comandita) or a limited liability company (Sociedad de Responsabilidad Limitada) is used, especially if the objective is that the Mexican entity be treated as a foreign partnership for tax purposes in the investor’s home country. A foreign corporation may also conduct business activities through a registered branch or permanent establishment in Mexico, such as a Representative office with or without income.

#### ***Government approval***

Prior authorization to use a specific corporate name is required from the Ministry of Foreign Affairs (Secretaría de Relaciones Exteriores) to form any business entity in Mexico. No approval is needed to amend its charter or bylaws unless the amendment involves either a change in the corporate name or the substitution of a provision allowing foreign participation for one prohibiting foreign participation.

Certain activities may require prior authorization from the Foreign Investment Commission if the entity will be wholly, partially or neutrally owned abroad. See Chapter 5 for details on restrictions on foreign investments.

#### ***Formation requirements***

The minimum share capital for a regular corporation established as an S.A., S.A.P.I. or S.A. de C.V. is 50,000 pesos, and it must have at least two shareholders. After all necessary governmental authorizations have been secured, the charter and bylaws must be formalized in a public instrument executed before a public notary. The corporation must then be registered in the Public Registry of Commerce (Registro Público de la Propiedad y del Comercio) and with all tax and regulatory authorities, as the case may be.

### ***Repatriation of funds***

There is no restriction on remittance of profits or on the repatriation of initial or subsequent investments.

The sale, exchange or transfer of shares issued by a Mexican corporation is generally treated as a taxable event, and any resulting gain is considered as from Mexican sources, irrespective of the residence of the selling shareholders or where the transfer takes place. Applicable tax treaties reduce or eliminate the capital gains tax.

### ***Tax considerations***

No Mexican companies are considered as transparent for income tax purposes in Mexico, even if they are classified as partnerships or flow-through entities for foreign purposes. However, certain Mexican trusts are considered transparent for income tax purposes (see Chapter 21). All Mexican resident companies are taxed in the same manner and must use the calendar year for legal and tax purposes.

Intercorporate dividends are not taxed twice, although if the recipient corporation has employees, its dividend income would again be subject to mandatory profit sharing.

### ***Professional advice***

Legal and tax advisers should be retained early in the planning stages to secure the necessary government approval and design the most flexible and desirable corporate structure best suited for the particular global group, as well as to ensure a smooth setup and regulatory compliance.

### ***Forms of business enterprise***

The different forms of organization of business entities in Mexico are regulated by the General Law of Mercantile Companies (Ley General de Sociedades Mercantiles), the Commercial Code (Código de Comercio) or the Civil Code (Código Civil). Some of these forms are summarized in Table VI below and are discussed in more detail later in this chapter.

## VI—Principal Forms of Business Enterprise

Sociedad Anónima (S.A.), Sociedad Anónima Promotora de Inversión (S.A.P.I.) or Sociedad Anónima de Capital Variable (S.A. de C.V.)	Stock corporation, stock corporation for the promotion of investment and stock corporation with variable capital. (These are the forms most commonly used by domestic and foreign investors)
Sociedad de Responsabilidad Limitada (S. de R.L.)	Limited liability company. (Used frequently)
Sociedad en Nombre Colectivo (S. en N.C.)	General partnership. (Rarely used by foreign investors because of unlimited liability, unless they want to qualify as a foreign partnership in the home country)
Sociedad en comandita (S. en C.)	Partnership with limited and unlimited liability partners.
Sociedad Civil (S.C.)	Civil partnership, i.e., of a noncommercial nature. (Used for non-profit entities and by professional practitioners)
Asociación en Participación (A. en P.)	Joint venture contract. This is not a legal entity but is treated as a separate entity for income tax purposes.
Sucursal de sociedad extranjera	Branch of a foreign corporation.
Comerciante Empresa de persona física	Sole proprietorship. (A foreigner must qualify as a permanent resident “inmigrado” to be able to do business in this way)
Asociación Civil (A.C.)	Civil association. (Used by charitable and other nonprofit organizations)
Oficina de Representación con o sin ingresos	Non-income or income-earning representative office

Corporate law is federal in nature and applies throughout the country. Although civil law is a matter of state law, the different state civil codes are practically identical as to the formation of entities of a civil nature.

For points to consider in setting up a business operation in Mexico, see Appendix XIV.

## ***Stock Corporation***

A most common way for domestic and foreign investors to operate in Mexico is through a stock corporation (Sociedad Anónima—S.A.) formed under the General Law of Mercantile Companies (Ley General de Sociedades Mercantiles). In this case the corporate name selected is followed by the initials S.A., which indicates that it is a stock corporation. A foreign-owned Mexican corporation is subject to the laws relating to all local companies in general, as well as to the Foreign Investment Law (Ley de Inversión Extranjera) discussed in Chapter 5.

### ***Formation procedures***

Prior permission to use a specific corporate name is required from the Ministry of Foreign Affairs (Secretaría de Relaciones Exteriores) for establishing a stock corporation in Mexico. No permit is needed for modifying its bylaws, unless the amendment involves either a change in its corporate name or substitution of a provision allowing the participation of foreigners for one prohibiting such participation. The authorization is reproduced in a notarial instrument, which represents the combined charter and bylaws.

The principal matters covered in the permit are the name and type of corporation. Upon incorporation, when foreign ownership of shares is permitted, a statement known as the Calvo Clause (Cláusula Calvo) is included; this clause states that any foreign shareholders must consider themselves as Mexican nationals with respect to their stock ownership and agree not to invoke the protection of their governments in matters connected with such ownership under penalty, in the case of noncompliance, of forfeiting their holdings to the Mexican state. In a few cases, specific authorization may be required from the Foreign Investment Commission, as indicated in Chapter 5.

The formation of a Mexican stock corporation usually takes an average of four weeks if no permit is required from the Foreign Investment Commission. Certain details of the initial shareholders are also included in the notarial instrument of incorporation, including the names and identification of founding shareholders and their Mexican Taxpayers' registration or foreign tax ID; the amounts of capital contributed by each and the terms for payment of any amounts due; the names of the initial officers (president, secretary and treasurer), members of the board of directors or sole administrator and inspector of accounts (statutory auditor—comisario), as well as the granting of power of attorney for the representatives acting on behalf of the stock corporation.

The charter and bylaws must be certified by a public notary and recorded in the Public Register of Commerce of the state where the corporate domicile is located. The stock corporation is considered to exist as from the date of the notarial instrument. Minimum details regarding each new corporation, but not its shareholders, must be filed with the Ministry of Finance (Secretaría de Hacienda y Crédito Público).

## ***Capital structure***

A Mexican corporation may never have less than two shareholders; there is no limit on the maximum number.

### *Minimum capital-authorized, issued, paid-in*

The minimum paid-in capital required is 50,000 pesos, of which at least 20 percent must be paid in cash at the time of incorporation. The authorized capital should be fully subscribed within one year. Additional capital stock cannot be issued until the outstanding shares are fully paid. Shares paid for with assets in kind must be held in the treasury of the corporation as restricted stock for two years. If at the end of the period the value of the assets received is 25 percent less than that at which they were received, the shareholder must pay in the difference to the stock corporation. A stock corporation may not acquire its own shares, except through a court judgment in order to pay the liabilities of the corporation, in which case the shares must be sold within three months or the capital stock must be reduced accordingly. There is an exception to the above-mentioned rule for publicly traded companies, which can hold their own shares in treasury for up to one year. If the treasury shares are not re-issued by the end of that term, they must be canceled and the capital stock reduced.

### *Par value/no-par-value*

The shares usually have a stated par value, although no-par-value shares are also allowed and have been used more frequently in recent years.

### *Types of share ownership*

All shares must be registered shares.

### *Classes of shares*

Mexican corporate law specifies that under no circumstances may one or more shareholders be excluded from participating in the profits. In the case of shares having limited voting rights, i.e., limited to extraordinary shareholders' meetings (referred to below), a cumulative dividend of not less than 5 percent per annum must be granted by law. The charter may provide that these shares will receive higher rates of dividends than the common shares. Debentures convertible into shares may also be issued.

Where a minimum percentage of the stock must be held by Mexican nationals, a separate series of shares must be issued that may not legally be owned by non-Mexicans, except for permanent immigrants in certain cases. A second series, usually with identical rights, may be freely subscribed.

### *Loans and debentures*

Stock corporations may issue mortgage obligations or unsecured debentures, which may be listed on the stock exchange for sale to the public, or may contract loans with or without guarantee, as desired.

### *Increases and decreases in capital*

Modifications of the minimum authorized capital stock are considered amendments to the charter of incorporation and, in some cases require permission from the Foreign Investment Commission. Existing shareholders have the preferential right to subscribe to any authorized increases in capital or to submit some of their shares for redemption if the capital is reduced, in proportion to the number of shares held by each. Reductions in minimum authorized capital must be published three times in the Official Gazette to provide protection for creditors. Shareholders may also vote to make additional capital contributions for which shares are not received, sometimes to absorb losses incurred or to require the payment of a premium by subscribers to new shares. Such share premium accounts can subsequently be distributed to the shareholders (in proportion to their shareholdings, rather than in proportion to their original payments of the premium), although this is rarely done before liquidation.

The provisions of the General Law of Mercantile Companies specifically authorize the capitalization of surplus arising from the revaluation of assets, as long as the revaluation surplus is based on an independent appraisal by professional appraisers recognized by the Securities and Exchange Commission and is shown on a balance sheet previously approved by the shareholders. If the revaluation surplus relates to investments in shares or commodities, it must be based on certified market quotations. However, such revaluation surpluses may not be in accordance with Mexican Financial Reporting Standards (See Chapter 12). Certain limitations on the amounts of revaluation surplus that can be capitalized are also imposed on corporations listed on the Mexican Stock Exchange.

### *Transferability of shares*

Transfers of registered shares are not valid until they are recorded in the share registry book kept by the stock corporation.

### *Liability of shareholders*

Shareholders are liable only for the amount of their subscribed capital. A seller of shares only partially paid in is jointly liable with the buyer for any unpaid balance for five years.

Relationship of shareholders, directors and officers

### *Conduct of the entity*

The shareholders assembled in a general meeting are the supreme authority of a corporation. A minority shareholder usually has no legal recourse against a legally taken decision of the majority. In this connection, the charters of corporations with substantial minority shareholders, such as those that are 49 percent owned by foreigners, often provide that resolutions in certain key specified areas, such as amendments to the charter, incurring substantial indebtedness, appointments of higher-level employees and their salaries, etc., may be validly approved only by, say, 60 percent of the total shares outstanding, or, if applicable, of the members of the board of directors.

The shareholders may elect either a sole administrator or a board of directors to manage the affairs of the stock corporation. The charter and bylaws will specify the powers and responsibilities of the administrator or board, as well as any specific acts that might require a resolution of the shareholders, such as, in some cases, disposition of real property or acceptance of substantial loans. A sole administrator is occasionally preferred during the organizational phase of a business, and the company elects a board of directors later. This should be provided for in the original charter in order to avoid the necessity of holding an extraordinary meeting of the shareholders and protocolization of the minutes of the corresponding meeting.

Directors are usually elected for one year or until replaced, and it is customary to elect alternate directors to facilitate having a quorum, particularly if one or more of the directors reside outside Mexico. Meetings of the board are usually held at the domicile of the corporation. The charter normally authorizes the board to name a general manager for the actual operation of the business of the corporation and should specify any powers or responsibilities that the board may not delegate.

### *Meetings*

Mexican law requires at least one annual general meeting of the shareholders and specifies that certain matters may be handled only at extraordinary meetings. Annual meetings must be held at the geographical area of the official domicile of the company within four months of the end of the year. Such meetings are held to approve the annual financial statements, decide on the distribution of the profits for the year and elect directors and the inspector of accounts (statutory auditor or comisario). Extraordinary meetings must be held to approve any modification of the charter and bylaws, mergers or issue of debentures. Other matters may be specifically reserved in the charter for such meetings, at which resolutions must be approved by more than 50 percent of the outstanding capital stock entitled to vote. The charter of incorporation may require a larger majority in special cases, as mentioned above. Each share represented at a meeting may have only one vote, and some classes of shares may be limited to voting only at extraordinary meetings. The required prior call for a meeting of shareholders may be omitted if 100 percent of the outstanding shares are present or represented.

### *Dividends*

Five percent of annual net profits must be set aside in a statutory legal reserve until its balance equals 20 percent of the capital stock. Dividends may be validly declared only by a meeting of shareholders and on the basis of a balance sheet that shows sufficient accumulated profits available for distribution. Accordingly, dividends cannot be declared until losses of prior years have been absorbed. If dividends are paid without fulfilling these conditions, the shareholders and the administrators who authorize the payments may be held jointly liable for the return of the funds to the corporation upon demand of a dissatisfied shareholder or creditor.

### ***Liquidation***

The charter should also specify the circumstances in which the corporation may be dissolved and the procedures for naming one or more liquidators and for carrying out a liquidation. The law includes as a cause for liquidation the accumulation of a deficit equal to more than two-thirds of the capital stock. Although the law provides no penalties if a corporation continues to operate in such a situation, an unpaid creditor or dissatisfied minority shareholder might bring court action to force the company to enter into liquidation.

Shareholders usually have equal rights in a liquidation, based on their paid-in contributions, although shares having limited voting rights must be redeemed before common shares. Shares may not be redeemed until all creditors are paid, although partial redemptions may be made if the agreement to make such a payment is published three times in the Official Gazette within a period of 30 days and if creditors do not object. The final liquidating balance sheet showing the net amount payable on each share must be so published before redemption can be completed.

For legal purposes, liquidators must retain the books and records of the company for a period of ten years.

### ***Books and records***

In addition to the accounting records mentioned under “Books and records” in Chapter 11, corporations are required to maintain bound books for minutes of meetings of shareholders and the board of directors, as well as a share registry book and capital stock variations book.

### ***Statutory audit***

All companies incorporated under Mexican law are required to appoint one or more inspectors of accounts (statutory auditors or comisarios), as described in “Audited financial statements” in Chapter 11, except for public companies whose shares are traded on the Mexican Stock Exchange. The latter must appoint a firm of auditors and must have an audit committee.

## ***Stock Corporation with variable capital***

### ***Capital structure***

The most common type of stock corporation is the stock corporation with variable capital (Sociedad Anónima de Capital Variable—S.A. de C.V.). This type of corporation can be organized with a minimum fixed capital (50,000 pesos) and further variable capital for any amount desired. Usually, an unlimited maximum capital stock is provided for most of these companies.

The procedures for the increase and decrease of the variable portion of the capital stock should be established in the charter. The law permits considerable latitude in this area. Although an extraordinary shareholders' meeting is generally required, a resolution of the board of directors or of an ordinary shareholders' meeting might be the only requirement. Since Mexican corporations may not hold their own shares, an arrangement providing minimum formalities for the issue of additional variable capital may prove to be a good substitute for treasury shares. However, whether it is stated in the charter or not, an increase in capital stock must first be offered to existing shareholders, who have the right to purchase the same proportion of the increase as they hold in the existing capital stock, before the increase can be offered to outsiders.

Capital increases of corporations having foreign investors, whether a majority or not, may require the approval of the Foreign Investment Commission, although, in accordance with the regulations under the Foreign Investment Law and the National Registry of Foreign Investment (Registro Nacional de Inversiones Extranjeras), discussed in Chapter 5, prior authorization is not required in the majority of cases.

### ***Other considerations***

Except as regards matters related to the variable portion of its capital stock, the S.A. de C.V. is identical to the Sociedad Anónima.

## ***Stock Corporation for the promotion of investment***

The SAPI was created in order to strengthen the minority shareholders' rights, allowing the issuance of much more flexible stock, and acknowledging value to shareholders agreements. The SAPI is increasing its popularity and it has been chosen in real estate and technology joint ventures. In all other respects this type of entity is identical to the *Sociedad Anónima*.

## ***Limited liability company***

In most ways the limited liability company (Sociedad de Responsabilidad Limitada—S. de R.L.) is similar to a corporation in actual operation. However, as an organization of individuals its bylaws can be drafted in such a way as to give it most of the characteristics of a partnership under the tax laws of foreign countries, except for unlimited liability.

### ***Formation procedures***

This form of organization requires the same prior authorization and registration as a Sociedad Anónima. Costs and time required for organization are essentially the same. The S. de R.L. may be organized by no less than 2 and with up to 50 persons (including corporations), with a minimum capital of 3,000 pesos. No shares may be issued, and investors participate in profits and vote at general meetings in proportion to their equity investment. Unanimous agreement may be required to transfer or increase the equity accounts or take in new investors, although the charter may reduce this requirement. In the case of transfers to a new investor, the existing investors have a prior right to acquire the capital account to be sold. Transfers to the heirs after an investor's death do not require the consent of the other owners unless the charter provides for dissolution of the company upon the death of any investor. Investors are liable only for the amount of their agreed contributions to the capital of the company, 50 percent of which must be paid in immediately.

### ***Relationship of investors and managers***

The investors may name one or more managers or administrators, or they may elect to operate the business without any centralized administration. In any event, the general meeting of investors, which is required to be held at least once a year, is the highest authority of the company and the only one that may authorize a distribution of profits. All investors have the right to vote at the meetings, with the votes being counted in proportion to the equity account of each.

### ***Liquidation***

The applicable rules are the same as those for a Mexican corporation.

### ***Books and records***

The requirements are the same as for a corporation, except that the limited liability company uses a registry book of the equity accounts of the investors in place of a share registry book.

### ***Board of Managers and Board of Examiners***

If the charter so prescribes, the investors may elect a board of managers entrusted with the administration of the company, as well as a board of examiners (Consejo de vigilancia), who carry out duties similar to those of the inspector of accounts (statutory auditor) of a corporation.

## ***Partnership***

The General Law of Mercantile Companies also provides for partnerships (Sociedades en Nombre Colectivo), as well as for partnerships with limited and unlimited liability partners (Sociedades en Comandita), but as a result of the unlimited liability of all or the general partners, as the case may be, these forms are not common. These forms of business organization have most of the attributes associated with the U.S. concept of a partnership because of the unlimited liability of the partners so designated. Partnerships require at least two partners.

### ***Civil partnership***

Professional practitioners are usually organized as a civil partnership (Sociedad Civil—S.C.), which resembles in many ways the limited liability partnership (S. de R.L.) mentioned above. The managing partners have unlimited liability, while other partners' liability is limited to the value of their contributions (2704 Civil Code). This form, is also used by some non-profit entities such as educational establishments. By definition, these entities should not engage in commercial operations (any activities involving commercial speculation). The transferability of rights, as well as the admission of new partners, is subject to approval of all the partners.

In general, a civil partnership is taxable in the same manner as a corporation. However, civil partnerships involved in educational, cultural, and other activities specifically listed in the Mexican income tax law are classified as nontaxable entities. Distributions of interim profits to the partners are treated as deductible salaries (fully deductible by the S.C.), and distributions of retained earnings are treated as corporate dividends.

### ***Joint venture contract***

The joint venture contract (Asociación en Participación—A. en P.) is one whereby a person grants a participation in the profits and losses of a specific venture or business to others who provide property or services. Such a contract has no legal personality, i.e., a separate legal entity is not created, and operations are conducted in the name of the active managing joint venturer (asociante). The asociante is the only one with any direct liability to third parties. The silent partner (asociado) has no direct relationship with third parties. The tax treatment applicable to the Asociación en Participación is essentially the same treatment as regular corporations solely for tax purposes. Please see Chapter 19 for additional tax aspects of the joint venture contract.

Legal requirements for a valid joint venture contract are minimal. Basically, the contract should identify the contracting parties; specify the contributions and obligations of each under the contract, the purpose of the venture and the life of the contract; and establish the method for distributing profits and losses.

### ***Formation procedures***

A joint venture contract need not to be registered, although a signed written agreement must exist.

### ***Capital structure***

There are no requirements as to minimum capital, and there are no shares. It is often stipulated that foreign venturers should receive a maximum of 49 percent of the profits of the venture, in which case attorneys believe that neither approval nor registration with the Foreign Investment Commission is required. However, legal advice is necessary to comply with requirements, if applicable. Higher percentages of participation would require prior approval of the Commission.

### ***Relationship of venturers and managers***

Full responsibility for managing the venture rests with the asociante, although some contracts for large ventures, often in the construction field, provide for the establishment of a technical committee with representation of the asociados (silent partners) as well and with responsibilities quite similar to those of the board of directors of a corporation. In such cases a representative of the managing venturer would be in charge of the committee and the venture.

### ***Liquidation***

The procedures for liquidation that are used are those of a partnership, except that, unless the contract contains other provisions, a joint venture contract is considered as terminated upon the death of any of the venturers.

### ***Books and records***

Managing venturers must keep accounting records of the operations of the joint venture, separate from their other activities. Tax returns must also be filed for the joint venture operations separately from those of the asociante.

## ***Branch of a foreign corporation***

A foreign corporation can be registered to operate in Mexico, with full access to the local courts, through a branch office (Sucursal de sociedad extranjera) after complying with certain formalities and obtaining the approval of the Mexican government through the Ministry of Economy.

The Foreign Investment Commission has expressed a willingness to authorize Mexican branches of nonresident companies, except in those activities where foreign investment is restricted. Please refer to Chapter 5.

A principal advantage to setting up a branch office in Mexico is establishing the presence of the foreign company in Mexico without the necessity of having a local board of directors or being subject to the provision of the General Law of Mercantile Companies applicable to Mexican companies. However, a disadvantage of this form of organization is that because a branch has no independent legal status in Mexico, the parent company will be liable for any claims arising out of activities performed by the branch office.

## ***Sole proprietorship***

As in many Western countries, the sole proprietorship (comerciante/persona física) is a very popular form of organization for small businesses. However, the element of unlimited liability generally inhibits the use of this form of organization for large operations, particularly in view of the substantial amount of severance pay that may accrue in favor of employees. Moreover, resident aliens may engage in business activities only if their immigration status is that of permanent resident (inmigrado). However, in some instances it has been concluded that non/resident individuals with a taxable permanent establishment might operate under the same principles applicable to branches of foreign entities.

## ***Nonprofit organizations***

Charitable and other nonprofit organizations take the form of a civil association (Asociación Civil—A.C.), whose charter prohibits the distribution of profits to its members.



# Chapter 10

## Labor relations and social security

### **Investor considerations**

- Labor is readily available in most regions of Mexico, with internationally competitive levels of efficiency.
- Basic minimum wage is low; in 2009 it was increased 4.20 percent.
- Fringe benefits, including labor law benefits, are significant relative to total payroll costs.
- Unionization and collective labor contracts are common in both capital- and labor-intensive industrial enterprises.
- Turnover is moderate to high, especially in the highly competitive labor-intensive industries.
- Profit sharing is mandatory for most business concerns with employees and amounts to 10 percent of adjusted taxable income.
- Social security system is in effect for all industrial areas and many agricultural zones.
- Social security premiums are payable by both the employer and the employee.
- Employment of foreign nationals is generally limited to 10 percent of the total workforce; certain exceptions apply when a free-trade agreement is in effect. Work visas are required.

10

### **Labor relations**

#### **Availability of labor**

Because of rapid population growth, unskilled and semiskilled labor is readily available throughout Mexico. With the rapid expansion of labor-intensive processing plants (*maquiladoras*), a pool of skilled labor is also available, especially in the northern border areas. Most companies find that the skills of the younger members of this pool can easily be upgraded through adequate training programs, particularly in the less-industrialized areas. Skilled technical and professional personnel and well-trained office workers can usually be found, or less-experienced personnel can be trained for more demanding positions.

### ***Employer/employee relations***

Comprehensive labor legislation has been in effect for many years. The federal labor law is clearly intended to favor the employee in all relations with an employer, as it contains the principle, previously sustained by the labor authorities and the Supreme Court, that in case of controversy in the interpretation of the law, the treatment most favorable to the employee will always take precedence. Nevertheless, in most cases companies are able to employ and keep satisfactory employees at all levels.

### ***Unions***

The law provides that 20 or more employees may form a labor union to bargain collectively with the employer regarding the terms of their employment. Such labor unions are formed in many cases, and collective labor contracts are executed in the case of industrial enterprises. Contracts usually amplify or add to the rights enjoyed by the workers under the federal labor law or the social security law and are subject to renegotiation at least every two years. The labor law provides that an application for review of the daily-rate cash wages shall be made at least thirty days before the end of one year following execution, review or extension of the collective labor contract. The contract clauses regarding salaries and other benefits may be reopened after one year.

Labor unions are particularly strong in the petroleum, mining, education, entertainment, textile, restaurant, telephone, rubber, sugar, automotive and newspaper industries.

Labor unions have traditionally used the threat of a strike during the negotiation process to exert pressure on management, but negotiations are usually concluded before reaching the stage where the employees actually strike. The Labor Ministry is empowered to mediate and rule on labor disputes and to impose sanctions on unions or employers for labor law infringements. Additionally, and in an effort to end a long tradition of irregularities in some unions, the Mexican government has taken steps to avoid abuses of power and to limit the unions' activities to their intended purpose of employee protection and welfare.

### ***Managerial employees***

Confidential employees (i.e., those in positions of trust) are those who exercise the functions of management, supervision, inspection, and auditing when these functions are of a general nature.

The principal provisions that relate to confidential employees are that the employer is not required to reinstate them in their jobs in case of unjustified dismissal, they are not entitled to belong to a union, and they are not entitled to vote in strike proceedings.

### ***Employee training programs***

Mexican labor law requires all employers to provide their employees with a minimum of training, and for this purpose requires the formation of training committees composed of members of management and of the workforce. The law does not establish the minimum training by number of hours or days but states that the training should allow workers to improve their skills, prepare them for higher positions that may become available, improve their productivity and general welfare, and minimize work-related accidents. All trades and industries should participate and provide minimum training and should submit their programs to the Labor Ministry. Training may also be provided externally through institutions registered for this purpose. Training programs are not directly subsidized by government funds; however, the employer is allowed a corporate tax deduction for program costs and expenses. Entities engaged in the high-technology industries are the employers participating most actively in training programs.

### ***Workers' councils***

Except in relatively isolated cases where the government has taken over an industry (principally, the oil industry and electric utilities) there has been relatively limited demand for greater labor participation in management, although some collective labor contracts do contain provisions requiring union agreement with some decisions.

### ***Profit sharing***

Since 1963 practically all businesses with employees, whether organized as sole proprietorships, partnerships or corporations, have been required to distribute a portion of annual profits among all employees, except the principal director.

The employees' right to share in the profits of a concern does not give them the right to intervene in the administration of the concern.

### ***Calculation of amount of profit sharing payable***

Employees are entitled to receive as their share of their employer's profits an amount equal to 10 percent of adjusted taxable income, initially determined in accordance with the income tax law, with some adjustments. This is applicable in all cases, except for isolated situations, referred to below, in which the labor law establishes a limitation equal to one month's salary.

The base for profit sharing (adjusted taxable income) is defined in the current income tax law, as discussed in Appendix III. In cases where a net taxable income figure is not computed for income tax purposes (e.g., special regime), taxable income for profit sharing will be the theoretical profit that corresponds to the tax paid by such businesses.

In the case of entities organized as a Sociedad Civil, whose income is derived exclusively from personal services, such as professional partnerships, the amount of profit sharing for each employee may not exceed one month's salary. The same limitation applies in the case of employees whose duties relate to collecting loans and interest thereon or who manage rental property.

### *Method of distribution*

Distribution of the employees' share in the profits must be made within five months after the year-end. The employer is required to make a copy of the company's tax return available to the employees so that they may exercise their right to object to it. Any objection by employees to the tax return is communicated to the Revenue authorities, which make the final decision; this cannot be contested by the employees. In practice, only a relatively small number of objections are made by employees. However, labor law provides that noncompliance with the provisions of the law establishing profit sharing is grounds for a valid strike.

The portion of the company's profit that is distributed among its employees is divided into two equal parts, the first of which is distributed among the employees in accordance with the number of days worked during the year, and the second in accordance with the salaries earned by each employee (with the exception of the principal director) and which is limited for this purpose to 120 percent of the salary of the highest-paid non-confidential employee.

### *Persons subject to or exempt from profit sharing*

All individuals, companies or economic units without legal personality that have employees are required to distribute a portion of their profits to the employees. Taxpayers exempted from income tax will consider as the base for profit sharing the difference between their gross receipts and the expenses as shown by the return that must be filed for income tax purposes. Taxpayers that are entitled to statutory reductions of their income tax will use as the base for profit sharing their tax profit computed as in the case of a taxpayer that is not entitled to these reductions. Profit sharing is not applicable to the following.

1. Newly established concerns during the first year.
2. Newly established concerns that manufacture a new product during the first two years.
3. Mining and similar concerns during the exploration period.
4. Public and private welfare institutions recognized by law, and
5. Enterprises whose capital and gross income are less than a specified amount established by the Labor Department.

## **Working conditions**

### ***Wages and salaries***

Minimum daily wages are established for separate regions of the country by a National Minimum Wage Committee, working through local committees made up of representatives of government, organized labor and private industry. Formerly, new minimum wages were approved every year, but in the past, as a result of the relatively high rate of inflation, on occasion minimum wages were adjusted more than once a year. In recent years the annual increases have not exceeded the inflation rates as measured by the National Consumer Price Index. The variation in wage rates in the different regions has been considerably reduced, and only three different minimum rates are now in effect, varying from a low of 54.47 pesos per day in some regions to 57.46 pesos per day in Mexico City and in some regions near the U.S. border.

The Minimum Wage Committees have also established professional minimum wage rates for an expanding number of semiskilled and skilled jobs and office jobs. The committee for Mexico City fixed rates for a total of 84 different positions for 2010, including, for example, those shown in Table VII.

## VII—Examples of Professional Daily Minimum Wages, 2010

(all amounts are in Mexican Pesos and applicable in Mexico City)

Bricklayer	83.74
Truck driver	85.69
Drugstore clerk	72.87
Blacksmith	80.66
Receptionist	74.83
Shoe maker	75.20

Double time must be paid for the first nine hours of overtime each week and triple pay if unusual circumstances require more than nine extra hours (the legal maximum) in any week. Triple pay is also provided for work on the seven legal holidays. Sunday work entitles a worker to a premium of 25 percent of regular pay, even if the worker receives a day off during the week. A Christmas bonus equivalent to 15 days' pay must be paid to all employees on or before December 20 each year.

### *Fringe benefits*

Collective labor contracts often provide for benefits over and above those stipulated by the federal labor law and other legislation with regard to early retirement, number of holidays, length of vacations, and a wide range of benefits that are not taxable to employees, such as contributions to general savings funds. Many taxpayers grant coupons for meals and groceries, which under certain conditions are not taxable to the employees.

Some contracts still oblige the employer to pay the employees' part of the social security contributions or even the personal income tax, although the latter does not represent deductible expenses for the employer and is becoming less frequent. Many companies provide major medical and group life insurance, particularly for white-collar employees and executives. However, the provisions of the income tax law described in Chapter 15 should be reviewed before benefits are granted to only part of a company's workforce.

Fringe benefits, including labor law benefits, are significant relative to total payroll costs.

### *Hours worked*

The maximum work week is six eight-hour shifts, although in practice a 40-hour week is often in effect, particularly in offices. Regular time for the night shift is seven hours and for a split shift seven and one-half hours.

### ***Paid holidays and vacations***

The legal holidays are listed in Chapter 1 under “Hints for the business visitor;” four or five more are often granted to office employees and under collective labor contracts. The present law requires that a vacation of six working days be granted after the first year of service, with an additional two days for each of the next three subsequent years, with an additional two days for every five years of service after the fourth year. A premium of 25 percent of the regular salary must also be paid during vacations. Nonunion employees are commonly granted a two-week vacation period.

### ***Equal opportunities***

Workers are categorized as unionized and nonunionized employees. In the case of entities with no unions, the distinction commonly made is between confidential employees (those conducting managerial activities, as discussed above) and regular employees.

Under the Mexican Constitution no individual may be discriminated against on the basis of race, religion or sex. However, employers have traditionally enjoyed the liberty to hire or dismiss confidential employees at their discretion, and, in the case of unionized employees, companies commonly fill vacancies in accordance with the collective labor contract but can also hire and dismiss unionized employees as required (however, see “Termination of employment” below).

### ***Health and safety***

All employers must meet minimum health and safety requirements on their premises. For this purpose the labor law provides for the formation of health and security committees made up of members of management and the workforce. The committees, together with labor authorities, have the responsibility to analyze and investigate causes of work-related accidents and illnesses and to develop safety practices and procedures, to communicate them and to oversee compliance.

Both the Social Security and the labor authorities are empowered to issue safety regulations and to inspect the employers’ premises in order to evaluate compliance with minimum work safety standards and special standards developed in accordance with the type of industry or activity and to impose sanctions for noncompliance.

Further, Mexican Federal Labor Law provides that all business activities and ventures have the obligation to create five employer-employee committees so as to regulate and control the labor conditions of the labor relationship. These committees consist of a mixed number of members from the workforce and management and are as follows:

- a) Security and Hygiene Committee.
- b) Training and Teaching Committee.
- c) Committee in charge of drafting the Internal Labor Regulations.
- d) Committee in charge of elaborating the Seniority Chart.
- e) Committee in charge of elaborating the Profit sharing project.

### ***Termination of employment***

An employer in Mexico may dismiss an employee without liability other than the seniority premium referred to below only if there is a cause for the dismissal. The Federal Labor Law enumerates specific kinds of conduct that are cause for dismissal: [1] use of false documentation to secure employment; [2] dishonest or violent behavior on the job; [3] dishonest or violent behavior against co-workers that disrupts work discipline; [4] threatening, insulting, or abusing the employer or his or her family, unless provoked or acting in self-defense; [5] intentionally damaging the employer's property; [6] negligently causing serious damage to the employer's property; [7] carelessly threatening work-place safety; [8] immoral behavior in the workplace; [9] disclosure of trade secrets or confidential information; [10] more than three unjustified absences in a thirty-day period; [11] disobeying the employer without justification; [12] failure to follow safety procedures; [13] reporting to work under the influence of alcohol or nonprescription drugs; [14] a prison sentence; or [15] commission of other acts of similar severity to those described above.

An employee may appeal his or her discharge within two months of the dismissal to the Conciliation and Arbitration Board, an administrative agency charged with resolving labor disputes. The employer has the burden of showing that the employee engaged in conduct described above. If the employer fails to meet this burden, the employee can request either [1] reinstatement to his or her position, or [2] a constitutional indemnification equivalent to three months full salary, including premiums, bonuses, commissions, etc., and any fringe benefits. In order to avoid such reinstatement employers usually pay the severance compensation discussed below. The employee also has the right to receive back pay with no offset for interim earnings.

The labor law specifies that at the date of termination of employment, the reasons for dismissal must be presented to the employee in writing. It also provides that those employees with more than 20 years' service can be separated only for very serious cause.

The right to reinstatement is not applicable in the cases of certain employees, such as those considered as occupying positions of trust or who have less than one year of service with the company. Severance compensation in these cases may be payable at the rate of three months' salary plus 20 days' wages for each year of service if the work contract is for an indefinite period (otherwise, the amount is different), and it may include payment of salary from the date of unjustified dismissal to the day on which these indemnities are paid. In practice, a similar amount is often paid to unsatisfactory employees as a bonus in exchange for voluntary resignation.

### *Seniority premiums*

Permanent employees are granted the right under the 1970 law to receive seniority premiums equal to 12 days' salary for each year of service when separated with or without just cause. Such compensation is also payable upon the death of an employee to his or her beneficiaries. To compute such compensation the daily salary may not be less than the legal minimum wage; the maximum daily salary for this purpose is twice the minimum wage. The seniority premiums are also payable to employees who retire voluntarily if they have at least 15 years of service with the employer. If voluntary retirements exceed 10 percent of the total number of employees in any year, the company may defer payment of the excess until the following year. The law states that this special compensation based on length of service is payable to employees or their beneficiaries regardless of any other benefits to which they may be entitled. Decisions of the Supreme Court have established firm precedents for interpreting the provisions of the labor law for calculating the premiums in the following situations.

1. Voluntary retirement:

The right to the premium is vested in employees once they have completed a minimum of 15 years of service, including the years prior to May 1970, and the premium should be paid for the entire period.

2. Death:

The premium is payable to the heirs of an employee who dies from whatever cause, regardless of the number of years of employment by the company. Service prior to 1970 must be included in calculating the premium.

3. Separation for any other reason:

A minimum number of years of service with a company is not required, but the premiums will be payable only for the period after May 1970.

### *Reserves for termination pay*

It is now clear that in most cases (except voluntary retirements of employees with less than 15 years' service) employers must pay seniority premiums to their employees when they leave, probably covering their entire period of employment. Accordingly, most Mexican companies will find it necessary to record provisions for seniority premiums currently in order to be able to present their financial statements in accordance with Mexican financial reporting standards, although provisions for such reserves are not deductible for tax purposes, unless funded as described for pension funds below. In accordance with financial reporting standards, companies should set up a reserve for other severance compensation that might be payable to all employees, based on actuarial studies.

## ***Pensions***

The average age of employees of most companies in Mexico is relatively low, particularly in the case of new companies and those that have expanded recently, and pension plans have not yet become a major factor in obtaining or retaining employees. Nevertheless, old age is not considered a justifiable cause for dismissal, and many companies follow the practice of paying full severance benefits to employees who reach retirement age.

As noted below, favorable tax treatment is accorded to funded pension plans, but, perhaps because of the high level of interest rates for loan funds, few companies have as yet been willing to tie up capital in pension funds to cover the needs of the rather distant future. In these circumstances Mexican insurance companies have been offering insured plans that also provide cash surrender values available for indemnities to employees dismissed before reaching retirement age. Premiums for this type of insurance are high, but if the plan covers all or major groups of employees, the premiums are deductible for income tax purposes with certain requirements.

Estimated provisions are not deductible for income tax purposes. However, contributions to a funded pension plan may be deductible if certain requirements are fulfilled. The principal ones are that the funds must be invested through an irrevocable trust in securities approved by the National Securities Commission or in houses to workers, with 30 percent in government securities; contributions to the fund must be based on a report of a Mexican actuary and the plan must cover all employees.

## ***Foreign workers***

If any foreign national performs professional activities on Mexican territory, he must obtain a work visa, called FM3, issued by the Mexican Immigration Authorities. Depending on the foreigner's activities, it will be necessary to carry out a specific procedure with the Immigration Authorities.

The Mexican Labor Law establishes that in all companies 90% of employees should be Mexican citizens. In consequence only 10% of foreigners may be employed in Mexican companies. This rule is not applicable to foreign nationals employed as Directors, Administrators and General Managers in Mexico.

## ***Social security***

### ***Social security system***

The Mexican Social Security Institute (IMSS) was established in 1942, and the social security system is in effect in all industrial areas and agricultural zones throughout Mexico. In these areas the employer's statutory obligations in connection with occupational risks are covered by payments of social security premiums.

The Institute provides for employees' and their dependents' medical attention, including hospitalization, and limited unemployment compensation in cases of illness and maternity, occupational disease and accidents, in addition to disability and old-age pensions. A separate social security system operates for employees of the government and its agencies.

## **Coverage**

The IMSS system is mandatory in regard to all nongovernment employees throughout the country. Special rules cover self-employed persons, domestic servants and some others. All employers having at least one employee, including nonprofit institutions and others that might be tax exempt, are required to register with the IMSS and pay its premiums. Foreign employees of Mexican companies working in Mexico are subject to the social security system on an obligatory basis.

## **Contributions**

Social security contributions/premiums are incurred by both the employer and the employee (through withholding) and remitted to the social security authorities every month. Premiums are determined as a percentage of each employee's wages, and the computation differs depending on the following categories.

- Sickness and maternity.
- Life and disability.
- Day-care centers and social benefits.
- Retirement Savings System (SAR) and old age.
- Occupational risks.

The percentage contributions for each category (except for occupational risks) and maximum contributions are shown in Appendix XI.

The premium for occupational risks, paid entirely by the employer, is a percentage of the total earnings base. The applicable percentage varies, depending on the risk class to which a company is assigned. Table VIII shows the average percentage applicable to each risk class in the case of a newly incorporated entity.

All employees of a company located in the same city or other social security jurisdiction are classified in the same group, regardless of the type of work each performs. The percentages shown can be lowered or raised somewhat, depending on the safety equipment installed and the actual frequency and costs of claims made by the employees of a particular company (actual experience).

In the second month of the year the corresponding percentage rates will be self-determined, based on prescribed procedures and according to actual experience under the regulations of the Social Security law.

Employers are also required to pay 1 percent of covered payrolls as an additional premium to cover the cost of maintaining day-care centers for children of working mothers and social benefits.

On the basis of the above percentages and those described in Appendix XI, in 2009 a company classified in risk class III, paying just minimum salaries, would currently incur social security premiums, including SAR, aggregating approximately 34.59 percent of its total payroll for the first year. Other cases would be subject to the wage ceiling computations in Appendix XI.

## VIII--Premiums for Occupational Risks

<b>Risk Class</b>	<b>Includes</b>	<b>Average additional percentages*</b>
I	Commerce, the professions, administrative or sales offices (see below)	0.54355
II	Some commerce, warehouses, very light manufacturing, laboratories	1.13065
III	Light, manufacturing, textiles, etc.	2.5984
IV	High-risk industry using metals, chemicals, heat	4.65325
V	Maximum risk, including construction, mining, heavy industry	7.58875

\*These percentages may decrease or increase 1 percentage point (from 0.50 to 15 percentage points) in subsequent years.

### **Benefits**

#### *Sickness and disability*

The Social Security Institute provides medical and hospital service throughout the country, alongside private hospitals and many physicians in private practice. It maintains modern hospitals and clinics to give medical attention to covered employees and provides without charge medicines, etc., prescribed by its doctors. If employees are absent from work for more than three days as a result of a nonprofessional illness, job-related accident or illness or maternity, the Institute will pay 60 to 100 percent of their regular salary during their absence; the employer is relieved of the obligation to pay the salary, although in some cases employers pay the difference. A guaranteed minimum salary is payable in the case of permanent disability, and benefits to heirs are provided in case of death.

#### *Pensions*

Old-age pensions, as well as those for disability, have been increased in recent years. The pensions are normally payable from age 65 if the person has paid social security premiums for the required minimum of 1,250 weeks. Early retirement at reduced rates of pension can be taken from age 60. There are minimum guaranty pensions equal to the monthly minimum salaries.

Currently employees can qualify for one of two different pensions. Employees who began working after July 1, 1997 receive their pension through AFORE; employees who started working before that date can receive their pensions through AFORE or through the traditional system.

### ***Retirement Savings System (SAR) and Old Age***

In order to supplement retirement pensions under the regular social security system, which have been deemed insufficient to provide adequate retirement benefits, a Retirement Savings System has been established. The employer's contribution per employee is 2 percent of salary, with a wage ceiling of 25 times the minimum wage for Mexico City. The Old Age system includes an additional contribution per employee of 3.15 percent of salary. These employer contributions will be credited to individual employees' restricted interest-bearing bank accounts established specifically for this purpose. The funds so accumulated over the years may be withdrawn, under certain rules, only upon retirement or unemployment due to disability and will be partially or totally exempt upon withdrawal, together with any other retirement payments received from the employer, following the general rule for taxation of pensions payments (i.e., pensions are taxable only to the extent that they exceed nine times the minimum wage). Employees may elect a company authorized to manage the fund (Individual account) for the Retirement Savings System (*Administradora de Fondos para el Retiro—AFORE*).

### ***Totalization agreements***

Except for Spain and Canada, Mexico has not subscribed to totalization agreements with other countries. Additionally, whenever an employer sends an employee overseas (for training, exchange programs, scholarship programs, etc.), the Mexican employer is still required to cover the assignees' medical expenses and to not suspend them from any pension or other benefit programs in which they have a vested right.

### ***Housing***

On May 1, 1972 the National Workers' Housing Fund Institute (INFONAVIT) was inaugurated under the terms of amendments to the federal labor law and a law establishing the Institute.

### ***Obligations of employers***

The Mexican Constitution provides that all agricultural, industrial, mining, and other enterprises of whatever nature are required to provide adequate housing for their employees; this obligation must be fulfilled by means of contributions in the name of the individual employee. In accordance with the law, employers are required to contribute to the Institute amounts equal to 5 percent of the earnings of their employees, calculated on the same basis as for social security purposes.

Foreign employees of Mexican companies working in Mexico are also entitled to the housing contributions.

The contributions paid by employers represent social welfare benefits (previsión social). Accordingly, they are deductible expenses for income tax purposes of the employers. In accordance with Article 36 of the law establishing the Institute, deposits in the names of employees are exempt from all taxation.

Employers are required to register themselves and their employees with the Institute under rules issued by the latter. The mechanics to provide housing, consists in granting loans to employees through specific selection procedures in order that they can acquire a home. Employers are also responsible for making such deductions from the salaries of employees who receive housing loans, including those earning minimum wages, as may be required by the Institute to repay the loans.

Enterprises must pay the 5 percent contribution in respect of all employees as long as they are employed, even if they have already received a loan from the Institute or if they reside in quarters rented to them by the employer.

### ***Benefits to employees***

The entire amount of the 5 percent housing contribution for each employee is deposited in an interest-bearing bank account in the employee's name. Employees have the following rights.

1. The employee may use these funds to build, buy or repair a home or to repay an existing debt incurred for such purposes.
2. The entire net balance accumulated in the name of an employee (after deducting amounts so utilized) will be paid to the employee in the case of total disability or retirement or to the employee's heirs upon death.

### ***National Workers' Housing Fund Institute (INFONAVIT)***

INFONAVIT was established as an independent social service organization with legal personality and control of its own assets. Control of the Institute is vested in a general assembly of 45 members, 15 named by the executive branch of the federal government, 15 by national labor organizations and 15 by national employers' organizations. In addition to having full authority over the policies and operations of INFONAVIT, the general assembly also elects the board of directors, consisting of five members, each representing government, labor and employers, and the general director, who is proposed by the President of Mexico.



# Chapter 11

## Audit requirements and practices

### ***Investor considerations***

- Statutory audits are required for all private Mexican corporations. In public listed companies, this function is performed by the Audit Committee.
- Larger companies are required to file tax compliance audit reports electronically with the tax authorities.
- Accounting profession is mature and well organized.
- Auditing standards are comparable to those in the United States and other developed countries.

### ***Statutory requirements***

#### ***Books and records***

The Mexican Commercial Code and income tax law provide that certain summary accounting records must be contained in bound books. When mechanized or computerized accounting systems are in use, the individual sheets used for the records mentioned below must be bound after they are used.

Loose-leaf or any other type of auxiliary records may be maintained. Such principal and auxiliary records as may be necessary to record clearly the transactions of the company must be written up in pesos and in the Spanish language and must be kept at the official domicile of the company, but there is no prohibition against records also being expressed in another currency or language. These requirements apply to all businesses described in Chapter 9.

By law, all fiscal years must coincide with the calendar year.

### ***Audited financial statements***

All private companies incorporated under Mexican law (sociedades anónimas) are required to appoint one or more statutory auditors (comisarios). The statutory auditors are representatives of the shareholders, and their principal function is to exercise vigilance on behalf of the owners of the business over the records of the company's transactions. Statutory auditors must be elected by the shareholders in general meeting and may not be employees of the company or of subsidiary or parent companies, or related, within certain limits, to the individuals entrusted with the management of the business.

Shareholders owning 25 percent or more of the shares are entitled to elect a separate statutory auditor, although the charter of incorporation may grant this right to holders of smaller percentages. The statutory auditors attend directors' meetings and have the right to speak but not to vote; they report to the shareholders on the annual financial statements; and they may issue calls for shareholders' meetings.

The statutory auditors' report must include, as a minimum, their opinion as to whether (1) the accounting and reporting policies followed by the company are appropriate and adequate in the circumstances and have been consistently applied and (2) the information presented by management gives a true and adequate picture of the company's financial position and operating results.

Statutory auditors need not be public accountants. However, when a company has independent auditors, a member of the auditing firm frequently serves as statutory auditor. This is very common in the case of subsidiaries of foreign companies. In other cases statutory auditors who are not members of the auditing firm frequently cite the independent auditors' reports as the basis of their reports. When public accountants are appointed as statutory auditors, they usually insist on carrying out a normal audit in accordance with generally accepted auditing standards as described below, although this is not specifically required. In general, local as well as foreign banks are requesting audited financial statements more frequently as a normal requirement before granting substantial lines of credit, with the result that full-scope examinations by independent auditors are becoming increasingly common.

Business taxpayers meeting certain size criteria (see Chapter 14) or belonging to a group that as a whole meets these criteria must file a tax-compliance audit report every year with the Federal Tax Audit Department, a dependency of the Ministry of Finance. This report consists of audited financial statements and detailed additional schedules, together with a report by the auditor stating that no irregularities were observed in respect of the taxpayer's compliance with its federal tax liabilities. These reports must be filed electronically. The auditor for this purpose must be a Mexican public accountant registered with the tax authorities. When the company has independent auditors, a member of the auditing firm usually renders this service. From 2008 onwards, the amount of detailed information to be filed, and the auditor's responsibility in connection therewith, have been increased significantly.

All companies listed on the Mexican Stock Exchange are required to submit annual consolidated financial statements with the opinion of a Mexican public accountant. Commencing in the year ending December 31, 2012, these financial statements must be prepared in conformity with International Financial Reporting Standards (IFRS) and cover three years. In addition, financial institutions and insurance companies must file audited financial statements with the appropriate regulatory agency.

PricewaterhouseCoopers' highly trained staff is in a position to render any or all of the audit services described above and to assist investors in every phase of the establishment and operation of a business enterprise in Mexico (see Chapter 25).

### **Accounting profession**

The Mexican accounting profession is mature, independent, well organized, and well regarded by the business community. Its governing body is the Mexican Institute of Public Accountants (IMCP), which is a federation of state and other local associations of registered public accountants.

The title of public accountant (*contador público*) is a degree conferred by Mexican universities on graduates who have completed the required four to five years of specialized college-level studies and certain other requirements. The degree, which entitles the public accountant to use the initials C.P. before his or her name, must be registered at the licensing office (*Dirección General de Profesiones*) of the federal Ministry of Education if the C.P. wishes to have the right to practice as such. In order to practice before the tax authorities, accountants must also be members of their local association of public accountants. In addition, the IMCP issues Professional Certificates to C.P.s meeting certain experience and continuing education requirements, entitling them to use the designation C.P.C. (*contador público certificado*). The total membership of the IMCP in May 2009 was approximately 20,000, of whom probably the majority were in public practice.

Mexican public accounting firms vary in size from the offices of individual practitioners to firms with professional staffs of well over 1,000, one-half of whom on average are public accountants. All of the national firms in the United States have arrangements with associated firms in Mexico or are represented by Mexican firms. Many other U.S. and foreign firms are also represented on a permanent basis by local public accountants. The larger firms provide nearly the same range of services as in the United States and other industrialized countries, including specialized tax services and management advisory services, and they usually have offices in several Mexican cities. Some of the smaller firms specialize in bookkeeping work for numerous clients.

The Mexican Institute of Public Accountants is an independent nongovernmental professional association, representing the overwhelming majority of public accountants. Through its standing committees the IMCP formulates auditing standards and rules of ethics for Mexico. Until May 31, 2004, the Institute also formulated accounting principles for Mexico. However, on June 1, 2004, this responsibility was taken over by the Mexican Financial Reporting Standards Board (CINIF, for its initials in Spanish) (See Chapter 12).

Although the Institute does not maintain a large permanent staff and works through the members of the profession who serve as its officers and on its committees, it has been very active in the preparation of statements formalizing generally accepted principles and standards. The IMCP was a founding member of the International Accounting Standards Committee, which has now been replaced by the International Accounting Standards Board.

### ***Auditing standards***

Generally accepted auditing standards applicable in Mexico closely parallel those in effect in the United States and are contained in the statements issued by the Auditing Standards and Procedures Board of the IMCP (Comisión de Normas y Procedimientos de Auditoría del Instituto Mexicano de Contadores Públicos, A.C., Tabachines 44, Bosques de las Lomas, 11700 México, D.F.). A translation of the standard short-form report of public accountants in use in Mexico is given below.

#### ***To the Stockholders of Mexican Company, S.A.***

We have audited the balance sheets of Mexican Company, S.A. as of December 31, 2009 and 2008, and the related statements of income, of changes in stockholders' equity and of cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and that they were prepared in accordance with Mexican Financial Reporting Standards. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of Mexican Company, S.A. at December 31, 2009 and 2008, and the results of its operations, the changes in its stockholders' equity and its cash flows for the years then ended, in conformity with Mexican Financial Reporting Standards.

Financial statements presented usually cover two years. In such cases, the opinion must cover both years presented, as shown in the standard three-paragraph report shown above.

The wording shown in the above standard audit report would be appropriately modified to reflect any of the following circumstances: a limitation on the scope of the examination, a departure from generally accepted accounting principles, the existence of a material uncertainty affecting the financial statements, inconsistency in the application of accounting principles, or the fact that the auditor was not independent.

# Chapter 12

## Accounting principles and practices

### ***Investor considerations***

- Basic financial statements usually cover two years.
- In general, conformity between accounting and tax treatment of income and expense items is not required.
- Until December 31, 2007 financial statements had to be comprehensively restated to reflect the effects of inflation.
- In most other respects Mexican accounting principles are substantially similar to U.S. principles.
- Public companies transitioning to IFRS

### ***Accounting principles***

Until May 31, 2004, the Mexican Institute of Public Accountants (IMCP), through its Accounting Principles Board, issued a series of formal statements on generally accepted accounting principles, which were, in substance, generally similar to those followed in the United States, except in the area of accounting for inflation which is discussed below. Generally speaking, the Mexican statements were less specific and detailed than their U.S. counterparts, and some significant areas were not covered, for example, employee share and stock options plans, specialized industry practices, real estate sales, and off-balance-sheet financing. From time to time the Accounting Principles Board also issued circulars containing interpretations of various matters.

Beginning June 1, 2004, the Mexican Financial Reporting Standards Board (CINIF, for its initials in Spanish), assumed the responsibility for setting accounting and reporting standards in Mexico. In compliance with this responsibility and after due exposures, the CINIF has issued a large number of Mexican Financial Reporting Standards (MFRS) that became effective on January 1, 2006, 2007, 2008 or 2009. The main objective of the MFRS is to achieve the maximum possible harmonization and convergence of Mexican accounting and reporting standards and regulatory practices with International Financial Reporting Standards (IFRS).

The full hierarchy of the MFRS, in effect beginning January 1, 2006, is as follows:

- MFRS and Interpretations of MFRS issued by the CINIF.
- Statements issued by the Accounting Principles Board of the IMCP that have not been amended, replaced or repealed by the new MFRS.
- IFRS, when no applicable Mexican standard exists.

Commencing with the year ending December 31, 2012, all, Mexican public companies will be required to file their audited financial statements, covering three years, with the Mexican Stock Exchange in conformity with IFRS. Early adoption of this rule is permitted.

MFRS make no distinction between large and small companies with respect either to the standards themselves or to disclosure requirements. Statements issued by the CINIF and the IMCP are applicable to all business entities. However, the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores—CNBV) sometimes issues specific rules for companies listed on the Mexican Stock Exchange. These rules, whose purpose is to ensure greater comparability among the financial statements of listed companies, either eliminate certain options available under Mexican Financial Reporting Standards or require that all listed companies adopt a newly promulgated reporting standard in the same calendar year.

The IMCP was a member of the International Accounting Standards Committee (IASC), and MFRS are generally in compliance with IASC and IFRS standards. IFRS must be applied in Mexico in areas not covered by existing Mexican accounting standards.

Financial institutions, stockbrokers and insurance companies are required to prepare their financial statements in accordance with accounting practices prescribed by the appropriate regulatory agency. These practices differ in some respects from MFRS.

## ***Form and content of financial statements***

The following basic financial statements, usually covering two years, are included with reports of public accountants.

- Balance sheet.
- Income statement.
- Statement of changes in stockholders' equity.
- Statement of cash flows.
- Notes

A typical set of financial statements for a subsidiary of a foreign company is included in Appendix XIII. Mexican company law requires that the above statements and notes, together with the statutory auditor's report (in the case of a private company) and management's report on the company's operations, be presented at the annual stockholders' meeting. In the case of a listed company, the independent auditors' report and the report of the Audit Committee would be presented instead of the statutory auditor's report. Each stockholder has the right to receive a copy. Listed companies must publish their annual financial statements and notes, but not management's report on operations, in a major newspaper. However, unlisted companies are not required to publish their financial statements or otherwise make them available for public inspection.

### ***Income statement***

The income statement usually begins with net sales and will show cost of sales, gross profit, operating expenses by major classification, comprehensive financing cost (see below under Accounting for inflation), provisions for income tax (or flat rate tax), and net income.

### ***Accounting for inflation***

Until December 31, 2007, because of severe inflation in Mexico in earlier years, all primary financial statements had to be restated to show the effects of inflation. A summary of the procedures applied follows.

1. Inventories, fixed assets and other nonmonetary assets, accumulated depreciation, depreciation for the year, and cost of sales were normally restated by applying general price indexes. However, inventories and cost of sales could also be restated by determining current replacement cost, and imported fixed assets could be restated by the “specific indexation” method (see “Property, plant and equipment” below).
2. All components of stockholders’ equity were restated by applying general price indexes.
3. The gain or loss on net monetary position and all exchange differences were included in income. Together with interest, they were grouped under the heading “comprehensive financing income (expense)” (resultado integral de financiamiento).
4. All financial statements had to be stated in “constant” pesos of purchasing power as of the date of the latest balance sheet presented. This meant that all current-year income statement items, all prior-year financial statements presented for comparative purposes and all footnote information had to be restated by using factors derived from the National Consumer Price Index (NCPI). The statement of changes in financial position (now replaced by the statement of cash flows) was similarly presented in constant pesos, which meant that the resulting “cash flows” did not represent cash flows as understood in the context of historical-cost accounting but rather flows of units of constant purchasing power.
5. Companies using replacement cost to restate inventories or cost of sales or the “specific indexation” method to restate imported fixed assets (rather than indexed historical cost) had also to determine the gain or loss from holding nonmonetary assets, which was equal to the amount by which such restated values exceeded or fell short of the value determined using general price indexes. This gain or loss was included directly in stockholders’ equity. Commencing January 1, 2008, the effects of inflation should not be recognized unless the cumulative inflation of the three preceding years exceeds 26%. This was not the case in 2008 and is not expected to be the case in the foreseeable future. Consequently, transactions occurring from 2008 onwards are accounted for at historical cost. However, the cumulative effects of inflation included in nonmonetary assets and stockholders’ equity at December 31, 2007 were not reversed, so that from 2008 onwards these items are recorded on a mixed basis; that is, items originating prior to December 31, 2007 were inflation-adjusted through that date, and subsequent additions were recorded at historical cost.

## **Capital**

As explained in the previous section, all components of stockholders' equity were restated for inflation through December 31, 2007 by applying factors derived from the NCPI to the historical balances. Subsequent movements are recorded at historical cost.

Capital stock is shown at par or stated value, partially restated as indicated above. Any excess is shown separately as a premium on issuance of capital stock. Additional contributions by stockholders are usually shown as such. Treasury shares are shown as a deduction from capital stock in the consolidated balance sheet.

Stock dividends paid are recorded by transferring the appropriate amounts from retained earnings to capital stock (and possibly premium on issuance of capital stock). Stock splits would not affect the amount of capital stock. No value is attributed to shares authorized but unissued.

### *Marketable securities*

Marketable securities held as temporary investments are stated at market value and gains or losses on valuation are included in income.

### *Long-term investments*

These investments, comprising investments in debt and capital securities, are classified in the following categories in accordance with management's intention at the date of acquisition: investments to be held to maturity, financial instruments held for trading, and financial instruments available for sale. They are initially stated at acquisition cost and are subsequently stated as described below:

- (i) Debt securities to be held to maturity are stated at acquisition cost reduced by amortization of premiums or increased by amortization of discounts, as applicable. Any permanent decrease in value is recognized when appropriate, with charge to income.
- (ii) Financial instruments held for trading and those available for sale are stated at fair value, which is similar to market value. Changes in the fair value of financial instruments held for trading are charged or credited directly to income. Changes in the fair value of financial instruments available for sale are included in stockholders equity as part of comprehensive income until the instruments are sold or reclassified, at which time amounts included in comprehensive income are transferred to income for the year.

### *Inventories*

Inventories are stated at the lower of cost or market.

### *Property, plant and equipment*

Property, plant and equipment are carried at partially restated cost less accumulated depreciation (except that land is not depreciated). Cost includes the comprehensive financing cost (see “Accounting for inflation”) incurred during the construction or installation period.

As explained under “Accounting for inflation”, until December 31, 2007 all property, plant and equipment were restated for inflation. Assets of Mexican and foreign origin were restated by applying factors derived from the NCPI to their cost or their appraisal value at December 31, 1996. Assets of foreign origin could optionally be restated by applying factors derived from the general inflation index of the country of origin to the assets’ cost expressed in the corresponding foreign currency and translating the resulting foreign currency amount to pesos at the exchange rate prevailing at the closing date. Assets acquired after December 31, 2007 are stated at historical cost. In all cases, the asset values must be reduced by accumulated depreciation, calculated on both historical cost and revaluation increments, based on realistically estimated useful lives. The depreciation of revaluation increments is not itself deductible for tax purposes; however, the tax system has its own method of indexing depreciation, and this gives approximately similar results.

### *Impairment*

In general, all long-lived assets should be tested for impairment whenever there are indications that their value may have been impaired, other than for purely temporary reasons. In addition, goodwill and intangible assets with an indefinite estimated useful life, or an original estimated useful life in excess of 20 years, must be tested for impairment at least annually, even if no indication of impairment exists.

Impairment should be recognized whenever the net book value of the long-lived assets exceeds their recoverable value. The recoverable value is the higher of their estimated net realizable value and their value in use. Value in use is defined basically as the sum of the discounted future cash flows expected to be generated from the operation of the business.

The amount of any impairment so determined, and also of any recovery determined in future years, should be charged, or credited, to income currently.

### *Depletion*

Depletion of natural resources is based on partially restated cost, as described above. It is usually calculated at rates per number of units produced, determined at the time normal production is commenced. For tax purposes, exploration and development expenses may be deducted currently or written off over a ten-year period, in which case the deferred balance is adjusted for inflation.

### *Purchase of another business*

The purchase method of accounting for an acquisition is currently the only method permitted.

All assets, including identifiable intangible assets, and liabilities acquired in an acquisition must be valued at fair value. Any excess of the price paid for the shares over the fair value of the net assets acquired, usually referred to as “goodwill,” should be shown in the consolidated balance sheet. Goodwill is not amortized, but is subject to annual testing for impairment.

If the acquisition cost of the shares is less than the fair value of the underlying net assets (“negative goodwill”), the excess is applied to write down the value of the nonmonetary assets acquired. Any remaining excess, after the nonmonetary assets are reduced to zero, is carried to income in the year of acquisition.

A company acquiring another business may also purchase the acquiree’s assets rather than its shares. The assets acquired would be depreciated in the normal way, based on the cost to the acquirer, for both accounting and tax purposes. The purchase of assets rather than shares may insulate the acquirer from any contingent liabilities of the acquiree, especially possible tax contingencies, but has the disadvantage for the acquiree that it would normally have to separate all its employees, paying them seniority premiums and separation pay.

Purchase accounting is not followed when the acquiring company and the acquiree are under common control. In these cases the net assets acquired are recorded at their book value in the acquiree, and any difference between such book value and the purchase price is treated as a contribution or distribution of stockholders’ equity.

### *Consolidation*

Except in unusual circumstances, the financial statements of companies controlled by Mexican corporations should be consolidated with those of the parent company. Control is defined as the ability to determine the operating and financial policies of the investee and to obtain benefit from its activities. Normally, control exists when the investor owns more than 50 percent of the voting common stock of the investee, but it may also be acquired by other means. Parent company financial statements, prepared on an unconsolidated basis, are acceptable only when prepared to comply with legal requirements, such as the report of a statutory auditor to its annual shareholders’ meeting or statements prepared for federal tax audit purposes. Even in such cases, the parent company’s statements must include condensed consolidated financial information in the notes, unless full consolidated statements are also presented. Investments in unconsolidated subsidiaries or associated companies of which 10 to 50 percent is owned by an investor company should be accounted for by the equity method, except for investments in companies in other countries subject to exchange control. The latter should be stated at the lower of cost or the equity basis.

The CNBV requires that all companies listed on the Mexican Stock Exchange publish consolidated financial statements.

## ***Provisions and reserves***

### ***Income tax and employees' statutory profit sharing***

Employees' profit sharing is payable on the basis of adjusted net profits (see Appendix III). The differences between accounting income and profits for profit sharing purposes are comparable, although not identical, to differences between accounting and taxable income.

Mexican reporting standards require comprehensive interperiod tax allocation by the assets-and-liabilities method, similar to the current U.S. and international standards (FAS 109 and IAS 12, respectively). Under this standard a deferred tax is recognized, in principle, for all differences between the book and tax amounts of assets and liabilities. A valuation allowance should be recorded for any deferred tax asset whose realization is doubtful. Deferred employees' profit sharing is recognized on a similar basis, to the extent that it may reasonably be assumed that such differences will give rise to an actual future benefit or liability.

Commencing in 2008 businesses pay either income tax or flat rate tax, whichever is higher in any given year. For accounting purposes they must prepare financial projections to determine whether they expect to be primarily paying income tax or flat rate tax, and should record either deferred income tax or deferred flat rate tax, but not both, based on the result of these projections.

Deferred income tax and deferred profit sharing are usually grouped together in the balance sheet.

Profit sharing expense, both current and deferred, is normally shown in the income statement in other income and expense.

### ***Valuation allowances and estimated expenses***

All necessary provisions for items such as bad debts, inventory valuation or obsolete merchandise and estimated expenses must be included in the financial statements. However, these items are not normally deductible for tax purposes until realized.

### ***Derivative financial instruments***

All derivative financial instruments are included in the balance sheet as assets or liabilities at fair value. Changes in their fair value are recognized in income as part of comprehensive financing income (expense), except when the instruments are entered into to hedge against risks and comply with all related requirements. Changes in the value of fair value hedges are recorded in income under the same caption as the hedged item. In the case of cash flow hedges, changes in the value of the effective portion are temporarily included in comprehensive income in stockholders' equity and are reclassified to income when the hedged item affects income. Any ineffective portion is recognized immediately in income.

### ***Employee pensions, seniority premiums, termination pay***

Provisions for employee pensions, seniority premiums, termination pay, etc., should be recorded currently, on an actuarial basis, with charge to income. The underlying accounting and disclosure rules are very similar to those in effect under U.S. generally accepted accounting principles.

Until 2007 actuarial gains and losses and any transitional liability for prior service costs were amortized over the average estimated service lives of the employees. Commencing in 2008 these items are generally amortized over a maximum period of five years.

Provisions for pensions, seniority premiums, etc., are deductible for tax purposes only if funded in accordance with plans approved by the Ministry of Finance (see “Pension funds” in Chapter 15).

### *Contingent liabilities*

General contingency reserves are not acceptable under generally accepted accounting principles in Mexico. Provisions for specific contingent liabilities must be estimated and recorded whenever future payment is considered more probable than not.

### *Statutory reserves*

Five percent of net profits of corporations should be set aside in a statutory (legal) reserve until the balance reaches 20 percent of the value of the outstanding capital stock. However, since these provisions represent appropriations of retained earnings, the balance of the reserve is shown in the stockholders’ equity section of the balance sheet.

### *Footnote disclosure*

The requirements for disclosures in footnotes are generally similar to those in effect under IFRS. They include information as to the principal accounting policies of the company, material contingencies of whatever nature, commitments for substantial purchases of assets or under lease contracts, mortgages and other charges on assets, details of long-term debt and foreign currency exposure, details of derivative financial instruments, limitations on dividends, guarantees given, employees’ pension plans, transactions with related parties, and income taxes.

### *Recording of income*

Income statements are almost universally prepared on an annual basis for presentation at shareholders’ meetings and for income tax purposes. The value-added tax law requires monthly returns of revenue. Accordingly, difficulties are sometimes encountered by companies that wish to keep their accounts on the basis of periods consisting of precisely 4, 13 or 52 weeks. Annual income tax returns must be prepared for fiscal years that end precisely on December 31. The law provides that invoices must be issued no more than 30 days after a sale is made, but accrual accounting requires that all shipments be recorded in the period in which they were made. Gross profits on installment sales are generally recognized in the period of sale, although in certain cases, particularly where collection is not assured, they are recognized as collections are made.

## ***Book and tax differences***

Numerous differences between the book and tax treatment of items of income and expense may and usually do exist. The tax treatments mentioned below are discussed in more detail in Chapter 15. The more important are shown in Table IX.

It should be noted that, generally speaking, conformity between accounting and tax treatment of income and expense items is not required.

## ***Foreign investors***

There are no disclosure requirements applicable exclusively to foreign investors. However, a foreign-owned subsidiary or investee company would have to comply with the disclosure requirements applicable to all entities doing business in Mexico. These include the need to disclose all significant transactions with related parties, including parent, affiliated and subsidiary companies, together with the following information.

1. Nature of the relationship.
2. Amount and description of transaction (even when no charge is made for the goods or services).
3. Effect of any changes in the terms of recurring transactions.
4. Balances with related parties and a description of any special characteristics (for example, due dates, interest rates).
5. Any other information considered necessary for an understanding of the transaction.

Transactions of a similar nature may be grouped together. Remuneration paid to company directors, officers and executives for services rendered in such capacities and the extent of directors' or officers' shareholdings need not be disclosed. However, in the case of public companies, the total combined remuneration paid to directors and principal officers must be disclosed.

**IX—Book and Tax Differences**

Item	Tax treatment
Depreciation	Deductible at the maximum rates specified by law by the straight-line method and inflation-indexed. However, depreciation (and other operating expenses) of automobiles is deductible only up to a certain limit (see Chapter 15). In the case of new fixed assets, taxpayers may elect to take an immediate deduction approximately equal to the present value of future depreciation deductions, except for automobiles, trucks, buses, trailers, airplanes, and assets located in the principal metropolitan areas. Impairment of long-lived assets is not deductible for tax purposes.
Provisions for specific estimated expenses	Only definitive amounts due to creditors may be deducted.
Provisions for pensions and other seniority benefits	Deductible only when calculated on actuarial basis and paid into an irrevocable trust fund.
Bad debts	Deductible only when practical inability to collect can be established for each debt or the statute of limitations to demand payment has expired.
Adjustments for inflation	The tax system includes adjustments for inflation with respect to depreciation, gain or loss on sale of capital assets, loss carryforwards, asset tax credits, and monetary gain or loss (componente inflacionario). As indicated in Chapter 12, until December 31, 2007 similar (but not identical) inflation adjustments were recorded for accounting purposes. However, these were discontinued from January 1, 2008 onwards.



# Chapter 13

## Tax system

### ***Investor considerations***

- Resident taxpayers (corporate or individual) are subject to Mexican taxation on worldwide income.
- Nonresident taxpayers (corporate or individual) are taxed on Mexican-source income only.
- Corporate income is taxed at the corporate level. No further withholding is applied on dividend distributions. See Chapter 17.
- Compulsory profit sharing, equal to 10 percent of taxable income as adjusted for this purpose, is payable each year to employees; and is deductible for tax purposes.
- Starting 2008 a new Flat Tax is assessed as minimum tax on enterprises.
- In general, form prevails over substance.
- Thirty seven tax treaties are now in effect, and negotiations for tax treaties with other countries are in progress.
- Double taxation relief is given by way of (limited) credit for foreign taxes paid.

13

### ***Principal taxes***

The principal taxes payable by commercial and industrial enterprises operating in Mexico and, in certain cases, by foreign companies and individuals, are those levied by the federal government. State and municipal governments have more limited tax powers and also receive allocations of some federal taxes collected within their borders. The principal taxes are as follows.

1. Federal taxes:
  - a. Income tax;
  - b. Flat tax;
  - c. Value-added tax;
  - d. Tax on cash deposits;
  - e. Custom duties;
  - f. Payroll taxes, mainly social security.
2. Local taxes:
  - a. On real property;
  - b. On salaries.

In addition to these there are a number of special federal taxes, such as excise taxes on specific products and services, including alcoholic beverages, cigarettes and gasoline. Transfers of real estate are subject to a state tax on acquisitions of real property. The states are not authorized to levy general corporate income taxes, although some states levy a tax on salaries and professional fees on the employer or payer.

## ***Legislative framework***

### ***Statute law***

Congress annually approves the federal revenue law, which mainly includes a list of the federal taxes to be imposed during the year. The Ministry of Finance is empowered to issue regulations for implementation of the tax laws, which interpret the legislation in broad terms.

Annual omnibus tax rulings published by the tax authorities may be relied on by the taxpayer, although they do not have the force of law. Retroactive legislation is not permitted by the Constitution and its application is not legal.

### ***Case law***

Although court decisions are valid only for the specific case involved, they do offer some degree of precedent. Supreme Court decisions when issued in the same sense on the same issue five times must be followed by other courts when deciding substantially the same factual situation.

### ***Antiavoidance***

Tax legislation contains specific antiavoidance rules similar to those of other countries. Examples are given below.

1. In the case of fraud, the authorities may look through the way a transaction is structured to determine its true economic substance.
2. General provisions that empower the authorities to reconstruct income on an estimated basis or disallow deductions are quite broad.
3. General rules to avoid abuse through intercompany pricing have been substantially broadened. Payments to related parties must be determined on an arm's length basis and properly documented in order for them to be deducted.
4. Strict rules (documentation, withholding taxes, prior authorization), if not complied with, deny deductibility of costs and expenses.
5. Transactions classified as subject to preferential tax regimes are subject to specific rules to anticipate the accrual of income, restrict deductions or apply higher income tax withholding rates.

### ***Form versus substance***

Generally, form prevails over substance, except as noted in the general antiavoidance rules discussed above. Authorities generally base their analyses of transactions on the documentation backing such transactions. Some attorneys are of the opinion that only if the authorities can prove that a fraudulent situation exists in a transaction would substance prevail. However, there is the tendency to consider substance instead of form, which might prevail in the near future.

## ***Clearance procedures***

Under the rules of the Tax Code, taxpayers may request advance rulings on actual and concrete specific situations before carrying out a significant transaction if they desire to have legal certainty as to the effects of a proposed transaction. However, such rulings are not easy to secure, and the process can be lengthy and time-consuming. If the ruling adversely affects the taxpayer's interests, its effects may be overcome by securing annulment in the tax court.

## ***Income tax***

### ***Concepts of income taxation***

In general, the federal income tax system is an all-inclusive system with certain exceptions, most notably in the case of some types of interest received by individuals. Interest from the Mexican financial system is taxed at a flat rate and may be credited in the overall annual personal return.

The federal corporate tax rate is 30 percent (in 2014, the tax rate will be reduced to 28%, 29% in 2013).

Provisions designed to recognize the effects of inflation for tax purposes in the areas of monetary assets and liabilities (monetary correction) and depreciable assets are incorporated in the law.

Resident individuals are subject to Mexican income tax on their worldwide income, regardless of their nationality, at graduated rates reaching 30 percent for individuals with income exceeding Ps392,841.97 in the year.

Nonresident corporations and individuals are subject to tax on their various types of Mexican-source income treated separately, but if they are considered to have one or more permanent establishments for income tax purposes in Mexico, all income attributable to such establishments must be consolidated in a single annual return.

Nonresidents, including Mexican citizens who can prove residence for tax purposes in a foreign country, are taxed only on their Mexican-source income.

Business entities that have established their main administration or their effective management in Mexico are considered to be tax residents of Mexico.

### ***Business Alternative Tax (Flat tax)***

Enacted in 2008, the Flat Tax (IETU) supplements the federal income tax, i.e., it is payable only when it exceeds the taxpayer's regular federal income tax for the year. This tax is payable at 17.5% from 2010 on (transitionally 16.5% for 2008 and 17% for 2009) on a cash flow base. Taxable income is similar to that applicable for income tax; however deductions are allowed only for the acquisition of goods and services, with the exception of royalties paid between related parties and interest (although there is a special rule for financial institutions), which are concepts not included in the Flat Tax base. Additionally, salaries and social security contributions are not deductible, but in turn generate a credit on the portion of the payment not exempt to the employee.

## ***Classes of taxpayer***

Taxpayers are divided into four main groups for which, in addition to the rules of general application, separate sets of rules are provided, as follows.

### ***Resident corporations and other organizations taxable as corporations***

Resident corporations, permanent establishments of foreign corporations and all entities other than those nonprofit organizations specifically so designated will generally be taxed in the same manner and under the same rules applicable to resident corporations. These include most privately owned business enterprises, sole proprietorships and professional service providers.

These taxpayers are required to include all their income from all sources, with very few exceptions, in a single annual return (see Chapter 15).

### ***Resident individuals***

Resident individuals, whether Mexican or foreign, are subject to Mexican taxation on their worldwide income of all types, most of which must be included in an annual personal income tax return. Taxable income is subject to tax according to the graduated rate schedule shown in Appendix VII. There is special treatment for capital gains and domestic interest (also see Chapters 17 and 20).

### ***Nonresident corporations and individuals***

As discussed in Chapter 16, nonresidents may be considered to have a permanent establishment for income tax purposes in Mexico under certain circumstances. In these cases the permanent establishments are taxed in the same way as duly registered branches of foreign corporations, basically following the rules for resident corporations.

Nonresident Mexican or foreign individuals are taxed only on their Mexican-source income, at flat or graduated rates applied separately to different types of gross income without deductions, although under special rules they may elect to be taxed at higher rates on net taxable profits from sales of real property or capital stock or short-term construction and similar work. No overall annual return is required of nonresidents.

Nonresident individuals rendering personal services temporarily in Mexico who are employees of a nonresident corporation that does not have a permanent establishment in Mexico are exempt if their services are rendered for less than 183 days, consecutive or not, in any 12-month period. If the duration of their services exceeds 183 days, they are subject to tax as described in Chapter 20. Nonresident individuals who render personal services temporarily in Mexico directly to Mexican taxpayers are subject to a graduated withholding tax rate as discussed in Chapter 20.

### ***Nonprofit organizations***

Under the law, a limited number of organizations and government agencies are exempt from taxes. These include formally registered political parties, the federal, state and municipal governments and their agencies not engaged in business activities.

Other nonprofit organizations are generally considered nontaxpayers, rather than as exempt from tax. These include a limited number of civil societies and civil associations that are specifically designated as such, although they are required to file annual returns on a calendar-year basis to determine their net excess of income over expenses, and their members are subject to tax only as to any amounts of net income actually distributed. These organizations are relieved of any obligation for advance payments of tax on their operations. The following types of entities are considered nontaxpayers:

1. Chambers of commerce, of industry, etc.; labor unions; employer, professional, cooperative, and agricultural associations.
2. Charitable organizations and those established for scientific, political, sports, or religious purposes.
3. Consumer cooperatives, civil associations or societies engaged in education, if officially recognized and civil societies organized solely to operate savings funds.
4. Civil societies and civil associations which grant scholarships, as well as entities engaged in the research and conservation of flora and fauna.

Notwithstanding the above, certain types of income of nontaxpayers are subject to income tax, including unrelated business income.

### ***Taxable income***

Taxable income is gross income, which includes any kind of income unless specifically excluded, less allowable deductions and unexpired net operating loss carryovers from prior years, as well as employee profit sharing. Gross income also includes the taxable annual inflationary adjustment, if any. The deductible annual inflationary adjustment, if any, is fully deductible. See Chapter 15 for a discussion of these items.

### ***Tax year***

The government's fiscal year is the calendar year, which must also be used by all taxpayers for corporate, legal and income tax purposes. Sole proprietorships and nonprofit organizations must also use the calendar year.

### ***Tax-free zones***

Free trade zones have been replaced by the border region concept. These are discussed in Chapter 8.

### ***Tax holidays***

There are no income tax holidays for domestic or overseas investors in Mexico.

## ***Capital taxation***

### ***Companies***

No tax is payable on the basis of the value of a company upon incorporation or upon issuance of shares (except for relatively minor state incorporation fees).

### ***Individuals***

There is no tax payable on total wealth or on the value of assets (see Chapter 15).

### ***Dividend taxation***

Legal entities are taxed at a rate of 42.86% of the value of any distributions of profits they carry out in excess of their after tax earnings account (40.85% in 2013, and 38.89% in 2014).

## ***International aspects***

### ***Foreign operations***

As stated above, both individual and corporate residents of Mexico are subject to Mexican taxation on their worldwide income. Tax credit up to the amount of the Mexican income tax is allowed for foreign income taxes paid on foreign-source income, and the law is designed to avoid double taxation of international transactions. Mexico has a number of tax treaties in effect and is currently negotiating additional tax treaties with several other countries. See Chapter 25 for details.

### ***International financial center operations***

Because of stringent immigration and taxation requirements, the Mexican tax system is not one that would encourage the location of multinational company headquarters and administrative offices.

# Chapter 14

## Tax administration

### ***Investor considerations***

- Corporate taxpayers are required to file an annual income tax return by March of the following year.
- Corporate taxpayers are generally required to make monthly advance payments; there are no extensions for corporate returns.
- Individual returns are due on April 30; no extensions are granted.
- Filing of financial statements that have been audited by an independent public accountant with an opinion on the tax status is mandatory, except for small companies.
- Penalty interest is payable on any unpaid tax, as adjusted for inflation.
- Joint returns are not permitted. Placing income-producing assets in the name of the nonworking spouse can result in some savings.
- Individuals receiving compensation directly from abroad must generally make monthly estimated tax payments.
- Severe penalties, including imprisonment, can apply in the case of fraud and for failure to file returns, withhold taxes or pay tax liabilities.
- Departing aliens should notify tax authorities of the cessation of their tax obligations.

### ***Administration of the tax system***

Taxes are imposed by the federal, state and local governments through the federal and state legislatures. The federal income tax, flat tax (IETU), value-added tax, excise tax, and customs laws are administered and the taxes collected by the Internal Revenue Service (Secretaría de Hacienda y Crédito Público—Servicio de Administración Tributaria or SAT).

## ***Corporate taxpayers***

### ***Tax returns***

Corporations are required to file an annual income tax return for each calendar year no later than March 31 of the following year and to pay the balance of tax due at that time. A newly organized company must file its first return for the period ending on December 31 of the year of incorporation.

In the case of taxpayers obligated to have their financial statements audited by a certified public accountant, these must be filed, together with the accountant's opinion on the taxpayer's compliance with the tax laws, by June 30 of the following year.

Penalty interest is payable on any unpaid amount.

### ***Information returns***

An annual information return must be filed by February 15 of the following year providing details of suppliers and customers and the volume of transactions with each.

Additionally, annual information returns are due by February 15 of the following year covering investments in low-tax jurisdictions, taxes withheld on payments abroad and to certain residents, charitable donations, and on loans received from or guaranteed by foreign residents.

An annual information return regarding transactions with related parties abroad should be filed with the annual income tax return.

### ***Amended returns***

A taxpayer may not file an amended return for a given year more than three times, except when the amendment is a result of an audit by the authorities or it results in an additional tax liability or a reduction in a net tax loss carryforward.

### ***Assessments***

The taxing system is largely one of self-assessment by means of periodic tax returns subject to audit by the authorities. Great reliance is placed on the requirements for tax withholding by those who make payments representing taxable income to the recipient, except for payments to resident business enterprises.

### ***Filing of financial statements and opinions of public accountants***

As a means of facilitating the official review of corporate tax compliance, the Federal Tax Code contains a procedure that requires most business enterprises to file audited financial statements together with the tax opinion of an independent public accountant registered with the Ministry of Finance.

Until 2010, this procedure had to be followed by taxpayers with gross income in excess of Ps 34,470,980, or whose assets were stated at more than Ps 69,607,920 in the preceding year or who employed 300 or more persons in each month of the preceding tax year. These thresholds are updated for inflation on a semiannual basis. The special report for tax purposes containing the opinion

of the independent public accountant must be filed in connection with the taxpayer's income tax return by June 30 of the following year. The above threshold amounts are applied to groups of related entities on a combined basis when a common parent or individual controls or owns more than 50 percent of the voting stock of the entities in the group. If the threshold is met in these cases, each company in the group must comply with this obligation even if the parent company does not file a consolidated income tax return. This procedure is also applicable to companies that merged, spun-off, or are in the process of liquidation, or selling off their business. Any taxpayer not required to file this report may elect to do so; in which case, a notification of the intention to elect filing the report in question must be filed with the tax authorities no later than March 31 of the year following the period to be audited.

There is no need to audit taxpayers that have formally suspended activities as from the second tax period after having filed the notification of suspension.

Detailed additional schedules must be filed with the accountant's report, together with a separate opinion to the effect that during the audit tests carried out in compliance with generally accepted auditing standards the accountant observed no irregularities in respect of any federal income tax or other federal taxes payable directly or required to be withheld by the company. Any items noted but not satisfactorily corrected must be included in the report.

The financial statements and opinions of public accountants must be filed electronically in accordance with the tax authorities' rules by June 30 of the following year. This period can be extended in some cases.

However, from 2011 onwards taxpayers previously required to file audited financial statements and a tax report with the opinion of an independent public accountant may opt not to present this report provided they file the same information on an unaudited basis in accordance with special rules, issued by the tax authorities.

Import and export tariff classifications and the values declared for custom purposes are not expected to be covered by the accountant's opinion.

Questions arising from the desk review normally carried out by the authorities are generally directed to the public accountant. The tax authorities are empowered to close their tax audits at their discretion based on the circumstances.

Additionally, similar compliance opinions are required for local payroll and real estate taxes and tariffs for water consumption imposed by the Federal District (i.e., Mexico City) when taxpayers employ 150 or more persons (monthly average), have net worth of Ps 32,852,824 (for each property or as a conjunct) or more, or use 1000 m<sup>3</sup> or more of water. The due date for filing the notification of the intention to file this report is generally February 15, and the deadline for filing the report with the local authorities is generally April 30. This period can be extended in some cases. Other states requiring similar opinions for local taxes are Mexico State, Guerrero, Quintana Roo and Oaxaca.

## ***Appeals***

If tax deficiencies are determined as a result of an examination by the tax authorities, objections the taxpayer may have against any of the findings included in the report issued by them must be stated and included in the same report at the conclusion of the examination.

The tax authorities are empowered to assess any additional tax to be paid. The taxpayer may present a formal request for revocation of the assessment (administrative appeal) to the technical division of the specific authority that made the assessment. This authority may be either the regional special collections office or the general local division. Alternatively, the taxpayer may appeal to the Tax Court or civil courts, asking that the assessment be canceled. Court cases are handled by attorneys, but, in any event, usually with assistance from accountants as expert witnesses.

## ***Payment and collection***

Corporate taxpayers are required to make advance payments of income tax on the 17th of each month; however, such advance payments should be made on the basis of an estimated annual taxable income, arrived at by applying to the gross income of the current year the preceding year's ratio of taxable income to gross income (the "profit factor"), less any loss carryforward of prior years still pending utilization. If good reasons are given, the SAT has authority to waive all or part of one or more of the advance payments at the taxpayer's request, in the last months of the year. Advance payments are not required during the first year of operation of a business.

The law provides a procedure whereby corporations must make advance payments even when there was no profit factor arising in the previous 12-month year (e.g., in loss years). Consequently, taxpayers are required to use the profit factor corresponding to the most recent taxable year that resulted in a profit, as long as that year is not more than five years prior to the year for which payments are to be made.

## ***Withholding taxes***

In many cases a company making payments to third parties is required to withhold and pay to the tax authorities an amount of income tax on account of the recipient. In all such cases the company is jointly liable for the tax that should be withheld, and on failure to do so it is subject to penalty interest and fines.

The withholding obligation exists in general for all payments to individuals, including employees, and payments to foreign entities that are not registered in Mexico. This includes most payments abroad, as described below. In all cases where the income tax law does not establish a specific period within which corporations should remit taxes withheld, the period for payment will be the 17th of the month following that in which the taxes should be withheld.

### *Payments to foreign residents*

In general, a withholding obligation exists in connection with income paid to foreign residents (corporations or individuals) with a source of wealth located in Mexico. The corresponding withholding rate is applied to the total income without deductions, except in certain cases where income tax withholding may be determined on the net gain, such as when a qualified resident representative is appointed in connection with, for example, sales of real property or shares or for short-term construction or similar income. The amounts to be withheld are summarized in Appendix IV and V. All withholding taxes from payments to foreign residents should generally be remitted by the 17th of the month after the date the payment was due, even if no payment or withholding is actually made. However, payments made in advance of their due date would accelerate the withholding and remittance obligations.

### **Tax audits**

In accordance with provisions of the income tax law, income tax returns are considered accepted by the authorities as filed, although the tax authorities are empowered to review or audit in detail any return they may select. There is no rule as concerns how the authorities may select a taxpayer for a tax review to be carried out, although electronic equipment has been installed to facilitate the selection of tax returns for review.

The tax authorities are empowered to review the taxpayers' accounting records in order to determine compliance with tax obligations. The authorities can review any kind of federal tax, including foreign trade taxes.

### **Penalties**

Penalty interest (surcharges) up to the amount accrued over a period of 5 years and in some cases ten years (based on the statutory limitation period, as mentioned below, and therefore generally limited to five years) is payable on delayed payments or additional assessments as from the date the tax should originally have been paid. Interest is calculated on the tax deficiency as adjusted for inflation.

Fines may also be assessed in the case of tax omitted, unless the taxpayer voluntarily pays the omitted tax or corrects the obligation not complied with prior to a formal request for payments or to a receipt of a notification of a tax inspection for the year in question.

In certain cases of failure to pay, incarceration can be imposed if smuggling or fraud is proved.

### **Statute of limitations**

In general, the right of the tax authorities to collect taxes, review tax returns or claim additional tax expires five years after the date the corresponding return is filed. However, where the taxpayer did not secure a federal taxpayer's registry number, did not have accounting records, failed to keep them for the required ten-year period, or did not file a tax return, the statute of limitations expires in ten years. Similarly, the period for claiming a refund of overpayment of taxes expires after five years.

## **Individual taxpayers**

### **Assessments**

In general, the tax system relies on withholding and advance tax payments from individuals as the basis for enforcing compliance with the income tax law. Also, annual personal income tax returns are required for most situations.

### **Imputation of taxable income**

When individuals spend more than the income shown in their income tax returns during a calendar year, the tax authorities are authorized to consider the excess of such expenses over the income declared as additional taxable income for the individual. After notification, the taxpayer is granted a period of 15 days within which to file a protest and 20 days to prove a case. Otherwise, the authorities will issue the corresponding additional tax assessment.

In addition, certain non-taxable items must be disclosed in the annual tax return, otherwise they will be considered taxable.

### **Tax returns**

Most individuals receiving income during the calendar year are required to file an annual tax return no later than April 30 of the succeeding year. Individuals with less than Ps\$400,000 or about US\$30,000 of salary income, in most cases, are not required to file an annual tax return.

Applicable forms, depending on the type of income and deduction to be declared, are listed in Table XI.

Penalties for late or improper filing are the same as for business enterprises, as stated above.

## **XI—Tax Forms**

<b>Form number</b>	<b>Applicability</b>
13 – Comprehensive form	Taxpayer with several types of income.
13-A – Salaries only	For taxpayers who receive only a salary or wages.

Under current tax provisions, except in specific cases, annual tax returns must be filed using the electronic system established by the Mexican Tax Administration (SAT). For that purpose, in most cases the taxpayer must have an electronic tax compliance password called Advanced Electronic Signature (Firma Electrónica Avanzada or FIEL).

## ***Payment and collection***

The amount of tax shown as due on the annual return (net of applicable taxes withheld, tax credits and advance payments) is payable upon filing the return, no later than April 30.

### ***Advance payments***

Substantial amounts are withheld from salaries and certain other types of income as summarized later in this chapter. In addition, individuals are required to make advance payments on the following specific types of income:

1. Salaries received from abroad:  
Monthly advance tax payments on salaries and wages received from foreign employers, or others not required to withhold tax, should generally be filed by the 17th day of the following month. The tax due should be calculated by applying the graduated rate table to the wages received each month. (See Appendix VIII for individual withholding tax rates.)
2. Business activities and Professional fees:  
Advance tax payments are due, on a monthly basis, on income net of deductible expenses.
3. Rental of Mexican real property:  
Monthly advance tax payments are due on income net of deductible expenses. Optionally, a flat 35 percent of the rental income can be deducted instead of the actual expenses. Advance tax payments are not required if the rental income during the year is less than ten times the minimum wage for the month (not applicable if the taxpayer has other income).
4. Sale of Mexican real estate:  
The notary public who processes the documentation for the sale must withhold income tax, in accordance with the holding period and should file an advance tax payment within 15 days after the transaction is completed
5. Sale of other personal property:  
An advance tax payment is due equal to 20 percent of the gross income and should be paid through withholding or paid within 15 days after the income is obtained.
6. Income from the acquisition of assets below fair market value:  
A 20 percent advance tax payment is due within 15 days after receiving the tax assessment from the tax authorities.
7. Interest received on loans if received on a continuing basis:  
A semiannual advance tax payment is due on the gross income without deductions.
8. Sporadic income (e.g., forgiveness of debt, guarantor fees, etc.):  
An advance tax payment equal to 20 percent of the gross income is due within 15 days following the date the income was obtained.  
In general terms, individuals are not required to make advance tax payments with respect to foreign investment income. It must be reported in the annual tax return, however.

## ***Tax withholding***

Tax withholding is required as follows.

1. **Salaries and wages:** Mexican employers are required to withhold income tax on remuneration paid to employees at the rates shown in Appendix VIII, and they must remit the withheld taxes generally by the 17th of the following month.

Furthermore, since most employees whose total taxable wages for the year do not exceed Ps \$400,000 or about US\$ 30,000 are not required to file an annual tax return, employers are required to true-up the tax withholdings by determining the total tax payable for the year and withhold any balance due or refund any excess withholdings. Any net balance due must be paid at this time, and overpayments are recovered by reducing withholdings for subsequent months. An adjustment of the withholding for December is authorized by the law to avoid overpayments. This true-up procedure does not apply to employees who leave the employer before December 1 or who confirm in writing that they will be filing their own annual returns. The regulations establish special procedures for calculating monthly withholding when, in addition to normal salary; an employee receives bonuses or payments covering several months, other than for severance compensation.

Employers are also required to file an information return no later than February 15 of the following year. The return requires a detailed disclosure of taxable and exempt compensation paid to each employee and the corresponding income tax withheld. The employer must also indicate which employees were subject to the true-up mentioned above and which ones received any cash payments corresponding to the salary subsidy.

2. **Severance compensation:**  
The tax to be withheld, if any, is calculated at the effective rate of tax withholding on the most recent normal monthly salary or, if less, by applying the monthly tax rates separately to the taxable portion of the severance compensation (see Appendix VIII).
3. **Fees for independent personal services, rent and miscellaneous types of income:**  
Corporations are required to withhold 10 percent of professional fees or rent paid to individuals, and 20 percent of miscellaneous income.
4. **Other types of income:**  
Under some circumstances, withholding taxes are also applicable to other types of income received by individuals, including the following:
  - a. Interest on fixed-income securities (see “Interest income” in Chapter 20); and,
  - b. Proceeds from sales of securities and other personal property (see “Capital gains” in Chapter 20).

### ***Penalties***

Penalty interest, inflation adjustments and fines for delayed or omitted tax payments are the same as those described for corporate taxpayers.

### ***Tax audits and appeals procedures***

Individual tax returns are subject to the same type of audit and appeals procedures as those described for corporations.

### ***Community property***

When an individual is married under the Mexican community property rules, income derived from capital investments is considered to belong to both spouses in the proportion established by the terms of their marriage contract. On the other hand, the income tax law provides that remuneration for personal services or profits from a business enterprise is reportable exclusively by the person who renders the services or carries out the business activities.

### ***Foreign personnel***

Foreign nationals residing in Mexico are subject to the same compliance requirements as Mexican nationals residing in Mexico. Nonresidents, including Mexican citizens who have terminated tax residency, are taxed only on their Mexican-source income, as discussed in Chapter 20.

### ***Exit permits***

Before the final departure of a tax resident, an appropriate notification must be filed in order to have the authorities suspend the individual's registration and obligations for tax purposes and notify the authorities of the termination of the individual's status as a tax resident. No formal tax clearance has been established as a condition for boarding or exiting for departing citizens or foreigners.

### ***Partnerships and joint ventures***

Tax administration for Mexican partnerships and joint ventures is the same as for corporations, as described above.

An association in participation agreement (Asociación en Participación—A. en P.—a type of joint venture) exists, but the activities carried out through this instrument do not create a separate legal entity. However, A. en P.s are subject to the same tax treatment as regular companies and the active partner must pay the tax and comply with the A. en P.'s tax obligations. (See Chapter 19 for further discussion).



# Chapter 15

## Taxation of corporations

### **Investor considerations**

- Mexican corporations are taxed on worldwide income.
- Corporate tax rate temporarily increased for 2010 to 2012 to 30% with a planned reduction to 29% in 2013 and to 28% in 2014.
- Net Operating Losses may be carried forward for 10 years. Specific losses (i.e. losses on the sale of shares) can only be carried forward against the same kind of income.
- Thin capitalization rules introduced in 2005 take full effect in 2010 as the 5-year transitional period concluded (a 3:1 debt to equity ratio is established, interest arising on excess indebtedness is not deductible).
- Interest paid to a related party may be treated as a dividend in certain circumstances.
- Although inflation rates have decreased in recent years, leveraged corporations must recognize an inflationary gain as additional taxable income and an inflationary loss as deductible expense.
- Dividends from after-tax earnings paid to individuals or corporations, residents or non-residents, are not subject to income tax withholding.
- Capital gains are wholly includable in gross income and are taxed at the same rates as ordinary income.
- All inter-company transactions are scrutinized closely and are subject to contemporaneous documentation requirements to support inter-company prices.
- Deduction of cost of goods sold was re-introduced as of 2005, replacing the deduction of purchases.
- An alternative tax, the Flat Tax, was introduced in 2008 and is computed at 17.5% on a cash flow basis (transitional rates of 16.5% in 2008 and 17% in 2009 apply). This tax is payable only if it exceeds the regular income tax liability.
- Consolidated returns are possible but are not available to a group whose domestic parent is owned more than 50% by a foreign corporation, unless such owner having at least 50% of the voting shares of the Mexican parent is resident in a country that has a broad exchange of information agreement with Mexico. Also, a 2010 tax reform limits the deferral benefits of consolidation to 5 years. Transition rules require for the recapture of deferred tax effects as of December 2009.

- Tax holidays are not available for federal taxes.
- Employee statutory profit-sharing payment is deductible
- A special regime for Real Estate Investment Trusts is applicable as from 2005.
- Specific rules are applicable for recognition of un-remitted income arising from investments in preferential tax regimes (tax haven rules).
- Mexico does not recognize any transparency for foreign corporations.
- Mexican source income obtained by foreign non-taxed corporations is considered as income obtained by an entity resident in a preferential tax regime (tax haven).

## ***Corporate tax system***

### ***Corporations and shareholders***

The tax rate for corporate taxpayers is 30% (temporarily for years 2010 to 2012; 29% for 2013 and 28% for 2014 and after). Profits taxed are included in the net-after-tax earnings account (CUFIN) from which dividends can be paid out free of corporate taxes. Its balance must be restated for inflation.

Corporate tax is imposed on corporate distributions that for any reason represent income that has not been subject to corporate income tax. Such dividends that are not paid out of the CUFIN or the Reinvested CUFIN should be grossed up by a specific factor (1.4286 for 2010-2012, 1.42085 for 2013 and 1.3889 for 2014 and after) in order to determine the tax payable by the company.

## ***Taxable entities***

Taxable entities include different types of corporations, such as limited liability companies, Mexican partnerships and organizations of a civil nature other than those specifically designated as nonprofit organizations, as described in Chapter 13 under “Classes of taxpayer.” Under certain circumstances nonresident corporations (or individuals) may be considered to have a permanent establishment in Mexico for income tax purposes, including branches of foreign corporations duly registered to operate in Mexico. The business operations of such establishments are taxed in the same manner as a corporation, with the relatively few differences described under “Branch versus subsidiary” later in this chapter.

The Federal Tax Code provides that corporations are to be regarded as residents of Mexico if their principal administration or effective management is established in Mexico. All partners and shareholders of Mexican companies must be registered for tax purposes, except those who acquire their shares on recognized stock markets or markets with high trading volumes. This requirement is met by corporations or entities providing the relevant information on partners and shareholders.

### ***Territoriality***

Domestic taxpayers (both corporations and individuals) are taxed on worldwide income from all sources unless specifically exempt, with a limited foreign tax credit for foreign taxes paid on foreign-source income. Permanent establishments of foreign entities are generally subject to tax only on income attributable to such establishments.

## ***Gross income***

### ***Accounting period***

Taxpayers are required to use the calendar year for income tax purposes. Newly formed corporations will have a short taxable year from the date of incorporation to December 31 of that year. Similarly, existing corporations will have a short taxable year in the year in which liquidation procedures commence.

### ***Accounting methods***

A modified accrual basis of accounting is required of all business taxpayers for income tax purposes. In the case of sales of goods or services, revenues should be recognized for income tax purposes in their entirety in any of the following situations (whichever occurs first).

1. When a document (invoice, receipt, etc.) is issued that supports the price or remuneration agreed on.
2. When the goods are physically shipped or delivered or when the services are rendered.
3. When the price or payment becomes legally due or payable, or is received in whole or in part, even if it is considered an advance.

The revenues of civil entities rendering professional services (e.g., legal, accounting, medical, engineering, or architectural firms) are not recognized until collected.

A special system is available to determine taxable income for taxpayers in certain industries (among others, farming, fishing, livestock breeding, or timber activities). This system establishes that taxpayers who engage exclusively in these activities will be able to reduce their taxes by 30% (temporarily for years 2010 to 2012; 27.59% for 2013 and 25% for 2014 and after) of the regular income tax determined.

### *Financial leases*

Financial or capital lease contracts are considered as a sale by the less for for tax purposes. Consequently, the less or is not entitled to depreciate assets covered by these contracts.

For income tax purposes, a financial lease exists when a person is obligated to provide to another the temporary use of tangible goods on a fixed term and the latter is obligated to pay several installments as the price of the good, which amount covers the acquisition cost of the goods, the financial charges and other payments, and to elect, at the end of the lease term, one of the following options, as stated in the General Law on Auxiliary Credit Organizations and Activities:

1. The purchase of the goods at a price lower than the acquisition value.
2. Extend the financial lease contract at a lower price.
3. Participate with the less for in the sale of the goods to a third party.

A written contract must exist specifying the value of the asset and the interest rate agreed on or establishing the method for determining the interest rate.

Revenues from long-term contracts for the construction of buildings or the long-term manufacture of personal property (e.g., large machinery) must be recognized for tax purposes when the periodic estimates of work completed are approved by the customer for payment. In the case of personal-property long-term contracts, revenues should be determined on the basis of the quarterly advance of the construction work or the manufacture of the equipment, if such estimates are not presented at least every three months. If advance payments, guarantee deposits, etc., are received, the entire amount of the advance or deposit must be recognized as income.

Costs incurred under such contracts are deductible in the years in which they are incurred, and in some cases estimated future costs can be charged against such revenues.

## ***Business profits***

There are several differences between business and tax profits (e.g., depreciation rates). These differences should be reconciled on an annual basis, when the annual tax return is filed.

### ***Inflation gain or loss***

Taxpayers are required to calculate an adjustment due to inflation (i.e., additional taxable income) on an annual basis by applying the percentage increases in the National Consumer Price Index to essentially all liabilities net of monetary assets, including bank balances, investments (except in shares) and some notes and accounts payable. On the other hand, taxpayers may have an inflation loss (i.e., additional deduction) if their monetary assets, including bank balances, investments (except shares) and some notes and accounts receivable, exceed their monetary liabilities.

It should be mentioned that liabilities that may arise from non-deductible items and the debts that exceed the debt-to-equity ratio (according to the thin capitalization rules) would not be considered in the calculation of the adjustment for inflation.

### ***Intercompany transactions***

For tax purposes, intercompany charges should meet arm's length requirements, (i.e., terms and conditions should be comparable to transactions between unrelated parties). Prices paid for goods bought from foreign or local affiliates or any other source are subject to review by the tax authorities and, if not considered to represent true local or foreign market prices, may be adjusted under broad transfer-pricing provisions. Domestic and foreign transactions must be supported by the application of a recognized transfer pricing method following a preferred method rule. Such methods are: (1) the comparable uncontrolled price method (CUP), (2) the resale price method, (3) the cost-plus method, (4) the profit split method, (5) the residual profit split method, and (6) the transactional net margin method. As from 2006, taxpayers are first required to apply the CUP method, when determining prices in transactions carried out with related parties. If the taxpayer can demonstrate that the CUP method is inappropriate, the other transfer pricing methods can be applied. Moreover, the resale price and cost plus methods are the next preferred methods after the CUP method.

A range of prices or margins could be established by the application of any of the above-mentioned methods. If the price or margin is within the range, the transaction would be considered as carried out at fair market value.

Taxpayers must secure and maintain contemporaneous documentation supporting transactions carried out with related parties, especially with foreign related parties, providing appropriate support that income and deductions are based on market values. This documentation must be prepared per type of operation, and must include all operations carried out with related parties.

In addition, the tax authorities have the power to reconstruct income declared by a taxpayer from sales made at less than current market prices or at cost or less. The income from sales at less than cost will be accepted as declared if the taxpayer can prove that the sales prices represented current market prices for the merchandise, that the items sold represented damaged or obsolete merchandise, or that other special circumstances existed that made it necessary to sell at less than cost.

#### *Tax havens*

Payments made to residents of tax havens are considered nondeductible, unless it can be demonstrated that the price of the transaction is the same as would be set between or among unrelated parties in comparable transactions.

#### *Shares*

The sales price of shares (other than publicly traded shares) sold to a related party must be set at market value and the transaction must be supported by the corresponding contemporaneous transfer pricing documentation.

#### ***Inventory valuation***

As from 2005, the deduction of purchased merchandise was replaced by the deduction of the Cost of Goods Sold. Such cost will be deductible in the year in which the income arising from the sale of goods is accrued. Special provisions apply for the inventory that was on hand as of December 31, 2004.

The cost systems to be used will be the incurred cost system, based on historic costs or predetermined costs. If the requirements in the Regulations to the IT Law are met, the direct cost system, based on historical costs, may be used.

Inventory may be valued by any of the following methods:

1. First in-first out (FIFO)
2. Last in-first out (LIFO)
3. Identifiable costs
4. Average cost
5. Retail

The FIFO and LIFO methods must be applied to each type of merchandise and each movement. The monetary LIFO and FIFO methods may not be used. Taxpayers selling goods that are identifiable by over numbers, at a cost exceeding \$50,000, must value their inventory by the identifiable cost method.

The election of a method is compulsory for five years and can only be changed when the requirements established in the IT Regulations are fulfilled. The results of the change in method will be amortized during the following 5 years.

For accounting purposes different methods and certain variations can be applied. However, a record of the differences must be maintained, and such differences will not be taxable or deductible.

#### *Imported merchandise*

The cost of imported goods may be deducted (and included in the cost of goods sold) only if it can be shown that the goods were legally imported into the country

## Capital gains

### *Securities*

Capital gains on the sale of shares and other securities are includable in regular taxable income. There are two different procedures for computing the tax basis of a Mexican company's shares, depending on the period the shares were held (i.e., less or more than twelve months). The cost basis/purchase price of shares of Mexican corporations sold may be increased by the inflation adjustment factor for the holding period.

In the case of shares with a holding period of more than twelve months, there are certain items to be considered when computing the tax basis of each share, such as the change in the Mexican tax basis earnings and profits account known as the CUFIN account of the issuing corporation (including the possible negative CUFIN effects), adjusted for inflation during the period the shares were held (considering for this purpose the CUFIN balance after January 1st, 1975, if the shares were acquired before that date); the unutilized prior years' tax losses at the date of the sale, as well as tax losses arising prior to the date on which those shares were acquired and amortized during the holding period; and any capital reductions of the issuing company.

A different but simpler procedure applies for computing the tax basis of shares held during a period of twelve months or less. Losses on the sale of shares are deductible only if the acquisition and sale, comply with the general rules established by the tax authorities. The deductible amount is limited to the amount of gains from similar transactions in the same or the following five fiscal years. Losses may not be deducted by nonresidents selling shares, and these losses are not deductible against ordinary income. Certain exceptions to the capital loss recognition rules may apply.

In general terms, the sale by nonresidents of shares issued by a Mexican company is subject to a 25% income tax applicable on the gross amount of the transaction.

Alternatively, gains realized by nonresidents on the sale of shares issued by a Mexican company may be taxed by applying the statutory 30% rate (29% in 2013 and 28% starting 2014) applied to the net gain (i.e., value of the transfer less the tax basis of the shares). This election is only available if the foreign shareholder is a resident of a country that is not considered to qualify as a "preferred tax regime jurisdiction"<sup>71</sup> (tax haven) or a country with a territorial tax system. The selling resident abroad must have previously appointed a representative in Mexico and have a public accountant issue a statutory tax audit report on the transfer of shares. The public accountant issuing the respective report must specify the accounting value of the shares sold, and explain the factors used in determining the sales price, at market value of the shares, when shares are sold between related parties.

Gains and losses from derivative financial transactions of a capital nature are taxed under a special procedure depending on the type of transaction. Related party losses from derivative financial transactions are nondeductible in certain cases (i.e., if the applicable terms are not arm's length).

In any case, certain tax treaties may reduce the rate of taxation of capital gains or change their treatment. This should be analyzed on a country-by-country basis.

### *Real estate*

In determining taxable gain or loss on the sale of real estate, the historical-cost basis of land and buildings may be adjusted (i.e., increased) for inflation, according to the time that the assets have been held. This is done by applying inflation-adjustment factors to the net undepreciated balance. Similar rules apply to nonresidents electing to pay 28% tax on net gain, by appointing a legal representative in Mexico. Otherwise, the 25% final withholding tax on gross income usually applies to nonresidents.

It is important to mention that a specific tax regime is applicable for Real Estate Investment Trusts, which is described below.

### *Machinery and equipment*

Gains or losses from the sale or disposition of machinery, equipment and other fixed assets are also calculated by deducting from the sales proceeds the net undepreciated balance as adjusted for inflation.

### *Gains on sales of assets restricted as to depreciation*

In the case of certain company-owned assets whose cost is generally not depreciable for tax purposes, such as personal residences, yachts and airplanes, which may be depreciated only in very limited circumstances, the entire sales price will be considered as the taxable gain without deduction of the original cost. When only part of the cost of an asset is depreciable for tax purposes, as in the case of some automobiles, the non-depreciable part of the cost will not be deducted in determining the gain on a sale.

### *Interest*

Interest income is taxable on an accrual basis, whether or not collected in the same period, except in the case of penalty interest charges (imposed for failure to meet designated obligations on time), in which case the creditor recognizes the income when it issues a formal invoice or receives the revenue in cash, in kind or in services.

Income tax withholding is required to be remitted to the government by the payer of interest on the earlier of: (1) when the interest is due, or (2) on the date on which the interest is paid. Withholding tax rates on interest payments differ according to: a) the type of loan b) the beneficiary of the interest and c) the effect of any tax treaty in force.

### *Derivative financial transactions covering debt*

Gains and losses from derivative financial transactions covering debt are treated similarly to interest income and interest expense, including recognition of inflation adjustments and foreign currency gains and losses and applicable withholding tax provisions. Transactions classified as mixed debt/capital are considered debt-related derivative financial transactions.

## ***Dividends***

Dividends received from another Mexican corporation are not includable in gross income (see “Intercompany dividends” below). Dividends from foreign corporations are fully taxable. A foreign tax credit is allowed for the foreign income taxes paid on such dividends, if certain conditions are met.

Undistributed earnings of foreign corporations are not taxable until actually received by the Mexican shareholder, except in the case of entities located in preferred tax regime jurisdictions.

## ***Intercompany dividends***

As was mentioned before, dividends received by Mexican corporations are not includable in gross income. However, dividend income is subject to 10% compulsory profit sharing (these dividends will be added to the recipient corporation’s CUFIN account).

No further taxes apply on dividends distributed out of the paying corporation’s net after tax-income. On other corporate distributions that for any reason represent income that has not been subject to the corporate income tax of the distributing corporation, a corporate tax at the general corporate income tax rate is imposed (on a grossed-up basis) on the corporation.

## ***Stock dividends***

Stock dividends are not taxable to the recipient. However, these dividends are generally subject to the 10% mandatory employees’ profit sharing (see Chapter 10).

## ***Dividends-in-kind***

Intercompany dividends received in kind instead of in cash are also nontaxable. The recipient treats them in the same manner as cash dividends for all purposes, including employee profit sharing. However, the distributing corporation may be required to recognize income when it makes a distribution-in-kind, as noted below.

## ***Distributions or payments-in-kind***

When a corporation effects a payment-in-kind or distributes assets that have appreciated in value it must include as regular taxable income, the excess of the appraised value over the net tax basis of the property transferred. In the case of stock distributions in corporate reorganizations the transactions may be tax-free or the tax may be deferred until the shares are sold out of the Group.

## ***Royalties and service fees***

Royalties for the use of patents, trademarks or trade names as well as fees for services of any kind are fully taxable.

## ***Exchange gains and losses***

Foreign exchange gains and losses arising from assets or debts in foreign currencies are taxable or deductible, respectively, on an accrual basis, there are specific rules on the methodology to be applied in determining these gains or losses which often differ from the financial statement treatment. However, the effects of the related inflationary gain or loss should be considered, as discussed under “Business profits” above.

### ***Tax havens or Preferred Tax Regimes***

As from 1997, Mexico incorporated a series of rules intended to regulate the taxation of investments and/or transactions in territories commonly known as tax havens, later denominated as Jurisdictions of Low Tax Imposition or Preferred Tax Regimes, establishing a list of such jurisdictions. As from 2005, Preferred Tax Regimes (hereinafter “PTR”) are no longer limited to a list of countries (“black list”).

Mexican taxpayers are now subject to immediate taxation on undistributed foreign source income that arises from its direct or indirect subsidiaries or any other investment vehicle when the income of that PTR vehicle is subject to an effective foreign tax rate of less than 75% of the Mexican tax to which the same income would have been subject, had it been generated under the Mexican income tax rules.

Investments in PTRs include those made directly or indirectly in entities, branches, real property, shares, bank accounts or investment accounts, and any kind of participation in entities, trusts, joint ventures or investment funds, as well as in any other similar legal entities created or incorporated in accordance with foreign law and located in a tax haven, including those that are carried out through an intermediary.

Income shall be deemed to be from a PTR when it arises from the application of a legal, regulatory or administrative provision or an authorization, refund, application as credit, or any other procedure, and the income tax actually due and paid in the country or jurisdiction concerned is less than that due or payable in Mexico. In other words, it is not a simple comparison of tax rates, but an analysis of the tax actually due or paid in each country is required, and if this tax is less than 75% of the tax rate that would apply had the income been earned in Mexico it is considered income from a PTR.

One of the effects of this is that Mexican taxpayers with foreign investments must calculate the effective rate of tax of all of their investments on an annual basis, in order to determine whether the undistributed income must be immediately reported and taxed in Mexico. The determination as to the effective rate abroad may be done on an entity-by-entity basis, country-by-country basis or for each operation.

The second effect of such rules is that Mexican taxpayers that make certain payments that are Mexican source must determine whether to withhold at a punitive 40% rate rather than the normal withholding tax rates applicable to payments abroad. This punitive rate is only applicable in transactions with related parties.

Mexican tax residents or Permanent Establishments of foreign residents are required to include the income located abroad subject to PTR that they directly generate or through entities or foreign legal structures in which they participate, directly or indirectly, in the proportion that corresponds to their participation in the capital of these entities or legal structures, unless it can be demonstrated that the party in question does not have management control over the investments.

The PTR income regime provides two other exceptions. If the PTR income arises in a country with a broad exchange of information agreement in place with Mexico and the income is “not” passive income, it will not be deemed to be PTR income. If a broad exchange of information agreement does not exist, the Mexican taxpayer may file the opinion of a certified public accountant. This exception for active income does not apply to Mexican taxpayers making purchases or sales through their PTRs to the extent the goods were produced or sold in Mexico.

Also, the income earned by a PTR entity will be exempted where the PTR income arises from a business activity and at least 50% of the total assets of the entity comprises fixed assets, land and inventory used in such business. This exception may not be applied, however, if income such as interest, dividends, royalties, certain capital gains and rents (i.e., passive income) represents more than 20% of the total income generated by the taxpayer.

The PTR income will be determined on a yearly basis and it will not be included with other income of the taxpayer. This means that the taxpayer must record such transactions separately. In general, taxable income would be gross income, unless the taxpayer has the books and records available to the tax authorities and an information return is filed on a timely basis. The inflationary gain on liabilities and stated interest income are included in taxable income without subtracting the inflationary component relating to receivables. However, the inflationary component relating to receivables may be subtracted from interest if an information return is filed.

The tax on direct investments in PTR is 28% of taxable income. Additionally, net operating loss carry forwards associated with the low-tax jurisdiction may be utilized in each of the 5 taxable years following the taxable year of the loss, as long as the accounting records of said investments are available and the information return is filed on a timely basis. Taxpayers must keep an account for income or profits arising in PTR. Dividends received must be added to the after-tax earnings account (CUFIN).

The obligation to file in the month of February of every year the informative return of income subject to PTR generated in the immediate previous fiscal year applies to those taxpayers who are in the following cases:

1. Obtain PTR income described above.
2. Obtain income of any nature from any of the territories indicated in the Transitory Provisions published in the ITL (black list – Appendix I).
3. Obtain income generated in one or more transparent foreign entities or legal structures for tax purposes and they are not deemed to be taxpayers in the country of their organization or the profits generated through them are taxed at the owner level.

### ***Withholding tax rate on PTR income***

As a general rule any income paid to related parties resident in a PTR are subject to a withholding tax rate of 40% on gross income, without any deduction. The withholding should be applied by the Mexican resident (or permanent establishments of non-residents) payer. This rate does not apply to distributions of dividend and capital gains income, as well as to certain type of interest.

### ***Association in Participation***

Associations in Participation are not separate legal entities. Legally, all the activities of the Association in Participation are conducted in the name of the active partner. Nevertheless, the Association in Participation is treated as a separate regular corporation for tax purposes, even though the active partner must pay the tax and comply with the Association's tax obligations. The active partner does not combine the taxable income or loss of the Association in Participation with its other taxable income or losses. Distributions received by passive partners from the Association in Participation are taxed as dividends.

The Association in Participation should record its own CUFIN, profit distributions are subject to the treatment applicable to dividends, and when the Association in Participation agreement is cancelled or terminated, the capital reduction rules apply.

Contributions of non-cash assets to the capital of corporations are treated for tax purposes as sold at fair market value by the shareholders. However, goods contributed to an Association in Participation by the active and passive partners are considered to be sold to the joint venture at a value equivalent to the restated net adjusted tax basis of the investment. Depreciation may only on assets which have been contributed to it be claimed by the Association in Participation.

### ***Nontaxable income***

The relatively few types of corporate income that are not subject to income tax include the following:

1. Dividend income from Mexican resident corporations. However, the payor of dividends is subject to tax in certain cases, as previously discussed.
2. Proceeds from stock redemptions associated with investments in shares of Mexican corporations. However, the redeeming corporation is subject to tax in certain cases.
3. Income from certain investments made by foreign funded pension plans whenever the funds are exempt from taxes in their home country, and these funds are registered.
4. Capital contributions or repayment by shareholders of losses sustained by a corporation.
5. Premiums charged upon the issuance of new shares.
6. Income recognized for financial purposes by using the equity method for valuing shares of investee corporations.
7. Income recognized for financial purposes as a result of revaluing assets or capital to recognize the effects of inflation.

## **Deductions**

Deductions of corporations are a matter of legislative grace, and many specific rules or limitations are established in the tax law and its regulations. The principal requirements and restrictions are described below.

### **General requirements**

The general requirements for deductibility are as follows:

1. Deductions should be for expenses considered as strictly indispensable for the conduct of the business, except for charitable contributions. They should be adequately documented by supporting evidence, in the name of the taxpayer, other than credit card charge notes, and duly recorded in the accounting records.
2. Invoices supporting expenses and the acquisition of fixed assets must be printed by officially authorized printing houses and must satisfy a series of very strict requirements. For example, the tax registration number of the client must be shown, and if the payments are for items subject to VAT, the amount of such tax must be shown separately on the bill. We should note that there is a strict procedure for requesting and allowing companies with certain controls to self-print invoices that comply with the above requirements.
3. Payments for amounts exceeding Ps 2,000 must be made by nominative check, except in the case of payments of salaries and wages. Also, such payments can be done through bank transfers or corporate credit cards. Original bank statements are considered enough supporting evidence for deductibility requirements in those cases, provided certain requirements are met.
4. Provisions for estimated expenses, such as severance pay, vacation and accrued expenses in general, are not deductible until actual payments are made.
5. Generally, all requirements for any particular deduction must be satisfied no later than the last day of the year to which the deduction applies, although the invoice supporting the expense may be provided up to the date on which the tax return for the period in question is filed. An invoice received for an item constituting an expense, must contain a date within the year for which the deduction is claimed. However, payments of fees and rent to individuals may be deducted only when actually paid within the taxable year. Amounts representing taxable income to individuals should have been actually paid and payment of the withholding tax on taxable income of individuals or foreign corporations must be proved.
6. Payments to foreign corporations (e.g. royalties, interest) are only deductible when withholding obligations are fulfilled, supporting documentation should be issued and preserved.
7. For the deduction of salaries and wages, the corresponding tax should be withheld and paid, social security and welfare payments should be made, tax returns should be filed and the employees must be registered in the Federal Taxpayers Registry.

### ***Business expenses***

As noted above, all “strictly indispensable,” fully documented business expenses are deductible, with the restrictions, exceptions and special requirements for specific expenses noted in each case below.

#### ***Bad debts***

Losses on uncollectible receivables are deductible if the statute of limitations for enforcing collection has expired, or earlier if, as is usually the case, the accounts can be proved to have become obviously uncollectible. For relatively substantial balances to be deductible, the existence of bankruptcy or other legal proceedings is normally required. Estimated provisions for bad debts are not deductible by companies that are not part of the financial system.

In the case of banks and other credit institutions, the deduction of bad debts will be allowed as ordered or authorized by the National Banking and Securities Commission, but in no event can the annual deduction exceed 2.5% of annual average receivables. The portion of the bad debts not deducted in the taxable year (because it exceeded the maximum authorized tax deduction of 2.5% of the average receivables) may be deducted in future years.

#### ***Cost of goods sold***

As was explained in the “Inventory Valuation” section of this chapter, from 2005 onwards the deduction for merchandise purchased was replaced by a deduction for the cost of goods sold. Several inventory accounting methods are acceptable to determine the cost of goods sold.

### ***Depreciation and amortization***

The income tax law permits the deduction of the costs of investments in tangible property or intangible assets only through annual charges for depreciation or amortization. The straight-line method, without recognition of estimated salvage values, is the only acceptable method for tax purposes.

Depreciable costs are defined as including not only the purchase price of the assets but also freight and handling charges, insurance, commissions, fees, customs duties, and taxes, except value-added tax, which is handled as described in Chapter 23. Maximum rates of depreciation and amortization are shown in Appendix II. In general, all types of fixed assets except land are depreciable for tax purposes, as long as they can be shown to have been acquired for the business purposes of the corporation itself. Depreciation of personal residences and ships or airplanes not licensed for commercial use may be deducted only if specific authorization is secured, based on factual evidence that such assets are necessary for the conduct of corporate activity. Depreciation of recreational property is prohibited.

Intangibles other than goodwill may be amortized at the rates shown in Appendix II.

Different methods of depreciation, as well as different straight-line rates, may be used for financial purposes. The rates used for tax purposes may be less than the legal maximum straight-line rates but, once adopted, may be changed only once in a five-year period. A second change within five years may be made only in special circumstances, such as in the case of a merger. Depreciation may commence in the fiscal year in which the assets are placed in use or in the following year, at the election of the taxpayer.

### *Vehicles*

Depreciation of automobiles is restricted to Ps \$175,000. All the expenses related to the care and maintenance of vehicles, as well as losses sustained on their subsequent sale, will also be deductible in the same proportion that this ceiling bears to the total cost of the vehicle. Vehicles must be strictly indispensable for the business and used solely for business purposes.

### *Indexation of depreciation expense*

Straight-line depreciation computed at the rates specified by the law, based on the estimated useful lives of the different types of assets, may be increased by the application of the percentage increases in the National Consumer Price Index since the month of acquisition of the asset. Also, specific annual depreciation rates are established for certain industries. When an asset is disposed of or becomes useless the remaining undepreciated historical-cost basis may also be deducted after application of the appropriate adjustment factor.

### *Immediate deduction for the purchase of depreciable assets*

As a tax incentive, investments in certain new fixed assets located outside Mexico City, Guadalajara and Monterrey are entitled to an accelerated depreciation deduction equal to the present value of the future stream of depreciation. Taxpayers may benefit from this deduction in the above-mentioned cities if they can show that their business operations are labor-intensive, do not contribute to pollution, and do not require the intensive use of water, under certain rules.

### *Leasehold improvements*

Leasehold improvements are depreciable by the lessee in accordance with the depreciation rates established by the tax law (in general, at 5% per year). If the related leases are effectively terminated before the leasehold improvements are wholly depreciated, the undepreciated balance will be deductible by the lessee. When leasehold improvements become the property of the lessor upon termination of the lease, the lessor will be required to include the appraised value of such improvements as taxable income.

### *Lease agreements*

Assets acquired under so-called financial leases are treated as purchases subject to depreciation. The related contracts must specify the value of the property being leased and the amount of interest due under the contract. Consequently, the lessee must capitalize precisely that amount as an asset for depreciation purposes and consider the balance as interest expense, deductible as accrued.

Amounts paid under an operating lease are generally deductible in full.

## ***Depletion***

Exploration and development expenses and the cost of mining claims incurred prior to the commencement of commercial operations of a mine are treated as preoperating expenses, which are amortizable at 10% per annum or, at the election of the taxpayer, may be deducted in the year in which incurred, as long as all expenses on each ore body in any year are generally treated in the same manner. Tangible fixed assets of mining companies are generally treated as depreciable assets. There is no percentage depletion allowance.

## ***Interest***

Interest on loans can be deducted if the proceeds of the loans have been invested in the business of the company and proper withholding taxes, if applicable, have been paid. Deductions for interest expense may be partially or wholly disallowed if a company makes non-interest-bearing loans to third parties or if such loans bear interest at rates lower than those paid by it. The amount disallowed may not exceed the amount of additional interest that should have been charged to the borrower, calculated on the basis of the average interest rate paid by the company on its loans. Also, very broad rules classifying loans as back-to-back loans result in the disallowance of interest deductions.

In addition, thin capitalization rules result in the disallowance of interest expense for highly leveraged companies.

## ***Correction for inflation***

Mexican corporations have to determine an annual income adjustment and a deductible loss for income tax purposes, by applying the percentage increases in the National Consumer Price Index to essentially all monetary assets, including bank balances and investments (except in shares).

Even though Mexican inflation has been significantly reduced in recent years, highly leveraged companies may have restrictions on the deductibility of their interest expense and foreign exchange losses as a result of the inflation adjustment. Because of this monetary correction, investors should evaluate the negative effects of financing their operations in Mexico through debt instead of equity.

## ***Thin capitalization rules***

In 2005, thin capitalization rules were introduced in Mexico, with significant changes in the rules taking place in 2006 and 2007. As a consequence, interest generated by excess debt coming from a related party is non-deductible for income tax purposes if the amount of debt is more than three times the shareholders' equity (3-to-1 debt-to-equity ratio), according to the taxpayer's balance sheet.

As from 2007 all liabilities are considered for purposes of calculating the disallowed interest expense amount in determining the annual average liabilities (in 2005 and 2006, the Mexican Income Tax Law appeared to refer solely to liabilities arising from loans).

Certain liabilities may be excluded if certain requirements are met.

In general, the thin capitalization rule still includes the possibility of taxpayers applying for a ruling from the Mexican tax authorities allowing them to apply a higher leverage due to the characteristics of their activities (higher than the 3 to 1 debt-to-equity ratio). Also, the thin capitalization rules still do not apply to the financial sector.

In addition, as from 2007, a provision grants the possibility of the taxpayer using, instead of its shareholders' equity, the sum of the average balances of the capital contributions account (CUCA) and the after-tax earnings account (CUFIN) to determine the 3 to 1 debt-to-equity ratio. The taxpayers that opt for this calculation must continue using it for at least five years. This alternative computation is mandatory for those taxpayers that do not account for capital following Mexican Financial Reporting Standards.

### ***Royalties, service fees and Technical assistance***

Royalties paid to foreign licensors are deductible if the appropriate taxes are withheld and certain other requirements are met. In order to be deductible, such payments must be made directly to companies having the required technical capabilities, and should correspond to services actually received. In the event of a tax audit inspection, the authorities may request documentation proving that technical assistance services were effectively received. The withholding rates on foreign royalties are shown in Appendix V.

Payments to residents outside Mexico for technical assistance or know-how, including royalties for these items, are deductible only if the corresponding fees are paid for services or know-how actually received, not merely for the right to receive services or know-how, and the payments are made to companies that directly provided the service using their own technical resources and staff. However, if the service provider is a taxpayer in Mexico, that service provider is permitted to subcontract technical assistance to third parties.

Royalties are considered to include payments for the temporary use of patents; invention or improvement certificates; trademarks; trade names; copyrights on literary, artistic or scientific works, including movies, films and recordings for radio or television; as well as designs or models, plans, formulas or industrial, commercial or scientific procedures; commercial, industrial or scientific equipment; as well as amounts paid for the transfer of technology or information relative to industrial, commercial or scientific experiences or other similar rights or property.

The temporary use of copyrights on scientific works also includes software programs.

Royalties are also considered to include payments made for the right to receive visual images, sounds or both for retransmission, or payments made for the right to permit public access to such images or sounds, when they are transmitted in either case by satellite, cable, fiber optics, or other similar means.

Payments for technical assistance are not to be considered as royalties. Technical assistance is the rendering of independent personal services whereby the provider agrees to furnish non-patentable knowledge, which does not imply the transmission of confidential information relative to industrial, commercial or scientific experiences, and agrees to take part in the application of said knowledge.

It is very important to consider whether pure technical assistance services may be afforded a different tax treatment under the terms of a tax treaty with another country.

### ***Employee remuneration***

All types of remuneration paid to an employee, as well as benefits paid for the employee's account that do not qualify as tax-free fringe benefits, mentioned below, must be considered in calculating the monthly income tax withholding required for all employees. There are no specific limits on payments to employees, as long as normal payroll taxes and income tax withholdings are paid. Social Security quotas paid by a corporation for the employees' portion of social security contributions are also deductible.

### ***Fees and other payments for services***

Fees and payments to administrators, general managers, directors, and statutory auditors (comisarios) are deductible expenses only if determined as specific amounts and comply with the following requirements.

1. Annual amount paid to each person may not be larger than the salary of the principal officer of the company.
2. Total of such payments may not be higher than the total salaries paid and may not exceed 10% of the total of all other deductible expenses of the company.

Moreover, the company is obligated to withhold personal income tax according to the income tax table for resident employees (up to 30%), unless the recipient is also an employee. Fees of this type paid to nonresidents by a company domiciled in Mexico are considered Mexican-source income even if paid outside Mexico. These fees paid to nonresidents are subject to a flat 25% income tax withholding rate.

### ***Travel, gifts, meals, and entertainment***

Reimbursements to employees for travel expenses incurred in areas that are more than 50 kilometers from the employee's base office are deductible (up to certain limits discussed below) and are not considered taxable personal income of the employee if proper supporting evidence is obtained from third parties, such as suppliers of transportation, meals and lodging. The employer must be able to prove a business purpose for the trip involved, should pay by means of a credit or corporate card and is obligated to inform the tax authorities if such expenses are over a certain amount.

The cost of meals incurred as a traveling expense is deductible only if the related transportation or lodging expenditure vouchers are attached to the meal vouchers. Furthermore, there are daily per-person ceilings for meals of Ps750 for domestic expenses and Ps1,500 for expenses incurred abroad.

In addition to the ceilings on meals deducted as travel expenses, the following travel expense ceilings also apply:

- Rental cars: Ps850 per day.
- Lodging: Ps3,850 per day for trips outside Mexico.
- Seminars and conventions: If the related fee includes all or part of the traveling expenses and these are not shown separately, only an amount equal to the daily deductible meal allowance may be deducted (see above).

Deductions for entertainment expenses are not permitted and business gifts or favors to customers are deductible only if they are directly related to sales or services and are offered on a general basis. Business mileage reimbursements are deductible if certain requirements are met, but monthly allowances for the use of personal cars and per diem living allowances are not deductible unless they are treated as taxable wages of the individual employees.

Investments in and expenses of private corporate dining rooms (i.e., those not available to all of the company's employees) are not deductible.

#### *Pension funds*

Contributions to funded pension plans can be deducted if certain requirements are met, such as that the funds be placed in trust with a Mexican bank for investment in approved securities (30% in government obligations), specific calculations should be made, annual provisions should be made at rates determined by a Mexican actuary and all or large segments of the employee workforce must be covered by the plan after a reasonable eligibility period.

#### *Savings funds*

Contributions by employers to employee savings funds are considered welfare expenses and are subject to the general rules and limitations for this type of deduction, described below. In addition, the regulations establish specific rules, some of which are mentioned below, in order for such contributions to represent deductible expenses for the employer and for payments from the fund to be tax exempt to the employees.

Employer contributions may not exceed 13% of each individual's salary, up to 1.3 times the annual general minimum wage for the region where the employee works. Employees may formally withdraw these savings only upon separation or once each year; these withdrawals are generally tax free to the employee. Employees are also permitted to request loans from these funds once a year. The fund is only allowed to invest in securities approved by the National Banking and Securities Commission.

The rules of the fund may also provide for contributions by the employee on a pretax basis. The above withdrawal rules apply for employee contributions. If employee contributions are for the same amount as contributed by the employer, the employer contributions are not considered as part of the salary for social security and workers' housing contribution purposes.

### *Welfare expenses*

Payments for welfare expenses must be for benefits or services offered to employees on a general basis. The tax treatment of welfare expenses is different if the employees are members of a union or not. For those unionized workers, fringe benefits and welfare expenses should be contained in the collective labor agreement in order to be deductible. For those workers not part of a union, welfare expenses should be the same for all workers. Otherwise, they could be considered to represent taxable income of the specific individuals benefited. The taxpayer should establish definite plans providing periods and requirements of a general nature as the means of determining the group of employees who qualify for the benefit, requirements for qualification, specific beneficiaries, and the procedures for determining the amounts of the benefits. The expenses that may be considered deductions as social welfare expenses are limited to payments of pensions, death benefits, disability compensation, medical and hospital services, scholarships for workers or their children, savings funds, child-care centers, cultural and sports activities, and activities of a similar nature. The regulations contain detailed rules limiting the deductions for what are classified as welfare expenses. Benefits granted to employees holding positions of trust on a general basis may not be proportionately larger than those granted to other employees.

The regulations also establish an overall limitation on deductible benefits to employees holding positions of trust by means of a provision to the effect that if the percentage of the total benefits authorized to such employees in relation to their total base salaries exceeds the percentage authorized to the other employees, the excess cost will not be a deductible expense to the company.

For those employees who are not members of a union, the deductible amount of welfare expenses should not be higher than ten times the yearly minimum salary, without including social security quotas, savings, pension and retirement fund payments, medical expenses and life insurance premiums.

There is a limitation on the exemption from tax of social welfare benefits granted in the form of disability subsidies, educational scholarships, day-care centers, cultural activities, sports, and other activities of a similar nature. Whenever the sum of salaries and social welfare benefits of the above types exceeds an amount equivalent to seven times the minimum wage of the economic area of the taxpayer, all such social welfare benefits in excess of one annual minimum wage are taxable to the employee, and the employer should consider any such amounts in making personal income tax withholdings. Under no circumstances will the social welfare benefits be taxable if their amount, together with other regular compensation, does not exceed seven times the minimum wage. This limitation is applicable only to the specific types of benefits mentioned above and does not apply to other types of benefits, such as the contributions made by the employer to employees' savings funds, pensions or allowances for medical expenses.

### ***Insurance premiums***

Premiums for life insurance payable to the heirs of employees can be deducted if all or large segments of the employee workforce are covered. The cost of key personnel insurance payable to a company is also deductible.

### ***Intercompany charges***

In order to be deductible for a Mexican taxpayer, charges for management fees by foreign or local companies, whether or not affiliates, should meet the test of being “strictly indispensable” for the conduct of the business. In order to be deductible, intercompany charges should also meet with arm’s length criteria.

Charges from a foreign affiliate for a pro rata share of general and administrative expenses or research and development costs are not deductible, except in the case of branches or other permanent establishments of foreign corporations (see “Nondeductible items” below).

### ***Foreign exchange***

Foreign exchange gains or losses are treated as additional interest income or expense, as discussed above under “Inflationary gain or loss.”

### ***Other deductions***

#### ***Donations***

Deductible contributions are restricted to those actually made within the fiscal year to the federal, state or municipal governments, legally authorized charitable or cultural organizations or scientific and technological research institutions appropriately registered as such. Donations to private nonprofit and public educational institutions are also authorized when the recipient institution has the recognition required by federal education laws and the payments are not for services. These deductions are limited to 7% of the tax basis of the previous year.

#### ***Value-added tax***

Since, in general, value-added tax (VAT) is not an expense except to the final consumer, payments of VAT charged by suppliers or paid directly on imports are not deductible unless the corporation does not have the right to credit the payments against the tax on its own activities or to obtain refunds thereof and such payments relate to deductible expenses or purchases subject to depreciation for tax purposes. In essence, VAT is deductible only insofar as it relates to purchases of goods and services for activities that are exempt from VAT, rather than those activities subject to the zero rate of tax (see Chapter 22).

### ***Nondeductible items***

In addition to deductions that do not comply with the above general requirements, the following items are not considered deductible expenses.

1. Corporate income tax, as well as the minimum tax on assets.
2. Payments of taxes levied on other taxpayers, such as withholding taxes for payments to foreigners.
3. Amounts that may be considered as participations in the profits of a taxpayer or that are based on the realization of profits, whether paid to employees, directors, creditors, or others.
4. Allocations of overhead and general and administrative expenses of the home office are deductible (as determined under Mexican tax rules) in the case of a Mexican branch or other permanent establishment of a foreign corporation. However, in the case of subsidiaries or affiliates, these pro rata allocations are nondeductible.
5. Goodwill or its amortization.
6. Losses arising from the merger, reduction of capital stock or liquidation of corporations in which the taxpayer has acquired shares.
7. Entertainment expenses and most business meals, as discussed earlier in this chapter.
8. Fines or indemnities for damages resulting from actions for which the taxpayer is responsible. However, taxpayers are permitted to deduct penalty interest assessed by the tax authorities.
9. Operating expenses or the cost of personal residences or ships or airplanes not licensed for commercial use except as may be specifically authorized under the regulations. In the case of automobiles and aircraft, operating expenses will be deductible only in the proportion which the deductible amount of the investment (Ps175,000) (maximum depreciable basis) for automobiles bears to the total cost of the vehicle.
10. Payments made to any type of person or legal entity or contract located in a PTR, unless the taxpayers can demonstrate the transaction was carried out at fair market value.

### ***Losses***

#### ***Carryback or carryforward***

An operating loss declared for tax purposes can be carried forward and deducted from otherwise taxable profits of the ten subsequent years. Such deductible loss carryforwards will also be indexed (increased) for inflation. Operating loss carrybacks are not allowed.

Losses carried forward may be increased by the percentage increase in the National Consumer Price Index between the seventh and twelfth months of the fiscal year in which they are incurred, and thereafter up to the sixth month of the fiscal year in which they are applied.

Tax loss carry-forwards are a right of the specific taxpayer and cannot be transferred to another entity.

In the case of mergers, operating loss carryforwards of the merged entity are lost, and in the case of carry-forwards of the surviving entity certain limitations apply.

In the case of a spin-off, tax loss carryforwards can be divided between the surviving entity and the spun-off entity(ies) in proportion to:

- a) the inventories and accounts receivable transferred in the case of commercial entities;
- b) the fixed assets transferred, in all other cases.

## ***Tax computation***

### ***Net income***

Net income for tax purposes is defined as the difference between taxable revenues and allowable deductions. The operating loss carryover from prior years and profit sharing paid may be deducted from net income to arrive at taxable income, to which the tax rate is then applied. See Appendix III for a sample tax calculation.

### ***Tax rates***

The corporate tax rate is 30% for 2010 to 2012 with a planned reduction to 29% in 2013 and to 28% in 2014.

Dividends paid to individuals, corporations and to parties' resident abroad are not subject to any income tax withholding.

### ***Tax credits***

A foreign tax credit is allowed for income tax paid directly or indirectly in foreign countries on foreign-source income, as described in Chapter 18.

Immex program companies, previously termed Maquiladoras, are entitled to a tax credit on export income based on a mechanical calculation, sometimes reducing the tax rate to approximately half of the normal tax rate.

In addition, a credit is provided for investing in qualifying film production activities.

### ***Consolidation***

The law allows certain holding companies to file a consolidated income tax return with their majority-owned subsidiaries (group taxation). Tax consolidation is applicable for income tax purposes, but not for other taxes (e.g., Flat tax, VAT) or compulsory profit sharing.

In general terms, the consolidation regime allows certain benefits, such as offsetting losses incurred by one subsidiary against the profits of another. As from 2005, Mexican entities may consolidate up to 100% of the taxable income or loss of group members, based on the top Mexican holding company's shareholding in its Mexican subsidiaries. During the period from 1999 to 2004 only 60% of the controlling company's interest in the controlled companies could be consolidated for income tax purposes.

A 2010 tax reform introduced important modifications to this regime that limit to 5 years the benefits of tax deferral. Also, transitional rules require the recapture of certain benefits from 2009 onwards.

The law establishes several provisions to specify a special tax treatment for the profits and losses incurred in the preceding years.

### *Advantages*

The main advantages of filing a consolidated tax return are the following:

1. The possibility of deducting (at the consolidated level) the tax losses incurred by the subsidiaries corresponding to the portion of shares owned by the holding company. In the case of tax losses incurred before the consolidation, the deduction may be applied only up to the amount of the controlling or controlled company's individual taxable profit in the period in question.
2. Tax-deferred flow of dividends in excess of the net previously taxed income, (individual CUFIN), to the extent that the dividend flow remains within the consolidation group, limited to 5 years.

### *Controlling and controlled companies*

The principal requirement for a company to qualify as a holding (controlling) company for this purpose is that it must be a Mexican tax resident and no more than 50% of the holding company's shares are held by other companies, regardless of their country of residence, although publicly traded shares and nonvoting shares are not regarded as company-owned for this purpose. Unfortunately, this rule precludes the possibility of filing a consolidated return for a Mexican group of companies that would otherwise qualify if more than 50% of the holding company's shares are held by a foreign corporation, unless the foreign corporation is a resident in a country that has executed a comprehensive agreement for the exchange of tax information with Mexico. At present, Belgium, Brazil, Canada, Chile, the Czech Republic, Ecuador, Finland, France, Israel, Italy, Rep. of Korea, the Netherlands, Norway, Romania, Singapore, Spain, Sweden, the United States and the United Kingdom have agreements of this nature with Mexico, and other agreements or tax treaties that might contain such an agreement are awaiting ratification or being negotiated.

Controlled companies are those which are resident companies more than 50% of whose voting shares belong, directly or indirectly, to the controlling company.

There are some entities that are non-eligible companies for consolidation purposes such as non-profit entities, banks, insurance corporations, trust institutions, auxiliary credit institutions, stock exchange entities, foreign exchange houses and capital investment companies; nonresident companies, or companies in liquidation, partnerships, cooperatives, and entities under the simplified regime for legal entities.

### *Relevant obligations*

The tax authorities must authorize the use of the tax consolidation regime, and for this purpose, financial statements and the written consent of the legal representative must be filed before August 15 of the year preceding the first year in which consolidation would apply. Once consolidation is authorized, the controlling company is obligated to file a consolidated tax return for the following 5 years.

A holding company which has elected to use the consolidation regime must record special accounts of consolidated distributable profits and the special accounts mentioned above (i.e. CUFIN), but taking into consideration the consolidated distributable profits.

### **Corporate reorganizations**

Mexican law no longer provides for tax-free reorganizations when non-Mexican entities are involved. However, the tax authorities may authorize the deferral of taxes that would otherwise be triggered by the transfer of shares through a reorganization of companies belonging to the same group, such as mergers and corporate spin-offs. The authorization must be obtained prior to the share transfer. The tax deferred is determined considering an arm's length price. This tax, adjusted for inflation, is payable upon the sale of the originally transferred shares outside the same economic group. An economic group consists of companies 51% or more of whose voting shares are held by the same ultimate parent company.

The representative is jointly liable for the tax on the sale of shares, even when a statutory report is issued by a public accountant.

In principle, such authorizations for deferral are not granted if the party acquiring or selling the shares is a resident of a tax haven or of a country that has not signed a broad exchange of information agreement with Mexico. However, in the latter case, an authorization may still be granted if the taxpayer provides documentation to the Mexican tax authorities stating that the taxpayer has authorized the foreign tax authorities to provide information to the Mexican authorities regarding the transaction for tax purposes.

If the sale of shares qualifies as an exempt reorganization under tax treaty rules the nonresident must appoint, prior to the sale, a legal representative in Mexico and file a notice with the Mexican tax authorities informing them of such appointment and the details of the reorganization process intended to be effected. Additionally, certain formal requirements have been established in the Regulations of the Mexican Income Tax Law that must be complied with when carrying out this type of transaction.

Tax treaty provisions may be applied in lieu of domestic law rules when the seller resides in a tax treaty country.

See Chapter 17 for further discussion of taxation of reorganizations.

## ***Other taxes***

### ***Flat tax***

#### ***Nature of the tax***

A flat tax designed to supplement the federal income tax is payable by corporations, unincorporated businesses, branches, and other permanent establishments of foreign persons, as well as by other entities or individuals carrying out business activities. The tax is payable only to the extent of the amount by which it exceeds the taxpayer's regular income tax liability.

#### ***Taxable amount and rate***

The tax base is the net cash flow related to the sale of goods, rendering of services or rental of property, with some exceptions. A flat 17.5% rate is then applied (transitionally 16.5% for 2008 and 17% for 2009).

Royalties between related parties and interest (except for special rules for financial institutions) are items not considered subject to this tax, hence no income nor deduction is derived from payments of this nature. Additionally, salaries and social contributions are not deductible but in turn generate a credit for the portion of the payment not exempt to the employee.

#### ***Due date***

The annual income tax return applies for purposes of computing and paying the annual flat tax and must be filed no later than March 31 of the following year. Any balance of tax due is payable upon filing the return.

#### ***Estimated tax payments***

Taxpayers are required to make monthly estimated payments of the flat tax during their taxable year on the 17th day of the following month. The estimated tax payment is computed on the accumulated taxable cash flow.

#### ***Income tax credit***

This tax, as noted above, was enacted to supplement the regular income tax and in lieu of the repealed asset tax. This feature is achieved by allowing an amount equivalent to the income tax payable (i.e., regular income tax less any amount deferred) as a credit against the taxpayer's minimum tax liability for the current year. Only the excess of the flat tax computation over the regular income tax liability for the applicable year is payable.

#### ***Carryover***

If in any year the deductions for flat tax exceed taxable income, not only will there be no flat tax to pay, but a flat tax credit can be used to offset the year's income tax or against the flat tax of the following 10 years.

### ***Value-added tax***

A value-added tax (VAT), discussed in more detail in Chapter 23, is payable at the general rate of 16% on sales of goods and services, as well as on rents and imports of goods and services. However, a 11% rate applies to certain transactions in border areas. Medicines and food products are subject to VAT preferences, as discussed in Chapter 23.

### ***Mandatory profit sharing***

Every business concern with employees is required to distribute a portion of annual profits among all employees, irrespective of its form of organization. The amount distributable to the employees in most cases amounts to 10% of taxable income, adjusted to eliminate income or deductions that relate to the recognition of inflation and increased by dividend income, which is not included in taxable income. As discussed under “Profit sharing” in Chapter 10, special rules apply to a limited number of specific businesses. (See Appendix III for a sample computation of the profit sharing base amount).

Profit sharing is deductible from taxable income or added to tax losses.

### ***Branch versus subsidiary***

Except as noted below, from a tax viewpoint there is no significant difference in operating through a branch or through a subsidiary of a foreign corporation.

Remittances (i.e. royalties, fees, commissions, services, or interest payments) made by a branch or other permanent establishment of a foreign corporation to its head office abroad are not deductible by the branch, although they would continue to be subject to any applicable withholding taxes.

It should be noted, however, that branches and other permanent establishments of foreign corporations which are located in a country with which Mexico has concluded double tax treaty are allowed to deduct pro rata allocations of home office expenses. This deduction is not available to subsidiaries of foreign corporations. Also, certain prorated expenses of the home office paid to third parties are subject to withholding taxes.

## ***Special industries***

### ***Farming, fishing, livestock, timber, and land transportation companies***

Corporate taxpayers engaged in these industries must use a special regime to determine their taxable income. In general, these businesses can apply an income tax reduction of 32.14%, among other benefits, such as making provisional payments only twice a year and not calculating the inflationary adjustment.

### ***Insurance companies***

The various types of insurance and bonding companies are allowed to deduct certain asset valuation and technical reserves, established on the basis of the instructions or with the approval of the National Insurance and Bonding Commission.

### ***Holding companies***

Dividends received by Mexican companies that own the shares in other Mexican companies are not includable in taxable income. However, such dividend income is subject to obligatory profit sharing (see “Profit sharing” in Chapter 10), which would therefore be duplicated in respect of dividends received from an operating company if the holding company has employees of its own. On the other hand, there can be tax advantages for a holding company and its subsidiaries if they are authorized to file consolidated income tax returns, as discussed above under “Consolidation.”

## Preferred Tax Regime List

Anguilla	Kingdom of Swaziland	Republic of Mauritius
Antigua and Barbuda	Kingdom of Tonga	Republic of Nauru
American Samoa	Kiribati	Republic of Panama
Aruba	Labuan	Republic of Trinidad and Tobago
Ascension	Macao	Republic of Tunis
Azores Islands	Madeira	Republic of the Marshall Islands
Barbados	Malta	Republic of the Seychelles
Belize	Montserrat	Republic of Vanuatu
Bermuda	Most Serene Republic of San Marino	Republic of Yemen
British Virgin Islands	Netherlands Antilles	Saint Helena
Brunei Darussalam	Nevis	Saint Kitts
Campione D'Italia	Niue	Saint Lucie
Canary Islands	Norfolk Island	Saint Pierre and Miquelon Islands
Cape Verde Republic	Oriental Republic of Uruguay	Saint Vincent and the Grenadines
Cayman Islands	Ostrava Free Zone	Socialist Democratic Republic of Sri Lanka
Channel Islands (Guernsey, Jersey, Alderney, Great Sark, Herm, Little Sark, Brechou, Jethou, Lihou)	Pacific Islands	Solomon Islands
Christmas Island	Patau	Special Zone of the Canary Islands
Cocos-Kelling Islands	Pitcairn Island	State of Bahrain
Commonwealth of Dominica	Principality of Andorra	State of Kuwait
Commonwealth of the Bahamas	Principality of Liechtenstein	State of Qatar
Cook Islands	Principality of Monaco	Sultanate of Oman
Falkland Islands	Qeshm Island	Svalvard Archipelago
Free Associated State of Puerto Rico	Republic of Albania	Tokelau
French Polynesia	Republic of Angola	Trieste
Gibraltar	Republic of Costa Rica	Tristan da Cunha
Granada	Republic of Cyprus	Turks and Caicos Islands
Greenland	Republic of Djibouti	Tuvalu
Guam	Republic of Guyana	United Arab Emirates
Hashemite Kingdom of Jordan	Republic of Honduras	U.S. Virgin Islands
Hong Kong	Republic of Liberia	Western Samoa
Isle of Man	Republic of the Maldives	



# Chapter 16

## Taxation of foreign corporations

### ***Investor considerations***

- Mexican tax law follows the OECD model treaty definition of a permanent establishment.
- Branches are taxed in the same way as corporations, except that payments for interest, commissions, royalties, or fees to the home office of the same legal entity are not deductible. However, some branches may deduct reasonable allocations of home office expenses.
- Mexican-source income that is not connected with the conduct of business through a permanent establishment is generally subject to specific withholding tax rates, although tax treaties reduce or eliminate withholding taxes in some cases.
- Sales people or agents with authority to execute contracts constitute a taxable permanent establishment.
- Goods held in bonded warehouses within Mexico do not constitute a permanent establishment. The Mexican customer is considered the importer at the time goods are released from the warehouse.
- Liaison or representative offices can operate tax-free in certain circumstances. However, if they employ local personnel, they are subject to normal payroll obligations.

16

### ***Tax concepts***

#### ***Separation of business and nonbusiness income***

Mexican income tax law contains specific rules for the taxation of Mexican-source income of nonresident foreign corporations and individuals. For tax purposes, Mexican-source income of nonresident corporations and individuals may be divided into the following general categories:

1. Income of Mexican branches of foreign corporations or income attributable to what are classified as permanent establishments for income tax purposes in Mexico—Income is taxed under similar rules as those applicable to Mexican corporations.

2. Mexican-source income not arising from branches or permanent establishments—This income is usually taxed at a flat rate applied on a withholding basis to the gross income without deductions of any kind, as discussed below, except in a limited number of cases when a higher rate of tax can be applied to net income if the nonresident meets specific residency requirements and has appointed a duly qualified representative in Mexico.
3. Income from personal services rendered in Mexico—Discussed in Chapter 20 under “Nonresidents.”

## ***Imports***

### ***Sales from outside Mexico***

Except in the case where a permanent establishment of a foreign resident is deemed to exist as described below, Mexico treats international sales to a resident of Mexico that legally imports the goods as sales completed outside Mexico. Accordingly, foreign corporations exporting merchandise through direct sales to Mexican customers are not subject to Mexican taxation. In these cases, the goods are imported by the customers and will normally be subject to import duties and value-added tax, but these are obligations of the Mexican importer.

### ***Sales of merchandise or other assets within Mexico***

Foreign residents are taxed on sales in Mexico in two general cases, as follows:

1. When the foreign corporation has a registered branch or permanent establishment for income tax purposes in Mexico—Sales within Mexico made by the head or other foreign office will be attributed to the Mexican establishment. Moreover, foreign residents who own merchandise on consignment in Mexico for sale in Mexico are generally considered to have a permanent establishment in Mexico for income tax purposes and therefore are subject to Mexican income tax on their profits from such sales. However, certain tax treaties that Mexico has in effect with other countries permit the maintenance of inventories solely for delivery. A nonresident is allowed to maintain inventories in a bonded warehouse for delivery in Mexico. The ultimate Mexican importer is responsible for any customs duties or licenses (if applicable) and for the value-added tax upon withdrawal of the merchandise from the bonded warehouse.
2. When the nonresident directly or indirectly sells land or buildings located in Mexico, trust rights to such real property, shares of stock issued by Mexican corporations, or capital interests in nonstock companies domiciled in Mexico, the proceeds of these sales are considered Mexican-source income no matter where the sales take place.

## ***Branch operations***

A branch of a foreign corporation formally registered to do business in Mexico, as well as any other permanent establishment for income tax purposes, is in general taxed as a Mexican corporate business enterprise. Only income attributable to the branch itself is considered for tax purposes, except that, under a rule of attraction, sales of goods carried out in Mexico by the head office or other offices of the same legal entity must be considered income of the branch or other permanent establishment. Income may also be attributed to the permanent establishment to the extent that it participates in the expenses incurred to produce income in any other establishment of the same legal entity.

It should be noted that if a foreign corporation has more than one branch or other unincorporated permanent establishment in Mexico, even in unrelated lines of business, a single annual return must be prepared that combines the income and deductions of all the establishments.

Duly registered branches or other permanent establishments of foreign corporations in Mexico are allowed the deductions corresponding to their activities, whether incurred within or outside of Mexico, as long as they comply with the specific requirements of the income tax law and regulations, including expenses that represent reasonable allocations from the head office or other offices located outside of Mexico. Allocations are only allowed if the head office is a resident of a country with which Mexico has signed a tax treaty and the other foreign offices are in addition residents of a country with which Mexico has signed a comprehensive exchange of information agreement. On the other hand, remittances to such offices will not be deductible even when made in payment of royalties, fees, commissions for actual services, or interest on funds provided to the establishment in Mexico or for similar purposes.

The cost of assets imported from the head office or other offices of the foreign taxpayer will be determined on the basis of the lower of fair market value or the amount declared for customs purposes.

### ***Permanent establishment for income and flat tax purposes***

In accordance with the income tax law, any place in Mexico where business activities are partially or totally carried out, such as branches, offices, agencies, or mining exploration sites, regardless of the length of time involved, will be considered as a permanent establishment in Mexico for income and flat tax purposes and subject to taxation as described above. The law also provides that if a foreign resident corporation or individual acts within Mexico through an individual or company that has and exercises power to sign contracts in the name of the foreign resident, involving business activities in Mexico other than activities referred to below, the foreign resident will be considered to have a permanent establishment for income tax purposes in Mexico as regards such activities even if they are not carried out in a fixed place of business. A nonresident is also considered to have a permanent establishment if it owns merchandise for resale in Mexico (other than that deposited in a bonded warehouse, as discussed above), or in the case of business activities carried out by a foreign resident through a trust, the premises in which the banking institution (i.e., the trustee) carries out such activities will be considered as the place of business of the foreign resident.

In addition to the cases where there is a power of attorney or there are inventories that are subsequently delivered on behalf of the nonresident, a permanent establishment of a nonresident will also be deemed to exist, even if there is no physical place where business is conducted, when a resident of Mexico (corporation or individual) on behalf of the nonresident does any of the following:

1. Keeps a stock of goods with which to make deliveries on behalf of the nonresident.
2. Accepts risks on behalf of the nonresident.
3. Acts under detailed instructions or under the control of the nonresident.
4. Carries out activities that from an economic point of view correspond to those of the nonresident.
5. Is compensated by guaranteed remuneration, independently of the results of the resident's efforts, or
6. Carries out activities with the nonresident at prices other than those that would have been used by unrelated parties in comparable transactions.

These situations have not been included in the definition of a permanent establishment in the tax treaties concluded by Mexico. In these treaties, Mexico uses a definition that is similar to that provided by the OECD model tax convention.

A permanent establishment will also be deemed to exist when a foreign resident renders services of construction, installation, erection, or maintenance of buildings in Mexico, or of inspection or supervision related thereto, when such services last for more than 183 days duration. This treatment becomes effective on the 184th day. Nevertheless, if it is known at the time a contract is signed that the services will require more than 183 days; income for this type of work will be treated as earned by a permanent establishment from its inception. This treatment is of importance in determining the income tax obligations not only of the foreign company but also of any foreign residents employed in the work, as discussed in Chapter 20.

The Mexican payer is generally required to withhold 25 percent of gross payments when the period is for less than 183 days. For more information on withholding taxes, see Appendix V.

All branch operations are subject to prior authorization of the National Commission on Foreign Investment, but in most cases this is a mere formality. It is understood that this is the interpretation of the Commission and that the Commission generally authorizes establishments as branches of a foreign company although authorizations for construction of highways and railways tend to somewhat more complicated.

Mexico has entered into tax treaties with several countries. In some cases the treaties provide a different time period for classifying a construction activity as a permanent establishment (e.g., six months or eight months) and generally do not provide withholding tax rates applicable during the period in which the foreign constructor does not have a permanent establishment in Mexico.

### ***Activities not constituting a permanent establishment***

The income tax law provides that a limited number of activities will not be considered as constituting a permanent establishment in Mexico. However, it is advisable to seek legal advice on whether the authorization of the National Commission on Foreign Investment is required. Such activities include the following:

1. Mere storage or exhibition of merchandise belonging to the nonresident at a specific location or the maintenance of inventories to be processed by another party.
2. Use of a place of business for the sole purpose of purchasing goods or obtaining information for the foreign resident.
3. Storage of goods in a bonded warehouse, described above.
4. Use of a place of business for the sole purpose of carrying out activities of a preparatory or auxiliary nature with respect to the business activities of the foreign resident. These include publicity, furnishing of information, scientific investigations, and preparations for placing loans or other activities of a similar nature.
5. Having goods in bonded warehouses (already mentioned), to the extent such goods are not released to third parties.

Foreign residents shall not be deemed to have a permanent establishment for any legal or financial relationship maintained with companies engaged in maquiladora operations to the extent a treaty for avoidance of double taxation is in force between Mexico and the country of the foreign resident and certain requirements established in the Mexican income tax law are met.

The obligations imposed by the value-added tax, social security and other laws, in addition to the normal income tax withholding from payments to employees and others, must be complied with in the above cases.

### ***Transfer of branch profits***

In the case of branches and other permanent establishments of foreign corporations no further tax will be imposed on the after-tax earnings of the branch. A corporate income tax rate of 30% on a grossed-up basis applies to remittances from permanent establishments (except remittances representing return of capital invested in the branch) when such profits have not previously paid income tax.

In addition, the following tax rules apply to permanent establishments:

1. Procedures established for the determination of the balance of the net after-tax earnings account (CUFIN) or the capital remittances account (similar to the capital contributions account). These involve a procedure similar to that followed by Mexican corporations in determining the tax that may apply to dividend payments and capital reductions.
2. Remittances made to the home office for reductions of capital in Mexico are first considered to be from profits. Once these remittances exceed profits, the excess will be considered a reduction of capital.
3. Any amount paid to the home office that does not arise from CUFIN or the capital remittances account results in additional income tax. This is payable at a 30 percent rate by the permanent establishment on a grossed-up amount arrived at by multiplying the total excess remittances by 1.4286 for the period 2010-2012.

### ***Tax rates***

Branches and other permanent establishments of foreign corporations are taxed in the same manner as Mexican corporations. Therefore, the tax rate of 30 percent is applied to the income tax base and a 17.5% rate is applicable to the flat tax base, as described in chapters 15 and 25, respectively.

### ***Income from subsidiaries***

#### ***Mexican-source income not arising from a permanent establishment***

Mexican-source income of foreign corporations that do not have permanent establishments for income tax purposes in Mexico or, if they do, whose income is not attributable to such establishments is taxed separately, generally through withholding taxes applied at source. The rules referred to in this section are applicable to foreign corporations and also apply to nonresident individuals if they receive Mexican-source income.

#### ***Nature of income***

Foreign corporations are taxed on their Mexican-source income received in cash, kind, services, or credit. Payments made for the account of the foreign corporation are also subject to tax. This includes traveling expenses of foreigners rendering services. Any income tax due from the foreign corporation that is absorbed by the Mexican company making payments to it is specifically considered as additional taxable income of the foreign corporation.

#### ***Tax withholding***

Mexican taxpayers making payments to residents of foreign countries or their representatives should withhold and remit the corresponding income tax (see Appendix V). These payments are generally considered as final payments of the income tax, with no further obligations on the part of the foreign corporation. There are a few cases where a foreign corporation is permitted to pay taxes on net income, provided it has a qualified representative in the country (see below).

The withholding taxes become an obligation at the time payments to the foreign residents become due (whether or not payment is actually made) or when the payment is actually made, whichever happens first. The amounts of tax due are generally required to be remitted to the tax authorities during the first 17 days of the following month.

### ***Election to be taxed on net income through a qualified representative in Mexico***

A foreign resident directly or indirectly selling real estate located in Mexico or shares issued by a company domiciled in Mexico, an individual receiving income from artistic or sporting events, foreign residents carrying out financial derivative operations, or foreign residents engaged in the construction business in Mexico may elect to be taxed on the net Mexican-source income in lieu of the withholding tax rates applicable on gross income. In order to elect this method of taxation, the foreign taxpayer must have a qualified representative in Mexico that meets the following requirements:

1. Individual or company must be a resident of Mexico or a permanent establishment of a foreign entity.
2. Representative should retain the supporting evidence of the income and expenses for five years from the date the tax is paid.
3. Representative is jointly and severally liable for any tax deficiencies.

In a stock transaction the election also requires that the seller not be a resident of a tax haven or a preferential tax regime country and that an independent accountant issue an opinion as to the propriety of the tax computation in conformity with the “net basis taxation” rules optionally available for stock transactions.

### ***Dividends***

Dividends paid by a Mexican company that exceed the after-tax earnings account (CUFIN) are subjects to a corporate tax rate of 30 percent on a grossed-up basis. For this basis, the Mexican Income Tax Law establishes that the excess must be grossed-up, multiplying it by 1.4286, prior to the calculation of the income tax. The tax will be payable by the company and will be creditable against its income tax liability of the year and the following two years. See “Corporations and shareholders” in Chapter 15.

### ***Interest***

Interest income is considered as Mexican-source income when the corresponding capital is placed or invested in Mexico or when the person who pays the interest is a resident or a permanent establishment in Mexico. The definition of taxable interest is somewhat broad and includes the following:

1. Earnings from loans or credit balances of all types.
2. Earnings from the public debt.
3. Earnings from bonds or debentures.
4. Other payments made which are related to the loan or credit balance (commission, guarantee fees, etc.)

The rates of tax on interest, payable on a withholding basis and applicable to the gross income in each case, are shown in Appendix V.

A tax exemption is applicable to the following types of interest, among others.

1. On loans granted to the federal government.
2. When paid on a minimum three-year loan agreement granted by financial institutions that promote exports and are duly registered specially for this purpose (i.e., not a regular bank) with the Ministry of Finance.
3. On preferential loans granted or guaranteed by foreign financial entities to institutions authorized to receive tax-deductible donations in Mexico, provided these institutions use the funds for purposes consistent with their tax-exempt status and are properly registered.

### ***Sales of shares or capital interests***

In the case of sales of shares or of capital interests in nonstock companies, Mexico continues to be considered the source of wealth if the issuing company is Mexican, regardless of where the sales take place. The tax payable, withheld at source, is 25 percent of the gross proceeds of the transaction, unless the foreign entity has a duly qualified representative in Mexico as described above and obtains a statutory tax audit report issued by a public accountant, in which case it may elect to pay generally at the rate of 30% on the taxable gain realized.

If the foreign resident has a duly qualified representative in Mexico, he may elect to calculate the taxable gain by deducting from the sales proceeds the average cost of the shares sold, as adjusted by the change in the after-tax earnings account (CUFIN) of the issuing company, any unamortized tax losses, reimbursement of capital and any similar items, during the period the shares were held to the date of the current sales transaction, all adjusted for inflation.

This election is available only if the foreign shareholder is not a resident of a country that is considered a tax haven (including countries that tax earnings on a preferential basis). Moreover, nonresident taxpayers are not allowed to deduct losses incurred in similar transactions. When the purchaser is also a foreign resident and does not have a representative in Mexico, the seller is obligated to pay the tax directly. Gains on sales carried out through the Mexican Stock Exchange continue to be exempt from income tax as long as the securities sold are considered to be available to the general investing public, as shown by lists published from time to time, and other requirements are satisfied.

### ***Group restructuring***

The Mexican tax authorities may grant a ruling to defer the income tax arising from the sales of the shares of a Mexican company during the course of a corporate organization. Such authorization will only be granted prior to the restructuring and provided the following requirements are fulfilled:

1. The seller or the acquirer must not reside in a territory with a preferred tax regime or a country with which Mexico has not entered into an agreement for comprehensive exchange of information.
2. A legal representative must be appointed.
3. A tax report is filed with the Mexican tax authorities.

In addition, the Mexican tax authorities require some additional information to be filed with the request for a ruling and the tax will only remain suspended while the shares remain within the same interest group.

### ***Royalties, including technical services***

The source of income is considered to be Mexican when the assets or rights that produce the income are utilized within Mexico or when the payments are made by a resident or a nonresident having a permanent establishment in Mexico. The rates of tax payable on a withholding-at-source basis and applicable to the gross income received are shown in Appendix V.

### ***Short-term construction, installation and related services***

Earnings from short-term construction, installation and related services are considered to include income from construction work, installation, maintenance, and assembly; erection of buildings and structures; and inspection work or supervision related to such activity when the services involved are expected to last for less than 183 days. The source of income is considered to be in Mexico when the work is carried out within Mexico.

Tax will be payable on a withholding basis at the rate of 25 percent on the gross income unless, the foreign corporation has a qualified representative in Mexico, as mentioned previously. In this case the taxpayer may elect to pay tax at a 30 percent rate applied to the net profit obtained from the activity. This taxable profit will be determined by deducting from the gross income received the directly-related deductible expenses authorized for resident corporations, whether incurred in Mexico or abroad. When the taxpayer elects to be taxed on a net basis, the Mexican customer should be advised so that the 25 percent withholding will not be made, and the representative should pay the tax due with a tax return to be filed during the month following that in which the work is completed.

If the work should actually last for a period longer than 183 days, the foreign resident will be considered to have a permanent establishment for income tax purposes in Mexico as from that time and will be taxed as such thereafter, rather than by either of the special methods of taxation described above. An income tax return must be filed within three months after the end of each calendar year from the incorporation of the permanent establishment. Additionally, advance monthly tax payments must be made during the year following that of the constitution of the permanent establishment.

When calculating the advance income tax payments, the permanent establishment must remain with the option chosen to determine its income tax prior to being considered as a permanent establishment (25% on gross income or 30% on net income).

Moreover, if it is known at the time the work begins that it will require more than 183 days, for example, based on the contract terms agreed, the foreign resident will be considered to have a permanent establishment for income tax purposes as from the date of commencement.

Mexico has entered into tax treaties with several countries, and the time periods vary for classifying a construction activity as a short-term construction activity or permanent establishment. In some cases short-term construction activities are no longer subject to Mexican withholding taxes under a particular treaty. Therefore, consultation with an international tax specialist is advisable prior to the execution of the contract or commencement of the work.

### ***Rental income***

Real estate rental income is considered Mexican-source income if the real estate is located in Mexico. Rental income for the use of personal property is considered Mexican source if the personal property is to be used in Mexico. Tax is assessed at the rate of 25 percent of the gross rental income without deductions of any kind, payable on a withholding-at-source basis:

There are two other exceptions to this rule, as follows.

1. In the case of personal property, a 25 percent rate applies for the use of “commercial, industrial or scientific equipment” which under the law are classified as royalties. Railroad cars, containers and airplanes and ships that may be commercially exploited are subject to a 5 percent withholding tax rate.
2. Property leased under a financial lease, in which case a 15 percent tax is applied only on the portion of the lease payments that is deemed to represent interest.

### ***Sales of real estate***

The proceeds of sales of land and of buildings located in Mexico or of trust rights thereto are considered to be Mexican-source income. In general, tax is levied on a withholding basis at the rate of 25 percent of the gross income received, unless the foreign corporation elects to pay tax at the rate of 30% rate on the net gain realized, which will be determined on the same basis as for resident individuals (i.e., including an adjustment to cost for inflation, based on the number of years the asset was held), except that foreign corporations are not allowed to deduct any loss carryforwards of a similar nature incurred in prior years. In order to elect to be taxed on the net gain, the nonresident should have a representative duly qualified within Mexico, as discussed earlier, and the transaction should be carried out through a public deed, unless the assets are represented by nonredeemable real estate trust certificates. When the sale is made through a public deed and provides for installments payable in a period of more than 18 months, the tax can be paid in the years the installments are actually collected or due under the contract in certain cases. When the purchaser is another nonresident and has no representative in Mexico, the seller is required to pay the tax directly.

### ***Fees paid to foreign corporations***

When the related specific services are rendered outside Mexico by foreign corporations, any fees paid to them are not subject to Mexican income tax, unless the services are classified as technical assistance or publicity, which are taxed by applying the same rates applicable to royalties, regardless of where the services are rendered. On the other hand, any type of fees or commissions paid to tax haven or preferential tax regime entities are subject to withholding tax at a 40 percent rate.

## ***Portfolio investments***

There is no difference in the taxation of income from subsidiaries, portfolio investments or unrelated parties. It should be noted, however, that investment income of foreign pension funds in existence and exempt under the laws of their respective countries is wholly exempt from Mexican income tax, provided such funds are duly registered with the tax authorities for this purpose.

## ***Taxes other than income tax***

As regards the value-added tax (VAT) described in Chapter 23, permanent establishments of foreign corporations in Mexico are subject to VAT on the same basis as resident business enterprises. Nonresidents are required to pay VAT in respect of their activities in Mexico if such activities are subject to the tax, regardless of whether the related income is subject to income tax. Accordingly, VAT would be payable on sales of assets in Mexico other than exempt real estate (land or residential property) and shares or capital interests, whether or not they are taxed under the income tax law. In such cases, the Mexican payer is obligated to withhold the corresponding VAT.

The rental of machinery, equipment and real estate from foreign corporations is generally VAT taxed, subject to the withholding mentioned above. In the case of services utilized in Mexico but for which payment is made to nonresident service providers, the Mexican resident making such payments is deemed to be the importer of such services and is required to reflect a VAT liability thereon at the time of making the monthly VAT returns, but may reflect a VAT credit in an equal amount against the liability for tax on the resident's own taxable activities.

## ***Regional administrative offices***

Mexican legislation does not favor the establishment of regional administrative offices. In addition, restrictions on the employment of foreigners may still make it difficult to staff such an office. Operations of this type may have to continue to be assigned to a Mexican subsidiary that also acts as regional headquarters.



# Chapter 17

## Taxation of shareholders

### **Investor considerations**

- Dividends paid to individuals and residents abroad are not subject to any withholding tax. If dividends are distributed in excess of net after-tax distributable earnings the company paying the dividend is subject to a corporate tax at an effective tax rate of 42.86 for 2010, 2011 and 2012, 40.85% for 2013 and 38.89% for 2014 and after.
- Intercompany dividends are not included in taxable income but must be included in the mandatory profit sharing-base.
- Dividends to domestic individual shareholders are taxable to these shareholders on a grossed up basis, although a proportional credit is available for their portion of the income tax incurred by the payor.
- Capital gains on the sale of shares by domestic corporations are generally fully taxable.
- Capital gains on the sale of shares issued by domestic corporations that are realized by individuals, whether Mexican nationals or foreigners, or by foreign corporations are taxable through a special procedure.
- Disposal by individuals and nonresident owners of Mexican shares traded widely and publicly in the Mexican or certain foreign stock exchanges is generally tax exempt. The exemption is not applicable when an individual or group of individuals collectively holding 10% or more of the shares of an entity sells 10% or more of the voting shares or sells shares that lead to the loss of control of the investee within a 24-month period.
- A reorganization of Mexican corporations of the horizontal type, i.e., a consolidation of two corporations or a spin-off of a corporation into two or more corporations, can be done essentially tax-free, except for the special tax on acquisition of real property. For non-Mexican entities involved in a reorganization of ownership in Mexican entities, an authorization can be granted for deferral of taxes.
- Tax basis of assets can generally be stepped up through acquisitions.
- Net operating loss carryovers of the surviving corporation in a merger may be utilized only against profits earned in the same line of business.
- Net operating losses of the merged company are permanently lost.

## ***Domestic shareholders***

### ***Dividends***

The tax treatment of dividends is as follows.

1. Dividends paid by Mexican corporations are not deductible by the corporation distributing them or includable in the gross income of the foreign residents and domestic corporate recipient. No further taxes are applied if the dividends are distributed out of earnings on which the regular corporate tax has been paid.
2. Dividends and other corporate distributions distributed out of earnings that for any reason have not been subject to the regular corporate tax are subject to tax at an effective rate of 42.86 percent (see above). This is a tax on the distributing corporation, not a withholding or other tax on the shareholder.

To enable a corporation to determine whether a dividend is distributed out of earnings that have already been subject to the corporate income tax (and therefore not subject to further tax upon distribution), it must keep a record of such earnings in a special memorandum account called “after tax earnings” (free translation of *cuenta de utilidad fiscal neta*, or CUFIN). In general terms, these accounts would include each year’s previously taxed net earnings plus domestic dividend income received by the corporation, minus dividends distributed out of the applicable account. Each year, before adding the current year’s previously taxed net earnings, the balance in the CUFIN account at year-end will be adjusted for inflation.

A detailed set of rules, illustrated in Appendix IV, establishes a procedure for computing the balance of a corporation’s previously taxed net income, taking into account the company’s taxable earnings since 1975. Appendix IV illustrates both the computation of each year’s additions to this account and the restatement for inflation to be made each year.

Dividends or distributions of profits from foreign sources received by Mexican shareholders must be included as ordinary income, but a foreign tax credit may be claimed by the taxpayer (see also “Dividends and interest” in Chapter 18).

Dividends distributed to Mexican resident individuals are taxable to those individuals on a gross-up basis, allowing a domestic deemed-paid credit for income taxes paid by the Mexican corporation paying the dividends, which will effectively make the dividends non-taxable since the corporate and individual rate is the same (30%).

### **Capital gains**

Gains on the sale of shares by corporations are fully taxable, although the historical-cost basis of the shares for this purpose is adjusted for inflation and, in the case of shares issued by Mexican corporations, the basis is also adjusted for the change in the after-tax earnings account (CUFIN), as discussed under “Capital gains” in Chapter 15. Capital gains on the sale of shares by individuals are taxable in the same manner as for corporations, except that if the gain arises from the sale of publicly and widely traded Mexican shares through the Mexican Stock Exchange (or certain foreign exchanges), it may be exempt. The exemption is not applicable when an individual or group of individuals collectively holding 10% or more of the shares of an investee sells 10% or more of the voting shares or sells shares that lead to the loss of control of the investee within a 24-month period.

### **Foreign shareholders**

#### **Dividends**

There is no withholding tax on dividends distributed to shareholders. As in the case of domestic shareholders, an additional corporate tax at an effective rate of 42.86 percent applies only if the dividend is distributed out of earnings that have not been subject to the regular corporate income tax.

#### **Capital gains**

Gains by foreign corporations on the sale of shares issued by Mexican corporations are taxable, irrespective of where the sale takes place, as described under “Sales of shares or capital interests” in Chapter 16. As in the case of resident individuals, gains by foreign shareholders, corporate or individual, are exempt if they arise from the sale of publicly and widely traded shares through the stock exchange.

### **Reorganizations**

#### **Incorporation**

The conversion of a Mexican branch of a foreign corporation into a subsidiary corporation would entail the following:

1. Formation of the subsidiary.
2. Transfer (generally through a sale) of all of the branch assets to the subsidiary.
3. Transfer of its employees, who would retain their seniority and,
4. Liquidation of the branch.

The transfer of the assets and the liquidation of the branch are taxable transactions that may give rise to taxable income or loss, value-added tax, flat tax and real estate transfer taxes. A specific authorization may be required to permit the incorporation of the branch of the foreign corporation, but if it is required, in all probability this authorization would be granted by the National Commission on Foreign Investment because operating as a branch already involves 100 percent foreign ownership. Net operating losses of the branch, if any, would be lost, as they are nontransferable.

### ***Merger or amalgamation***

Two different types of tax-free mergers are generally recognized in Mexico, provided all applicable requirements are met: (1) a vertical merger, where one company has already acquired the shares of the other company; and (2) a horizontal merger or amalgamation, where two or more companies are merged, with the assets and liabilities of one company exchanged for new shares of the surviving company.

In accordance with the income tax law the depreciable value for tax purposes of the fixed assets taken over may not exceed their net undepreciated value for tax purposes to the merged entity. Any accounting profit to the surviving company arising from the merger would not represent taxable income, assuming all requirements are met.

Properly structured mergers are tax free, except for the tax on acquisition of real property, which is payable even in the case of mergers or other tax-free reorganizations. In these situations there are no taxable profits to the shareholders of the merged company, and no gain, loss or goodwill arises from the merger. In order for mergers to avoid sale treatment for tax purposes, a one-year continuity-of-business requirement is imposed on the merged entities. If a merger occurs within five years of a prior merger, authorization must first be obtained from the tax authorities.

The cost basis of the shares acquired as a result of the merger is equal to the basis that the shareholder had for the shares of the merged corporation that are canceled.

### ***Split-up or spin-off***

In the case of the formation of one or more additional corporations where assets and activities of a corporation are transferred to the new entities, but where the transferor corporation may continue to exist and there is no change in the capital invested or in the original shareholders and their proportionate ownership (a corporate split-up or spin-off), the following rules apply.

1. Assets transferred will retain their original attributes, such as original cost, remaining basis and date of acquisition, without gain or loss being recognized.
2. The adjusted-cost basis of the shares of the company that is split up is apportioned among the original shares and those issued as a result of the split-up.
3. The transaction is free of income tax if certain requirements are met. If a split-up is recharacterized as a capital reduction under the Income Tax Law, it will always be subject to sale treatment for tax purposes.
4. Net operating loss carryovers may be similarly apportioned.
5. After tax earnings and the adjusted paid-in capital accounts are also apportioned between the surviving entities.

A corporate split-up will be treated as a tax-free reorganization, provided 51% of the shares with voting rights is maintained for three years, beginning one year prior to the split-up. The holders of the 51% must maintain the same proportionate holding in the capital of the resulting entities as they had in the original entity prior to the split-up.

Any transfer of real property will be subject to the tax on acquisition of real property.

The related entities in a merger or split-up are required to obtain a tax audit from a duly authorized independent accountant during the reorganization period and the following year. In addition, certain other filing requirements apply.

With the exception of mergers as discussed above and corporate split-ups, no special tax rules exist for other types of reorganizations. Each would be taxed on the basis of what actually takes place if any measurable net income in cash, credit or kind arises. A reduction in capital stock may also be taxed, depending on the circumstances.

## **Liquidations**

### *Consequences to shareholders*

Liquidating distributions in excess of amounts of paid-in capital of a corporation (indexed for inflation) or paid for the acquisitions of its shares (also indexed for inflation) are treated as dividends.

### *Consequences to corporations*

When a corporation is placed in liquidation it must (1) file an income tax return for the period from the end of its last taxable year to the date of liquidation and (2) file income tax returns covering the liquidation of its assets, paying the corporate income tax on the total net taxable income arising during the period of liquidation. These income tax returns must be filed and the related tax paid every six months during the liquidation period, each return being considered an advance payment of the tax due with the final return.

Distributions in kind would generally be treated as a taxable sale at market value, with any appreciation over the tax basis of the assets distributed representing income for tax purposes of the corporation being liquidated.

## ***Acquisitions***

### ***Asset acquisition***

A nonresident is allowed to own assets including shares of Mexican corporations in Mexico, subject to certain restrictions specified in the Foreign Investment Law (see Chapter 5). In addition, antitrust laws should be reviewed and permission may be required for this purpose.

### ***Buyer and seller***

There are no general or special rules that may be applied in trying to offset advantages of buyers and sellers from different ways of handling an acquisition. However, buyers should be aware that there is rarely an advantage in adopting a procedure that will result in a stepped-up basis for fixed assets, because this usually requires a sale of the assets by the seller (a Mexican corporation), subject to employee profit sharing obligations, value added tax, flat tax and possibly even corporate income tax. In calculating taxable gain, the cost of land and buildings (net value) is adjusted for inflation on the basis of the number of years the assets were held before the sale. The acquisition value of the building would be depreciable to the buyer at 5 percent a year.

Also, in the acquisitions of shares, the tax basis of the assets and other attributes of the Mexican entity remain the same for depreciation, amortization and other purposes. In this case, buyers should be aware that tax and other legal and formal obligations (and contingent liabilities) remain with the entity whose shares are acquired. Therefore, due diligence is indispensable prior to acquisitions of either shares or assets.

# Chapter 18

## Taxation of foreign operations

### ***Investor considerations***

- Foreign-source income of Mexican corporations is fully taxable, with limited double taxation relief by way of a foreign tax credit.
- Mexico has entered into tax treaties and has signed agreements to exchange tax information with several countries, and these treaties also include provisions to minimize the effects of double taxation.
- Earnings of a foreign subsidiary of a Mexican corporation are taxable only when repatriated as dividends, with the exception of companies with investments in entities located in a low-tax jurisdiction or preferred tax regime (PTR) (i.e., tax havens specially mentioned in the law as well as entities subject to a tax rate which is less than 75% of the tax that would be paid had the income been earned in Mexico) the income from which, the Mexican investor must generally consider as earned and taxable, although certain particular rules may apply.
- In some cases the Mexican corporate shareholder owning at least 10 percent of the shares of the distributing corporation is entitled to a deemed paid credit for taxes paid by the foreign corporation.
- Proceeds from the liquidation of a foreign subsidiary are taxable if they exceed their cost basis.
- Losses of a foreign branch can be offset against domestic profits, as the taxable income or loss of the foreign branch is included with the domestic operations on a current basis.
- Consolidation of foreign subsidiaries is not allowed.

### ***Taxation of foreign income***

Mexican corporations are taxed on their income from all sources. Foreign-source income usually qualifies for the foreign tax credit described in this chapter.

#### ***Branch income***

The net income or loss from operations of a foreign branch of a Mexican corporation is includable in the annual income tax return of the Mexican corporation and subject to the same income tax rates, with right to the foreign tax credit discussed below.

### ***Foreign subsidiary income***

The income of foreign subsidiaries of Mexican corporations is not taxed until dividends are paid to the latter, with the exception of investments in preferred tax regimes as described below.

### ***Consolidation for tax purposes***

The inclusion of foreign subsidiaries in a consolidation for Mexican tax purposes is not allowed.

### ***Capital gains and liquidation proceeds***

Gains on sales of shares or on the liquidation of a foreign subsidiary are taxed as ordinary income to a Mexican resident. Loss carryforwards on sales of shares can generally be used to offset gains from similar transactions.

### ***Dividends and interest***

Dividends or distributions of profits received by Mexican companies as shareholders or partners of foreign enterprises and interest from a foreign subsidiary must be included as ordinary income, subject to the foreign tax credit indicated below.

### ***Royalties and technical assistance fees***

Income from technical assistance fees and royalties charged to non-Mexican companies represents ordinary income for income tax purposes, with foreign tax credit allowed, but it is subject to favorable treatment for value-added tax purposes.

### ***Foreign exchange gains and losses***

Foreign exchange gains and losses resulting from certain assets or liabilities denominated in foreign currency are treated as additional interest income or interest expense, respectively, as discussed under “Business profits” in Chapter 15. Exchange gains and losses are recognized on an accrual basis at the end of each month.

### ***Translation of branch profits***

Foreign branches of Mexican corporations must keep full accounting records and recognize income or losses for tax purposes on a current basis. In most cases transactions may be translated into pesos when effected (i.e., at that day’s exchange rate) or, at the election of the taxpayer, at the exchange rate at the end of each month.

### ***Translation of subsidiary earnings***

Since the earnings of a foreign subsidiary are taxable only as and when formal dividends are remitted, its earnings need not be translated on a current basis. Dividend income is translated at the exchange rate of the day on which it is paid to the shareholder.

## Double taxation relief

### Foreign tax credit

The income tax law allows Mexican corporations and individuals a foreign tax credit on income from foreign sources. The law provides that taxpayers may credit against their Mexican income tax liability the amount of income tax paid in foreign countries on their foreign-source income, as long as such income is subject to income tax in Mexico.

In general, credit is available in respect of foreign income taxes directly withheld from foreign-source income or paid with a tax return filed in the foreign country in the name of the Mexican resident or by a foreign branch of a Mexican corporation. However, in the case of dividends or distributions of profits received from corporations resident in a foreign country, when a Mexican corporation owns at least 10 percent of the capital of the foreign corporation for six months prior to the dividend, a deemed-paid credit can also be taken for the proportionate part of the underlying foreign corporate income tax paid by that corporation, corresponding to the dividend or distribution of profits received. In calculating the amount of income subject to Mexican tax in these cases, the dividend or distribution must be grossed up to include the proportionate amount of tax paid by the foreign corporation, as illustrated in Table XII. This credit is allowed also on tax paid on a second holding tier.

### XII-Foreign Tax Credit on Dividends

(in Ps)

Cash dividend actually received from foreign subsidiary			85,000
Dividend tax withheld abroad			15,000
Gross dividend			100,000
Add – Gross-up for the foreign income tax paid by the subsidiary (Note)			53,846
Income subject to Mexican tax			153,846
Mexican corporate income tax calculated on above income of 53,846, at corporate rate of 30% shown by annual return (limitation)	(A)		46,153
Foreign taxes available for credit- withheld	15,000		
Deemed paid Dividend tax including grossed-up corporate income tax paid by subsidiary, as above	53,846	(B)	68,846
Foreign tax credit – Lesser of (A) or (B)			46,153
Mexican income tax payable on the income			-0-

#### Note:

Income tax rate of foreign country 35%

(Gross dividend ÷ Reciprocal of effective rate of tax paid by subsidiary) - Gross dividend = Gross-up (100,000 ÷ 0.65\*) - 100,000 = 53,846

### ***Foreign tax credit limitation***

The foreign tax credit will be allowed up to the effective Mexican rate of tax on the taxable income (tax result) shown by the annual return, as reflected in Table XII under an “overall” type limitation. Taxpayers who are not in a position to take full credit for the taxes paid to a foreign country on foreign-source income are allowed a ten-year carryforward of such excess foreign taxes, provided certain compliance requirements are met and the credit is limited to the corporate tax rate of 30 percent.

# Chapter 19

## Partnerships

### and joint ventures

#### **Investor considerations**

- Commercial partnerships, as well as professional partnerships organized under civil law, are taxed as corporate entities. Partners in a commercial partnership are taxed in the same manner as shareholders.
- Periodic distributions of professional partnerships are treated as salaries.
- A joint venture was previously a conduit and not a separate taxpayer. As from 1999 these are treated as a separate taxpayer under similar rules as corporations. Each venturer is taxed in the same manner as a shareholder of a corporation.

#### **Partnerships**

##### **Entity or conduit**

Partnerships are taxed in the same manner as corporations, as described in Chapter 15. The partners, whether individuals, corporations or other entities, either domestic or resident abroad, are subject to dividend tax on distributions of after-tax profits. In addition, as discussed in Chapter 17, the paying entity is required to pay tax on a grossed-up basis on the distributions that exceed the balance of the entity's after-tax earnings account (CUFIN).

Professional partnerships organized under civil law (Sociedad Civil, shown as "S.C." at the end of the legal name of the Mexican entity) are also generally taxed in the same manner as corporate entities, and the individual partners are taxed as recipients of salary income with respect to income distributed currently (which is treated as a deductible salary expense by the partnership) and in the same manner as dividends are taxed to regular shareholders with respect to actual distributions of retained earnings to the partners.

The Sociedad en Nombre Colectivo (often termed "SNC"), is a general partnership and is treated the same as a regular corporation for Mexican income tax purposes. In addition, the Sociedad en Comandita, (often termed "S en C") is a limited partnership and is treated the same as a regular corporation for Mexican income tax purposes.

The Sociedad de Responsabilidad Limitada (often termed “SRL”) is similar to limited liability companies in foreign countries and has the same tax treatment as corporations in Mexico.

There is no conduit entity in Mexico although certain trusts conducting business activities are considered flow-through entities for Mexican tax purposes. (See Chapter 21).

## ***Joint ventures***

### ***Entity or conduit***

An unincorporated joint venture or asociación en participación (A. en P.), described in Chapter 9 under “Joint venture contract,” was previously a conduit and not a separate taxpayer.

As from 1999 the tax treatment applicable to A. en P. agreements was modified. A. en P.s are now subject to the same tax treatment as regular companies when the A. en P. is used to carry out business activity in Mexico. In this case, the active partner does not combine the taxable income or loss of the A. en P. with its other taxable income or losses even though it is conducted as a division of the legal entity acting as the managing active partner (Asociante). The Federal Fiscal Code included a definition of A. en P. as of January 1, 2004, which includes a group of persons that carry out business activity pursuant to a contract so long as the persons participate in the profit and loss of the business in accordance with a legal provision or the contract itself.

In accordance with Article 8 of the income tax law, the managing active partner (asociante) of an A. en P. joint venture contract is required to pay the taxes arising from the A. en P., including estimated payments of income tax, and to comply with all of the tax requirements pertaining to the activities carried out by the A. en P., which is now treated as a separate taxpayer in most situations.

Profit distributions are subject to the treatment applicable to dividends, and when the A. en P. agreement is cancelled or terminated, the capital reduction rules apply.

Goods contributed by the active and passive partners are considered to be sold to the joint venture at a value equivalent to the inflation –adjusted net adjusted tax basis of the investment. Depreciation may only be claimed by the A. en P. after assets have been contributed to the joint venture.

The passive partners of an A. en P. are jointly liable for taxes pertaining to the activities carried out by the active partner through the A. en P. to the extent of any assessment not covered by the assets of the joint venture and for the amount of the contribution of the passive partners to the joint venture.

# Chapter 20

## Taxation of individuals

### *Tax planning for expatriates*

- There are no special tax concessions available for foreign nationals other than those established in tax treaties that Mexico has entered into.
- Residents are taxed on worldwide income; nonresidents are taxed only on Mexican-source income.
- Residents are subject to a tax table of progressive rates. Nonresident employees are subject to tax at graduated rates that are significantly different from the resident tax rates.
- Salaries paid by a nonresident employer who does not have a permanent establishment in Mexico to a nonresident employee rendering services temporarily in Mexico are exempt if the nonresident employee is present in Mexico for no more than 183 days, consecutive or not, in a 12-month period.
- Timing of arrival and departure could result in significant savings.
- Joint returns are not allowed. Investment income of a nonworking spouse is not includable in the other spouse's return, except under specific circumstances.
- Planning the timing of major transactions, such as the exercise of employee stock options or the liquidation of an investment, before establishing residence in Mexico, is essential.
- Moving expense reimbursements for specific out-of-pocket normal moving expenses are not taxable.

Deferred compensation paid from abroad after departure is not taxable if related amounts are not charged or billed to the local affiliate or allocable to a Mexican permanent establishment of the foreign employer, unless paid within 6 months of departure.

A large network of tax treaties has been entered into with other several countries (see Appendix VI).

## ***Territoriality and residence***

### ***Residents of Mexico***

Resident individuals are subject to Mexican tax on their worldwide income, regardless of their nationality. The tax is generally at graduated rates ranging from 3 to 30% percent for 2010. Residents are granted a foreign tax credit with respect to their foreign-source income. Nonresidents, including Mexican citizens residing abroad, are usually taxed only on their Mexican-source income, as discussed below. Mexican nationals are assumed to be residents for tax purposes, subject, however, to proof to the contrary, such as acquiring residency for tax purposes in another country.

The Federal Tax Code provides that a person is a resident of Mexico when he establishes a home in Mexico. If the individual has a home in another country, then the individual is a resident in the country where he has his center of vital interests. A person is considered to have his center of vital interests in Mexico if either (1) more than 50% of his income comes from Mexican sources in the calendar year or (2) Mexico is the primary place of his professional activities. For this purpose, salary income would be considered Mexican source to the extent the services are rendered in Mexico, no matter who pays the salary. The definition of home as used in the Federal Tax Code is not entirely clear, but it is generally believed to be an abode that it is permanently available to the individual. A number of factors should also be considered, such as the type of living quarters occupied in Mexico, i.e., furnished or unfurnished apartment, on site facilities provided by employers, transient quarters, etc.

### ***Nonresidents of Mexico***

Foreigners working in Mexico on short-term visits are usually not considered residents of Mexico for tax purposes. Other non-immigrants entering the country under a visitor's permit are not generally considered residents for tax purposes, until they establish a home in Mexico.

In the event that the nonresident has to pay taxes in Mexico, the tax is either withheld at source or paid directly by the nonresident. There is also an option that allows the Mexican company on whose premises the nonresident works to pay the tax on his behalf. The tax is calculated in accordance the graduated rate table shown in Appendix V. The table includes an exempt amount, and the balance is taxable at 15 or 30 percent, depending on the cumulative income level during a 12-month period. The tax paid is considered final; therefore, nonresidents do not file an annual tax return.

In general, nonresident individuals entering Mexico under a visitor's permit to work as employees of Mexican companies or permanent establishments of foreign corporations are taxed on their income from such companies and, in some cases, they are also taxed on their compensation even if paid directly from abroad.

Foreigners may also enter Mexico under temporary visitors' permits as employees of a foreign company with a prohibition on receiving remuneration from Mexican sources. This is often the situation of employees of foreign companies rendering technical services on a short-term project for Mexican companies. These individuals are not subject to Mexican taxation when paid from abroad by a nonresident employer that does not have a permanent establishment in Mexico, as long as they are present in Mexico for less than 183 days in any 12-month period. If their stay exceeds 183 days, they will be required to pay Mexican tax on their monthly salaries from the beginning of their stay, although there would be no withholding obligation on the part of the nonresident employer.

### ***Change of residence***

In accordance with the income tax law, individuals who become resident after having been taxed as nonresidents during part of the year will treat the taxes paid as nonresidents as final. Such individuals are subject to Mexican income tax as residents on their income for the part of the calendar year starting with the date they acquire residency in Mexico to the end of the calendar year, and they would be required to file a part-year resident annual income tax return.

Residents of Mexico who move to another country during a calendar year must treat tax withholdings and advance payments of income tax already made as final and may not file an annual income tax return. Moreover, they should be able to prove that they have acquired residence for tax purposes in another country in order to be able to show that they have changed the tax residence. Also, taxpayers are required to file a notice of suspension of activities due to a termination of tax residency within 30 days after terminating residency. Mexican nationals who move to a tax preferred jurisdiction (a "tax haven") are considered to continue to be tax residents of Mexico for 3 years after filing the notice of change of tax residency.

### ***Source rules***

The types of income considered as Mexican-source income are specifically defined in the section of the law dealing with nonresidents, as discussed in Chapter 16.

Income from personal services is generally considered to be Mexican-source income in proportion to the services rendered in Mexico. The tax is levied at graduated rates, as described for salary income for nonresidents in Appendix V.

Fees paid by a Mexican resident company to members of its board of directors or vigilance or advisory committees and to administrators and statutory auditors (comisarios) are treated as similar to salaries by the income tax law and are considered to be Mexican-source income, regardless of where the services are rendered and whether payment is made within or outside Mexico. In this case tax is imposed at a flat 25 percent of the gross fees earned, instead of at the normal graduated rates specified for other salaries.

## **Gross income**

### ***Definition of taxable income***

The law provides that individuals are taxed on income received in cash, kind or credit and, in certain cases, in services. However, the law includes a number of exceptions to the general rule as regards income in credit (i.e., earned but not paid). These exceptions provide that the following types of income become taxable only when received in cash or in kind.

1. Income from personal services.
2. Rental income.
3. Installment sales of assets.
4. Interest on fixed-income securities paid by Mexican residents.

Some exempt income received by resident individuals must be reported in the annual income tax return (i.e. loans, gifts or prizes exceeding Ps 600,000; business expense reimbursements exceeding Ps 500,000, etc.). The report is for disclosure purposes only, and the items remain nontaxable. However, failure to disclose an item in the annual tax return when required could cause it to be taxable.

### ***Employee service income***

Income from personal services (earned income) includes salaries, commissions, bonuses, and allowances of all types, including those for housing, living expenses, education, foreign service, tax reimbursements, and the participation of employees in the profits of their employer.

A company car provided to an employee is not taxable to a private sector employee. However, the employer's deduction will be subject to certain requirements that restrict deductibility (see related comment under "Depreciation" in Chapter 15).

Business expenses reimbursed to employees may be considered taxable income to the individual unless they are properly supported. Regarding business travel expenses, they are tax-free to the employee only in the case of short-term visits and only if supported by receipts from third parties and certain other requirements are met. A per diem rate paid without filing an expense report with the employer would be treated as a taxable allowance. It would be nontaxable if an expense report is filed that is properly supported by third-party documentation evidencing the disbursement for the travel, meals and lodging expenses.

Directors and statutory auditors (comisarios) are subject to tax on their fees which are treated as income similar to wages. Severance compensation is taxed under special rules, as described below.

### ***Tax-exempt income from employee services***

Certain fringe benefits, such as when the employer pays the employee's portion of social security premiums or contributes to the employee's savings fund, are tax-free to the employee if certain requirements are met. Resident taxpayers may exempt up to 30 days of the minimum wage for Christmas bonus. An exemption equal to a maximum of 15 days minimum wage each for vacation pay and obligatory profit-sharing is also provided. Compensation for disability, unemployment and old age; death benefits; and social welfare benefits, including qualified savings funds, social security benefits and pensions up to nine times the legal minimum wage, are tax-exempt subject to some limitations.

A limit is imposed on the exemption from tax of certain social welfare benefits granted in the form of, educational scholarships, day-care centers, cultural activities, sports, grocery coupons and other benefits of a similar nature, as follows.

1. Whenever the sum of both salaries and social welfare benefits of the above type exceeds an amount equivalent to seven times the minimum wage of the economic area of the taxpayer, all such social welfare benefits in excess of one annual minimum wage of the taxpayer will be taxable, and the employer should consider any such amounts in making personal income tax withholdings.

This limitation is applicable only to the specific types of benefits mentioned above and does not apply to other types of benefits, such as contributions made by an employer to an employee's savings fund or pension or reimbursements for medical expenses.

2. Under no circumstances will such social welfare benefits be taxable if their amount, together with other regular compensation, does not exceed seven times the minimum wage.

Seniority premiums, retirement payments, indemnities, and other similar one-time severance payments are tax-exempt up to 90 times the daily minimum wage per year of service, and tax is payable only on any excess, calculated as follows:

1. Part of the taxable balance (equal to the individual's most recent normal monthly salary) must be included with the rest of the individual's annual income and taxed accordingly.
2. The remaining excess, if any, is not added to the other income but is subject to tax at the annual effective rate of tax payable by the individual on annual income, including the amount shown in item (1) above.

Regarding the deductibility of the benefits to the employer, in general, fringe benefits are deductible only if similar benefits are provided to all of the company's employees. There are limited exceptions to this rule.

### ***Professional fees and business activities***

Independent professionals and individuals carrying out business activities through unincorporated enterprises (i.e., sole proprietorships) and other individuals rendering personal services (i.e., independent contractors) may deduct their normal expenses following rules similar to those for business enterprises, as described in Chapter 15. If the total of such deductions exceeds the income declared, the loss may be carried forward for 5 years and deducted against the same type of income.

### ***Capital gains***

Capital gains on sales or exchanges of assets, including those realized on all types of personal and real property are generally taxable.

#### ***Exempt gains***

Income from the following sources, among others, is exempt from income tax:

1. Sales of Mexican securities, when the securities qualify as being widely held and have been included in published lists of securities available to the general investing public. Such sales must be made through either the Mexican Stock Exchange or a foreign exchange located in a country with an exchange-of-information treaty in place. The gains realized on certain foreign securities listed and traded on the Mexican Stock Exchange are also exempt.
2. Gains realized on derivative financial instruments based on capital, baskets or indexes, when widely traded in accordance with rules issued by the tax authorities.
3. Mergers of corporations, since the cost basis of shares previously held in the merged company is carried over to the cost of the shares in the surviving corporation.
4. Sales of other types of personal property (other than shares of stock) when the total gain on such sale in a calendar year does not exceed three times the annual minimum wage (the excess is taxable).
5. Gain on the sale of the taxpayer's residence once every 5 years, subject to certain limitations.
6. Inheritances
7. Gifts between spouses and gifts to/from lineal descendants.

#### ***Determination of taxable gain***

In determining taxable gain, the costs and expenses of the transaction are deductible. In the case of shares, the average cost of shares or other securities or of capital accounts in nonstock companies can be adjusted by factors intended to recognize the effects of inflation over the period of years in which the shares were held. The cost basis of shares in a Mexican corporation is further adjusted by the fluctuation in the after-tax earnings account (CUFIN) and the additional reinvested tax profit account (Reinvested CUFIN) during the holding period of the shares. Therefore, the seller should add increases or subtract decreases in the CUFIN balance during the holding period in order to determine the cost basis of the shares sold. The CUFIN and the Reinvested CUFIN are calculated following the procedure described in Chapter 15.

### *Calculation of tax*

A portion of the taxable capital gain from the sale of shares, real estate and other assets is included with other taxable income in the annual personal income tax return. The remaining portion of the taxable gain is subject to tax at a flat rate which is the resulting effective rate of tax payable by the individual on the total income included in the annual return. The individual also has the option of applying a flat rate based on the average effective tax rate over the last 5 years. The proportion of income to be included with other taxable income in the annual return is calculated on the basis of the number of complete years the assets were held, up to a maximum of 20 years. For example, in the case of an asset held for more than 20 years, only 5 percent of the taxable gain must be added to ordinary income and the flat rate will apply to the remaining 95 percent.

Losses on sales of real estate and shares are partially deductible in the year sustained. The immediately deductible proportion of the loss is determined on the basis of the number of years the asset is held (not to exceed ten). This proportion may be deducted from other types of investment income (except salaries, professional fees and business activities) declared for the year or from capital gains of the following three years. The remaining portion of the loss not considered currently deductible gives rise to a tax credit against the tax on other capital gains in the same year or in the following three years.

### ***Rental income***

Resident individuals are taxed on income from the rental of real property. They are allowed a standard deduction equal to 35 percent of their gross rental income plus property taxes, in lieu of actual expenses and depreciation. Alternatively, they may elect to deduct actual expenses incurred on the property rented, including depreciation at 5 percent on the building cost (indexed for inflation), commissions (up to 10 percent of gross rental income), property taxes, insurance, maintenance and interest (net of inflation adjustments) on loans for the purchase or construction of the property rented.

### ***Interest income***

Special treatment is accorded to interest received on fixed-income securities, such as bonds, debentures, mortgage certificates that are classified as placed with the general investing public (as determined by the Mexican Tax Authorities), and interest received from Mexican banks or auxiliary credit institutions on acceptances, certificates of deposit, loans, and other credits. In general, banks (debtors) must withhold income tax at the statutory rate published by the Mexican Congress every year. This inflation adjusted interest is required to be included in the individual's annual tax return, except when the taxpayer's only taxable income is interest and it does not exceed MxPs\$100,000 in the calendar year.

Income derived from premiums, bonuses or gains on the sale of bonds, securities or similar credit instruments that are classified as traded among the general investing public is also considered as interest subject to the same rate of tax on interest mentioned above (withheld by the brokers), rather than as a capital gain from the sale of securities.

See the section for Other Income regarding the taxation of foreign currency exchange gains.

Interest paid on government bonds is generally taxable. Under a transition rule, the interest income derived from certain types of government related bonds issued before 2003 remains tax-exempt.

### ***Dividends***

Dividends received from Mexican corporations must be included in the gross income of individual shareholders, grossed up for the income tax paid by the corporation and reported in their individual annual tax return. It is possible to claim the underlying corporate income tax paid as a credit against the ultimate tax liability of the individual. This system allows individual taxpayers to compute their tax on dividends at their own personal tax rate, which may be lower than the 30 percent credit for corporate taxes paid.

Dividends received from foreign corporations are fully taxable. If the dividend is also taxed in the foreign country, a foreign tax credit may be claimed by the individual shareholder, limited to the tax rate as per the applicable tax treaty, if any.

See the discussion of tax treatment of dividends in Chapter 17.

### ***Closely held companies***

There are a few special tax rules that affect shareholders of closely held companies (i.e., companies whose shares are not traded on the Mexican Stock Exchange).

Amounts borrowed by shareholders from their own Mexican corporations can be considered to be constructive dividends. This can raise problems for closely held companies.

Gains on sales of the shares of closely held companies are taxable, since they do not qualify for the exemption for shares included in the official lists of corporate securities traded on the Mexican Stock Exchange that are considered as available to the general investing public.

### ***Income from the acquisition of assets***

There is a special income classification called “income from the acquisition of assets.” This class of income is generally taxable and includes acquisition by gift (except certain exempt gifts, as mentioned below), discovery, prescription, expiration of rental contracts (leasehold improvements), and by purchase when the appraised value of the asset exceeds by more than 10 percent the price paid. The amount of this type of income will be based on the appraisal value (or market quotation), as determined by persons authorized by the Treasury Department.

In connection with these acquisitions, local and federal taxes (except income tax), appraisal expenses, notary fees, and the cost of litigation to establish rights to assets and commissions and fees paid may be considered as deductible expenses by individual taxpayers.

Acquisitions considered to be tax exempt include alimony and inheritances (even from an unrelated individual). Gifts are also exempt if they are between spouses or from parents, grandparents, etc., or direct descendants, regardless of the amounts involved. The annual exemption for gifts from others (including gifts between siblings) is limited to three times the annual minimum wage. Any gifts in excess of this amount will be considered to be taxable income to the recipient.

The cost basis of a taxable gift is the value of the gift that was taxed. The cost basis of tax-exempt gifts and inheritances is the same as the cost basis of the donor (i.e. carry-over basis).

Income derived from prizes such as lottery winnings is subject to a special tax regime. There are no separate tax regimes applicable to gifts and inheritances.

### ***Other income***

Profits on transfers of government concessions or royalties related to such concessions, earnings from foreign investments, authorship royalties when not exempt, and, in general, any type of income from capital investments or operations not taxed under other sections of the law or specifically exempt are also taxable.

Included in the category of other income is interest (other than from certain Mexican bank deposits and fixed income securities), which is subject to a reduction for indexing for inflation. Foreign currency exchange gains are also taxed as interest on the accrual basis. Therefore, foreign currency exchange rate fluctuations in relation to the amount of principal held in foreign currency can cause accrued gains, which are taxable each year, even though no currency was exchanged to/from Mexican Pesos.

After 2010, the income from this interest will not be reported in the annual tax return but will be subject to definitive monthly tax payments.

### ***Nonresidents***

As mentioned under “Territoriality and residence” above, nonresidents, including Mexican citizens, are subject to tax only on Mexican-source income, as defined for each type of income in the chapter of the law dealing with the taxation of nonresidents. Similarly, the provisions of tax treaties should always be considered, as these override the provisions contained in the Mexican income tax law.

### ***Salaries***

Nonresidents are subject to Mexican income tax only on salaries for services rendered within Mexico. Such salaries are taxed by reference to a graduated rate table that exempts the first Ps125,900 obtained during a 12 month period, not necessarily a calendar year. Any income in excess of that amount but not exceeding Ps1,000,000 is subject to tax at 15 percent; all income in excess of Ps1,000,000 is subject to a 30 percent tax rate. Income from dependent

personal services is exempt if the remuneration is paid by a nonresident employer that does not have a permanent establishment in Mexico and if the services are rendered within a period in which the employee has been in Mexico for less than 183 days in a 12-month period.

#### *Exempt personal service income for diplomats and similar officials*

Remuneration of the following nonresidents is also exempt, generally when there is reciprocity in the treatment of Mexican nationals:

1. Diplomatic agents.
2. Consular agents.
3. Employees of embassies, legations or consulates of foreign nations who are nationals of such countries.
4. Members of official delegations representing foreign countries.
5. Members of humanitarian and scientific delegations.
6. Representatives, officers and employees of international organizations headquartered or with offices in Mexico, as established by the related treaties.
7. Foreign technicians hired by the federal government, as established in agreements between Mexico and their respective countries.

#### *Professional and other fees*

The source rules in regard to professional and other fees are the same as for salaries, in the sense that services rendered within Mexico are considered to produce Mexican-source income. If it can be proven that part of the services were rendered outside Mexico, Mexican income tax is not payable on the corresponding part of the fee. When paid by a resident individual or entity the withholding tax, which is final, is levied at 25 percent on the gross fees paid. Income from independent personal services is exempt if the remuneration is paid or deemed paid by a nonresident employer that does not have a permanent establishment in Mexico and if the services are rendered during a period in which the individual was in Mexico for less than 183 days in a 12-month period.

#### *Dividends*

Dividends distributed from after-tax profits to nonresident individuals are not subject to tax withholding.

#### *Other income*

Other types of Mexican-source income, such as interest, rental income, capital gains, and royalties, are subject to tax, generally on a withholding basis, in the same manner as for foreign corporations, which is discussed at length in Chapter 16.

However, it should be kept in mind that, as mentioned at the beginning of this chapter, the provisions of the multiple tax treaties executed by Mexico should be analyzed, as these may provide a more favorable tax treatment than that discussed here.

## ***Deductions***

### ***Business-related deductions***

Salaried employees are not allowed personal deductions of any sort for expenses that might be incurred in connection with their employment. Expenses directly related to the production of other taxable income, such as expenses of a professional practitioner or of an unincorporated business enterprise, expenses on rental property and cost of sales of real property and securities are deductible in arriving at taxable income, as discussed earlier in this chapter.

There are no standard deductions, except as noted in the case of rental income mentioned earlier.

### ***Personal deductions and allowances***

In arriving at taxable income, resident taxpayers may claim the following deductions when fully documented by official receipts.

1. Certain medical expenses provided they have been actually paid to persons residing in Mexico, after subtracting amounts reimbursed by third parties, such as through insurance. These include medical, dental and hospital bills of the taxpayer, spouse or common-law spouse, descendants, parents, or grandparents, provided these individuals do not have taxable income of their own in excess of one year's minimum wage. Medical insurance premiums are also deductible. Medicines are not deductible, unless included in a hospital bill.
2. Funeral expenses of the individuals mentioned above, up to an amount not in excess of one year's minimum wage (in 2010: about US\$1,500).
3. Charitable contributions to tax exempt organizations that are authorized to receive tax-deductible donations.
4. Inflation adjusted interest, paid on a mortgage for the purchase or improvement of the individual's personal residence, subject to certain limits..
5. Complementary contributions to social security retirement fund (AFORE) or Mexican personal retirement account. This deduction is capped at ten percent of individual's taxable income and the contributions must not exceed five times the year's minimum wage of the taxpayer's economic area (in 2010, about US\$ 7,500).
6. Mandatory school transportation, provided that the school obligates all its students to use the transportation, and a separate official receipt is given for the cost of transportation.

## ***Double taxation relief***

Foreign source income is fully taxable in Mexico. These are no exclusions except for those provided by tax treaties.

The law provides relief from double taxation by allowing a limited foreign tax credit for taxes paid abroad by Mexican residents. In essence, the credit is allowed for foreign taxes paid up to the amount of foreign tax that would correspond to the income earned by a non-resident of that country or the actual amount paid, whichever is lower.

Similarly, the law provides that tax treaty provisions override the provisions of the tax law, when they benefit the taxpayer.

## ***Tax computation***

A typical tax computation is illustrated in Appendix X.

### ***Personal allowances and credits***

The personal allowances and credits available are given in Appendix IX. For credits, also see below.

### ***Tax rates***

The tax rate schedule for individuals shown in Appendix VII has a maximum rate of 30 percent. Some examples of the amount of tax payable by individuals at different levels of taxable income are shown in Table XIII.

#### **XIII—Examples of Individual Effective Tax Rates**

<b>Annual Income Ps</b>	<b>Tax payable</b>	<b>Effective Tax rate</b>
50,000.00	2,933.26	5.87%
80,000.00	6,173.65	7.72%
100,000.00	8,923.99	8.92%
250,000.00	40,106.97	16.04%
500,000.00	105,850.81	21.17%
1,000,000.00	255,850.81	25.59%

Note:

Taxable income for the above calculation was computed by taking the exemptions for 30 days' minimum wage for the Christmas bonus, and 15 days each for the vacation premium and profit sharing. In addition, medical expenses and deductible donations of Ps2,000 were assumed.

### ***Tax credits***

An individual may obtain a credit against Mexican income tax payable, subject to limitations, for any foreign income tax paid on foreign-source taxable income.

## ***Other taxes***

### ***Local taxes on income***

The Federal District (Mexico City) and some states levy taxes on salaries and wages, which are payable by the employer. For example, the tax in Mexico City, Jalisco (Guadalajara) and Nuevo Leon (Monterrey) is from 2 to 3 percent of gross wages, without a cap.

Mexican states can assess an income tax on individuals but they rarely do so. The states of Guanajuato and Chihuahua currently assess an income tax of between 2% and 5% on certain kinds of income such as business income, and sales of real estate. Neither state taxes salary income at the personal level.

### ***Wealth, gift and inheritance taxes***

No wealth or inheritance taxes as such are levied by the federal government, the Federal District or the majority of state governments.

For federal income tax purposes, inheritances are tax exempt. Recipients of gifts from a spouse or lineal descendant/ancestor (parent, grandparent, child, grandchild, etc.) are also income tax exempt. In most circumstances, in order to maintain the income tax exemption, gifts and inheritances must be disclosed in the recipient's annual income tax return. Gifts from other sources in excess of three times the annual minimum wage (about US\$5,000 for 2010) are subject to federal income tax on the excess.

For state or local transfer tax purposes, acquisitions of real property through gift or inheritance, no matter the relationship to the donor, are subject to a transfer tax in the same way as other transfers of real property ownership. The rate varies by state, but usually is less than 5% of the value of the property being transferred.

## ***Alternative Business Tax***

There is an Alternative Business Tax, known as Flat Tax (IETU for its initials in Spanish) that applies to individuals who have income from independent services (professional fees), business income and rental income. The same rules apply for individuals as for corporations (See Chapter 22)



---

# **Chapter 21**

## Taxation of trusts and estates

### ***Investor considerations***

- Mexican trusts generally may only be created with domestic banks as trustees. In addition, insurance, bonding and brokerage companies can create trusts for specified purposes.
- Generally, trusts are not taxable entities; they are conduits of income to beneficiaries.
- Trusts have frequently been used to hold real property in the border zones and coastlines, where ownership by foreigners has been prohibited or otherwise limited. However, the foreign investment law now permits direct foreign investment in nonresidential property if certain requirements are met, making trust vehicles unnecessary.
- When business activities of a nonresident are carried out through a trust, a permanent establishment is deemed to exist for tax purposes, although applicable tax treaty provisions should be reviewed to determine if this rule is overridden.
- There are certain tax incentives for trustees and beneficiaries who participate in Mexico through Real Estate Investment Trusts.

## **Trusts**

### ***Types of trusts***

The organization of trusts (*fideicomisos*) in Mexico is governed by the banking law (*Ley de Instituciones de Crédito*) and the Law of Credit Instruments and Operations (*Ley General de Títulos y Operaciones de Crédito*).

Trusts are not legal entities. Therefore, they cannot own property and cannot open bank accounts in their own names. However, a taxpayer identification number is usually obtained.

Trusts established by entities other than banks (insurance, bonding and brokerage companies can now create trusts for specified purposes) are governed by their applicable regulatory body laws.

The trustee can generally only be a banking institution authorized to carry out fiduciary operations. With that exception and the fact that beneficiaries may only be individuals or corporate entities living or in existence at the time a trust is created, the rules applicable to trusts are quite flexible, and they can be organized for any lawful purpose.

All trusts are of the same basic type, and their terms can be as complicated or as simple as required by the purposes for which they are created. When a trust is formed to hold title to real property, the trust instrument must be notarized and entered in the general property register of the locality. Trusts may be revocable or not.

### ***Taxation of trusts***

Generally, trusts are not considered taxpayers. However, when they are created to carry out business activities in Mexico; they are treated as conduits of income to beneficiaries (taxpayers) or, if these have not been named, to the trustor (grantor). Trusts set up to maintain the assets of approved funds have no tax obligations, if certain requirements as to their income are complied with.

### ***Taxation of beneficiaries***

Where business activities are carried out through a trust the trustee is responsible for making advance payments of income tax on such activities and for determining the annual adjusted taxable income (*utilidad fiscal*) in accordance with the procedures applicable to corporations.

Although the taxable income is attributable to the trustee, these duties are usually carried out by the management committee or principal beneficiary of the trust. Corporate beneficiaries should include their proportion of such tax profits in their own annual income tax returns and treat their proportion of the advance payments made by the trust as advance payments on account of their annual income tax liability. The losses if any, cannot be transferred to beneficiaries until the trust is liquidated. Individuals who are beneficiaries must treat their proportion of the profits and advance payments as arising from business activities of unincorporated enterprises, as discussed in Chapter 20.

In the case of rentals of real property held in trust, the income is considered to belong to the grantor, even though the beneficiaries are third parties, unless the transfer of title is considered as irrevocable and the grantor has no further rights to reacquire the property. The income is then considered to belong to the beneficiaries. In either case the trustee is held responsible for making advance payments of income tax in May, September and January at 10 percent of the gross rental income collected during the preceding four months (see also Mexican Real Estate Investment Trust, below).

In other cases the income realized from assets held in trust will be considered as taxable to the beneficiaries. The appropriate capital gains treatment, depending on the beneficiary, would be accorded to sales of trust assets.

### ***Tax treatment of the grantor***

The transfer of assets to an irrevocable trust will normally be treated as a sale, taxable to the grantor, unless the trustor keeps the right to reacquire the assets. Rent on real property placed in trust but not yet on an irrevocable basis is also taxed to the grantor.

### ***Taxation of the constitution of trusts***

Transfers of real property to an irrevocable trust represent transactions subject to tax on the acquisition of real estate. If real or personal property is placed in trust for the benefit of others without reasonable compensation to the grantor, income tax on donations received may be payable by donees, other than a spouse or direct family members, if the value exceeds three times the annual minimum wage.

### ***Mexican Real Estate Investment Trust (MREIT's)***

Mexican tax authorities grant some tax incentives to the MREIT's whose main activity is the construction or acquisition of real estate property for sale or lease.

The treatment of this kind of trust differs from that of those described above, basically because the trustees and beneficiaries are exempt from making advance payments of income tax, on the income received by the MREIT's.

In addition, the transfer of real estate made by grantors will not be considered as a sale in accordance with the Mexican Income Tax Law if the grantor is a beneficiary of the trust or otherwise retains the right to reacquire the property.

### ***Use of trusts***

Trusts are not often used for tax planning but rather for other purposes, such as to facilitate the control of an estate paying benefits to various heirs, to guarantee loans and to enable foreigners to hold the rights to certain restricted residential real estate (see Chapter 5 and above).

Notwithstanding the above, the MREIT's provide good opportunities for international investors. Planning ideas regarding financing structures and exit strategies are available.

## ***Estate and gift taxes***

As noted in Chapter 20, no estate or inheritance taxes are levied by the federal government or local governments on the value of assets at date of death. During the period before an estate is finally distributed, the legal representative is required to pay income tax for the account of the heirs on the earnings of the estate considered as a unit. The tax paid in this way is considered final unless the heirs or beneficiaries of legacies elect to include their portion of the income in their own annual returns, in which case they may take credit for a proportionate amount of the tax paid by the legal representative.

Moreover, transfers of property at death are not taxable for income tax purposes as concerns the transferor and Mexican resident transferees, although there may be real estate acquisition transfer tax (usually ranging 1% to 5% of the value of transferred property) considerations.

There is no separate gift tax per se other than the possible real estate acquisition tax mentioned above, although an income tax may apply for the transfer of property to persons other than spouses, lineal descendants and lineal ascendants, and in certain cases withholding taxes apply.

# Chapter 22

## Alternative business tax

### ***Flat tax***

#### ***Investor considerations***

- IETU (flat tax) is effective as from January 1, 2008.
- Flat tax is payable only when it exceeds income tax for the year.
- Flat tax is determined on a cash flow basis.
- Asset tax was repealed by the flat tax law.
- Asset tax paid in previous years can be recovered via refund.
- Flat tax rate is 17.5% for 2010 and future years (for 2008 the applicable rate was 16.5% and 17% for 2009).
- No exemption for start-up period.
- Mexican corporations are taxed on worldwide income.
- Foreign residents with permanent establishment (PE) are subject to flat tax on income attributable to such PE in Mexico.
- Depreciation and amortization are not deductible for flat tax purposes.
- There is no future refund of flat tax in future periods when the income tax exceeds the flat tax.
- Flat Tax does not generate After tax earnings account (CUFIN).
- Tax accounting impact on deferred taxes.
- On November 5, 2007 there was a presidential Decree which grants several additional credits for maquiladoras, unutilized Net Operating Losses (NOLs), and inventories on hand at December 31, 2007, which will be explained in more detail below.

## ***Corporate tax system***

### ***Rate***

The initial flat tax is determined by applying the 17.5% tax rate to the net positive result from recognizing flat tax income which is effectively collected and deducting amounts that are effectively paid for authorized flat tax deductions.

A transitional rate was applied for year 2008 (16.5%). The rate for 2009 was 17% and for 2010 and future years the flat tax rate will be 17.5%.

### ***Taxable entities***

Individuals and entities resident in Mexico, as well as foreign residents with a PE in Mexico, are subject to the flat tax on income obtained from the following activities:

1. Sale (alienation) or disposal of goods.
2. Rendering of independent services.
3. Granting temporary use or enjoyment of goods or assets.

These activities are generally defined based on the provisions and the definitions provided by the Federal Tax Code (FTC) and the Value Added Tax (VAT) Law.

Regarding the sale of goods, it is defined as any transmission of property, capital contributions, financial leasing, some taxable mergers and taxable demergers (as defined in the FTC).

The rendering of independent services is defined as any obligation of making, granting, allowing or not making or doing that a person grants in favor of another, or any service of transportation, commission and technical assistance and transfer of technology (pursuant to the VAT Law).

Lastly, the temporary use or enjoyment is defined as the leasing, or any other legal transaction by which a person allows another to use or enjoy tangible assets temporarily, in exchange for a price or consideration. (as defined in the VAT Law)

### ***Territoriality***

For these purposes, the definition of PE and “attributable” income is provided by the Mexican Income Tax Law or in the International Tax Treaties entered into by Mexico.

Residents of Mexico will be subject to tax on worldwide sourced income taxable for flat tax purposes, while residents abroad with a PE in Mexico are subject to flat tax for income attributable to such PE.

## **Cash basis tax**

The flat tax is normally recognized when the payment of the activities subject to flat tax law is received, and follows the rules of the VAT law, with some exceptions, specifically with respect to the export of goods or services and certain other activities mentioned later on in this chapter.

Flat tax is based on a cash flow basis; therefore a special accounting will be required to control all the cash flow generated by a taxpayer.

## **Income**

1. Flat tax income includes income which is effectively “received” for the following concepts:
2. The price or consideration obtained for any of the activities mentioned above;
3. Additional amounts charged for federal taxes (except “transferred” taxes), interest and surcharges, including advance payments or deposits;
4. Advance payments or deposits returned to and discounts received by the taxpayer (as long as such payments have been deductible for the payer).
5. Amounts received from insurance companies by the taxpayers when the risk covered by the corresponding insurance or reinsurance policies occur, and such risk is related to assets deductible for income tax purposes.
6. If the price or consideration for an activity subject to flat tax is not received in cash, but in goods or services, income is considered to be the market value or the appraisal value of such goods and services.
7. Royalty income received for the temporary use or enjoyment of intangible assets (such as patents and trademarks) when those are contracted between unrelated parties. Consequently, the payment for these concepts to unrelated parties is deductible for flat tax purposes. It is important to note that, in general, royalty payments made to related parties are neither taxable nor deductible for flat tax purposes. As an exemption, payments regarding related party royalties for the temporary use or enjoyment of industrial, commercial or scientific equipment are considered as taxable income or deductible expenses for flat tax purposes.

## **Exemptions**

The following income is not included to compute the flat tax:

1. Income obtained by the Federation, the Mexican states, municipalities, and other organizations that are not subject to income tax.
2. The following entities, when their income is not subject to income tax:
  - a) Political parties, associations, and political groups
  - b) Labor unions
  - c) Civil associations or societies with scientific, political, religious or cultural aims, and certain organizations with limited sport facilities.
  - d) Chambers of commerce and industry, agricultural or forestry groupings, professional associations and organisms that group them, employer associations and the civil associations or limited liability companies of public interest that administer irrigation districts or units, with operating concessions and permits and the organisms that group cooperatives.

- e) Civil institutions or civil entities that solely manage employee funds or savings funds and those established pursuant to labor legislation; consumer cooperative organizations; authorized savings and loan associations; as well as authorized federations and confederations and mutual organizations that do not operate with third parties, when they do not incur in expenses associated with prizes, commissions and similar concepts.
  - f) Legally recognized parent associations and legally recognized societies for collective lobbying. It should be noted that income obtained by some of the above persons is subject to income tax when, for example, they sell goods other than their own fixed assets or provide services to persons other than their members or partners, and this income exceeds 5% of their total income.
3. Charitable organizations authorized to receive deductible donations provided no distributions of their retained earnings are made.
  4. Income derived from farming, cattle, forestry or fishing activities up to 200 times the general annual minimum wage corresponding to the geographic area of the taxpayer. Any excess would be taxable for flat tax purposes. These taxpayers may be exempted from flat tax when enrolled in the Federal Registry of Taxpayers (RFC) within a specific period contained in the Miscellaneous Tax Rules.
  5. Income of corporations exempt from income tax when their shareholders are non-resident pension or retirement funds, in the proportion such shareholder participates in the ownership of them, when at least 90% of the total income of these corporations consists of gains from the sale or the leasing of land and construction, located in Mexico.
  6. The following sales:
    - a) Of equity participations (including shares), documents pending collection (but not the sale of the goods underlying these documents), and certificates, except those related to the deposit of goods to which the flat tax applies and of non-amortizable real estate participation certificates listed (except registered certificates listed in the National Registry of Securities (RNV) and traded in the stock market) or other certificates granting rights over real estate.  
Of non-amortizable real estate participation certificates or others granting rights over real estate that would be exempt if sold in terms of the flat tax law.
    - b) The sale of non-amortizable real estate participation certificates issued by trusts for the acquisition or construction of real estate is also exempt for flat tax purposes, when the certificates are registered in the RNV and they are commonly traded in a recognized stock market.
  7. Of national and foreign currency, except when the transactions are entered into by persons dedicated exclusively to the purchase and sale of currency.
  8. Income accidentally earned for activities subject to flat tax by individuals. Income received by individuals pertaining to trade or business activities, professional service activities or the renting of real estate will not be considered accidental acts, and therefore will not be exempt from the flat tax.

## **Authorized deductions**

Taxpayers will be entitled to claim flat tax deductions for the following concepts:

- Payments effectively made for the acquisition of goods, independent services or the temporary use or enjoyment of assets, used to generate taxable income for flat tax purposes or for the management of such activities, as well as in the manufacturing, commerce and distribution of goods and services that give rise to taxable income for flat tax purposes. Taxpayers are required to fulfill the deductibility requirements established in the Income Tax Law in order to deduct those payments for flat tax purposes. Expenses incurred corresponding to taxable income for salaries and for the rendering of personal subordinated services for the individual in terms of the Income Tax Law will not be deductible for flat tax purposes.
- Local or federal contributions paid in Mexico, except for flat tax, income tax, cash deposit tax, employer contributions to the social security system, and those that must be transferred in accordance with other tax laws.
- VAT and Excise tax are deductible when the taxpayer is not allowed to credit such taxes that had been transferred or that had been payable due to importation of goods and services corresponding to deductible items for flat tax purposes, as well as contributions payable by third parties paid in Mexico when included in the price or consideration, except for withheld income tax and social security contributions.
- Expenses incurred for the exploitation of public domain assets, for the rendering of a service subject to concession or permission, as long as such expenses are also deductible for income tax purposes.
- The amount of sales returned, discounts and allowances received or provided, as well as the advance payments or deposits that are returned to the taxpayer, whenever the related flat tax income has been recognized.
- Compensations paid for damages and injuries, and conventional damages, provided the taxpayer is legally obligated to pay them. The creation of or increase in reserves related to life insurances or pension insurances derived from the social security laws, as well as the increase in administration funds related to life insurances, and the creation of or increase in catastrophe reserves with certain limits. In this regard, it is important to note that any decrease in reserves mentioned above would be considered as taxable income for flat tax purposes.
- Amounts paid by insurance companies to individuals or beneficiaries when the risk occurs, as well as the amounts paid by bonding companies to cover amounts claimed.
- Prizes paid in cash by those who organize lotteries, raffles, drawings, or gambling games and competitions of any kind as long legally authorized.
- The non-onerous and non-remunerative donations that comply with terms and limits established in the Income Tax Law.
- Bad debt expenses incurred by taxpayers belonging to the financial system in respect of services provided that generate interest income, provided the conditions established in the Income Tax Law are met.
- Bad debt expenses and losses resulting from fortuitous or “force majeure” events, deductible in terms of the Income Tax Law, corresponding to flat tax income on credit sales abroad and up to the amount of such taxable income for flat tax purposes.

## ***Non-deductible items***

The following every-day costs of operations are non-deductible for flat tax purposes.

- Royalties paid to related parties, except for payments for the temporary use or enjoyment of industrial, commercial or scientific equipment.
- Salaries, wages and social contributions. (Instead, an annual credit is obtained, applicable against Flat Tax payable)
- Employee profit-sharing payments.
- Interest expenses, unless they are included in the sales price.
- Depreciation and amortization (there was a transition period from September to December 2007 in which depreciation was deductible).
- Income tax net operating loss carry-forwards.

Cost of sales for inventories sold, except for the inventories on hand at December 31, 2007, as an additional credit (explained below).

## ***Computation of flat tax***

The flat tax is determined on an annual basis (calendar year) and should be paid through an annual tax return that should be filed on March 31 of the following year at the latest.

## ***Flat tax credits***

In general, the flat tax is determined by multiplying the difference between the taxable income less authorized deductions by the flat tax rate of 17% for 2009. This result may be reduced by certain credits which should be applied in order, as follows:

### ***1. Flat tax credit applicable for the excess of flat tax deductions over the flat tax income***

When in a tax period the taxpayer has an excess of authorized deductions for flat tax purposes over its taxable income, the difference may be credited against the annual flat tax and the advance payments of such annual flat tax. This credit is computed by multiplying the excess of deductions over income by the flat tax rate (for 2009, 17%, and for 2010 and future years, 17.5%). This credit is applicable against the flat tax of the tax period in which the excess arose. The taxpayer may credit this amount against its income tax of the same taxable year in which the flat tax credit originated; its application cannot give rise to any refund. However, due to a temporary provision, this credit is not available against 2010 income tax.

Any remaining favorable balance can be credited against the flat tax of the following 10 taxable years or until it is fully utilized, if earlier. For taxpayers with concessions for the exploitation of public domain goods or public service benefits (such as mining concessions), the credit can be applied over the number of years of the concession's life.

This credit amount can be indexed for inflation, multiplying the credit by the inflation index corresponding to the period from the last month of the first half of the taxable year in which the credit arose through the last month of that tax year. The remaining amount of such credit to be applied in future years will be updated for inflation by multiplying the remaining credit amount by the inflation index corresponding to the period from the month in which it was last updated through the last month of the first half of the year in which it is credited.

This credit can not be transferred to any other person, even in the case of a merger. In case of a spin-off, the credit may be divided in proportion to the division of the total value of the inventories and accounts receivable, or of the fixed assets, between the spun-off entities.

The following chart describes the computation explained above:

<b>Credit for excess deductions over taxable income</b>	
	Authorized deductions
(-)	Taxable Income
(=)	Excess
(X)	Flat tax rate (17.5% for 2010)
(=)	Credit

Credit for taxable wages and salaries and employer's social security contributions

The amount paid for taxable salaries and wages as well as for the employer contribution to the social security system can be credited against the flat tax after multiplying it by the 0.175 factor. Withholding requirements for such wages and salaries, established in the Income Tax Law, must have been complied with.

## **2. Advance flat tax payments effectively paid**

The advance payments effectively paid corresponding to the same tax period can be credited against the annual flat tax liability.

In this regard, taxpayers are required to make monthly advance flat tax payments, on account of the annual flat tax liability, on the 17th day of the month following that to which the payment corresponds, at the latest. The advance payments are determined based on the total taxable income for flat tax purposes earned in a certain period of time (from the first month of the tax period up to the month to which the payment relates) less authorized flat tax deductions for that same period. The result of this should be multiplied by 17.5% (for 2010 and future years).

Additionally, as against the annual flat tax liability determination, certain credits may be applicable for the corresponding monthly advance flat tax payments. Such credits should be applied in order and are the following:

- a) Credit obtained from multiplying the 17% flat tax rate (for 2009) by the excess of flat tax deductions over flat tax income, up to the amount of the advance flat tax payment corresponding to the tax period.
- b) Credit for taxable salaries and wages and social security contributions effectively paid and advance tax payments of the own Income tax liability effectively paid, corresponding to the same period and up to the amount of the flat tax to be paid.
- c) Credit for the prior advance flat tax payments to be applied against any difference resulting from the flat tax liability reduced by the credits mentioned above.

The advance flat tax payments effectively paid may be credited against the annual flat tax. If the whole amount of advance payments cannot be credited against the annual flat tax amount (i.e., advance payments are higher than annual amount), the remaining amount may be compensated against the income tax, and if higher, the excess can be claimed as a refund.

### **3. Own income tax credit**

The income tax of the taxable year, the income tax imposed on dividends in excess of the CUFIN, as well as any tax paid abroad, with certain limits, can be also credited against flat tax.

The income tax to be credited must be that effectively paid in terms of the Income Tax Law. The credits or reductions applied against the income tax liability (except for the credit for cash deposit tax or compensations made in accordance with FTC provisions) are not considered as effectively paid. Moreover, income tax of the taxable year can be credited and only tax arising from dividend distributions exceeding the CUFIN.

For 2009 (and 2008), taxpayers other than individuals are (or were) able to credit the income tax paid in 2006 and 2007 on dividends in excess of the CUFIN, whenever they had not been credited previously.

The credit for income tax is income tax paid “with respect to” the taxable year, and in the case of income tax on dividends the credit will be for the tax paid “during” the taxable year.

#### **4. Additional credits granted by transitional rules**

- i. Credit on investments in fixed assets and certain deferred charges and expenses made from January 1, 1998 to December 31, 2007, as long as in terms of the flat tax law such investments are deductible.

This credit results from determining the balance pending deduction (depreciation or amortization) of each of the investments, indexed for inflation from the acquisition month through December 2007. This balance should be multiplied by the corresponding factor (0.170 for 2009 and 0.175 for 2010 and future years).

Of the resulting amount, 5% may be credited each year for a 10-year period starting from 2008 tax period. For the application of this credit against advance flat tax payments, it is necessary to divide the amount of the annual credit by 12 and apply the sum corresponding to the number of months involved in the period for which the advance flat tax payment is being determined.

This credit may be updated for inflation by applying the inflation index of December 2007 and up to the inflation index of the sixth month of the tax year to which the credit is applied. For advance flat tax payments, the update for inflation would be from December 2007 through the last month of the prior tax year in which such credit is applied.

In the case of mergers, the surviving corporation after the merger will continue applying the pending tax credit generated by the disappearing entities as long as it records each credit individually.

In the case of a spin-off, the original entity and the newly created entity or entities will divide any unused credit on the proportion in which the investments (fixed assets and deferred charges) and the value of the inventories are divided.

- ii. Credit applicable to new investments in fixed assets and certain deferred charges and expenses acquired from September 1, 2007 through December 31, 2007, as long as they are deductible for flat tax purposes and up to the consideration effectively paid for such investments. This amount would be deductible on a straight-line basis over a three-year period from 2008 onwards. For purposes of the advance flat tax payments the annual amount of the credit to be applied should be divided by 12 and multiplied by the number of months involved in the period for which the advance flat tax payment is being determined.

This credit can also be indexed for inflation by applying the inflation index from December 2007 through the last month of the tax year to which it is being applied.

## ***Consolidated entities***

The parent and its controlled subsidiaries are required to determine the flat tax obligation on a separate company basis, even if income tax returns are filed on a consolidated basis. The parent and its controlled subsidiaries are required to determine and pay the flat tax by means of individual tax returns and must file such separate returns on the same due dates that apply for income tax purposes.

For these purposes, controlled entities will consider as their own creditable income tax the income tax they paid to the parent company under the consolidation rules, together with the income tax they paid directly to the Mexican tax authorities (i.e., the portion that was not included in the consolidation regime).

The parent will have to determine its income tax on an individual basis as if it were an independent company and will consider both its advance income tax payments and its annual payment as its own effectively paid income tax.

The amounts of own income taxes described above are the amounts that can be credited against each consolidated company's separate flat tax.

Moreover, consolidated entities are also required to file monthly advance payments. For these purposes, the controlled subsidiaries will file separate company advance flat tax payments considering as their own income tax the tax paid to their parent, as well as the income tax payments made to the tax authorities (on the position of income not subject to consolidation). The parent company will be obligated to cover its own flat tax advance payments on the basis of the tax that would have been due had it not been under the consolidation regime.

## ***Non-profit entities' members***

Non-profit entities authorized to receive deductible donations for income tax purposes will not be subject to flat tax for the income that they receive, as long as this income is used for their activities in accordance with their bylaws and they do not grant benefits to any other person except where the benefit is granted to another authorized non-profit organization.

When non-profit entities determine a distributable profit due to the omission of income or for purchases not carried out and improperly recorded as purchases, for non-deductible payments or for loans granted to their owners or members, the recipients will be subject to flat tax.

The members of a non-profit organization that must recognize distributable profit will be able to credit the flat tax against the income tax of the member in the same proportion that such member's distributable profit represents to the profit of all members, as long as such member recognizes his proportion of the flat tax paid by the nonprofit organization. The credit applicable to members residing abroad without a PE in Mexico cannot exceed the income tax.

The entity level flat tax cannot be credited by the members for the distributable surplus due to the omission of income, for purchases that were not made but improperly recorded as purchases, for non-deductible payments or for loans granted, if considered a surplus under the Income Tax Law.

Educational institutions organized as corporations or civil associations, but which do not have an authorization to receive deductible donations, must pay the flat tax. However, if these organizations receive such authorization for calendar year 2008, they will be able to request a refund of flat tax advance tax payments.

## ***Trusts***

The Trustee is required to determine and pay the flat tax. The beneficiaries will recognize the flat tax income of the trust as their own income, based on the proportions stipulated in the trust agreement, and shall credit in the same proportion the tax credits referred to in the law and the advance tax payments effectively made by the trust.

The Trustee will file a return for its own activities and for each one of trusts in which it acts as the trustee, for advance tax payment purposes. The beneficiary or the trust grantor, if applicable, which is not engaged in trade or business activities for income tax purposes but is engaged in activities subject to flat tax, such as leasing activities, will be able to fulfill the flat tax obligations on their own account whenever all beneficiaries and trust grantors formally approve this elective approach in writing to the Trustee, and file this document with the tax authorities by the 17th of month following that in which it made the election.

Trusts created for the acquisition or construction of real property, known as FIBRAS or Mexican Real Estate Investment Trusts, do not have the obligation to make advance flat tax payments.

## ***Small taxpayers' regime***

The flat tax will be determined by the tax authority under the small taxpayer regime by means of an imputation of the tax, based on the procedures to be established by the tax authorities. For this purpose, the tax authorities will credit against the flat tax obligation, the amount imputed as an income tax, and any other credits under the flat tax law, when applicable, relative to the month for which the tax applied; the difference will be the tax owed by the taxpayer.

Individuals paying taxes under the small taxpayer regime can consider the flat tax as part of the imputed income arrangement relating to Income Tax, until the tax authorities compute a revised combined imputed tax.

## ***Financial system entities***

Interest income is not subject to flat tax for non-financial system entities, to the extent it arises from regular financing activities. However, financial sector entities, which include credit institutions (banks), general deposit warehouses, financial leasing companies, stockbrokers, credit unions, financial corporations, financial factoring companies, “limited object” financial companies and “multiple object” financial companies (which are members of the financial system in accordance with the Income Tax Law), as well as taxpayers exclusively engaged in financial intermediation and those engaged in collection of receivables pertaining to credit portfolios, are required to compute their flat tax margin from financial intermediation activities, as follows:

General Computations
.....
Accrued interest income
.....
(-) Accrued interest expenses
.....
(+/-) Net monetary position
.....
Financial intermediation margin or flat tax base

For these effects, “interest” has the same definition as the definition for income tax purposes, and is on an accrual basis, rather than the cash basis generally used for other flat tax purposes. The activity of a financial service entity will be considered exclusively as a financial intermediation activity, when the income from this concept represents at least 90% of the total flat tax income of the taxpayer.

The above net monetary position result corresponds to debt obligations whose interest income and expenses are measured on a margin basis and are calculated in accordance with the requirements which must be observed by the members of the financial system.

The flat tax is also applicable to the other services for which financial entities receive income in the form of commissions.

## ***Insurance companies (financial intermediation margin)***

In the case of insurance companies, the financial intermediation margin will be determined by adding the accrued interest income corresponding to the resources that are subject to mathematical reserves for life and pension insurance, referred to in the General Law of Insurance and Mutual Insurance Companies (LGISMS) and the accrued interest on the resources represented by the funds used to administer life insurance contracts, minus the interest that refers to mathematical reserves and the additional accrued interest owed to the insured.

Insurance companies will have the following additional deductions:

1. The creation of or increase in the mathematical reserve which is linked to life or pension insurance, as well as the creation of or increase in the funds used to administer life insurance programs.
2. The creation of or increase in the special mathematical reserve, as well as the other reserves included in the LGISMS.
3. The creation of or increase in catastrophic event reserves, for the part that exceeds the real interest. If the real interest is greater than the amount of the creation of or increase in these reserves, the difference will be considered as taxable income for flat tax purposes.
4. Amounts paid by insurance companies to the insured or their beneficiaries, as well as the amounts paid by bonding companies to cover claims.
5. The losses arising from bad debts with respect to the services yielding interest income, whenever certain deductibility requirements are met.
6. A deduction also applies to amounts arising from debt forgiveness, allowances, and discounts on loan portfolios which generated interest income, as well as losses originating from the sale of the loan portfolios. An option is provided in lieu of the options previously mentioned, whereby the credit institution will be able to deduct the preventive global reserves that are created or increased, observing the rules established in the Credit Institutions law, as well as by the National Banking and Securities Commission, with respect to those loans classified as risk type C, D and E, but the deduction cannot exceed 2.5% of the annual average balance of the total loan portfolio of the corresponding tax year. In the event the accumulated balance of the global preventive reserve as of December 31 of the tax year is smaller than the balance at the closing of the immediately preceding tax year, the difference is considered additional flat tax income. Once this option is selected, it must also be applied in future years.

## ***Purchase and sales of currencies***

Gains or losses arising from purchases or sales of currencies are not subject to the flat tax, except when they constitute the primary business activity of the entity engaging in such transactions. It is considered that a taxpayer is primarily engaged in this trade or business when this income represents at least 90% of its total income.

## ***Bankruptcy process***

According to the FTC, when the declaration of bankruptcy is filed with the competent court, the collection of flat tax will be suspended until the agreement is signed by the taxpayer with the creditors and the tax authority, or until the bankruptcy decree is issued by the court and then the flat tax can be forgiven.

The suspension of the payment of the flat tax, as well as its forgiveness, will apply to those taxpayers who on the date the flat tax law was enacted, had filed the declaration of bankruptcy, or executed an agreement with their creditors in terms of the Bankruptcy law, in the following terms:

1. The agreement must stipulate that the taxpayer will enjoy the suspension of the flat tax while the agreement is in effect, without exceeding three years beginning on January 1, 2008.
2. At the end of those three years, the authorities will forgive the payment of the flat tax in accordance with the following:
  - a) The flat tax will be indexed for each tax year that the obligation was in suspension.
  - b) The amount forgiven each tax year will be the amount determined by multiplying the flat tax for each tax year by the factor resulting from dividing the flat tax income that would have been recognized if such law had existed in 2007, by the total flat tax income in each tax year.
  - c) The difference between the flat tax caused in the tax year and the forgiven amount must be paid by March 31 of the tax year immediately following the last year in which the suspension of collections of the flat tax applied, which cannot exceed three years.

The benefit will not apply in the following circumstances:

1. When during the suspension period, the taxpayer agrees to a merger transaction.
2. When during the suspension period, a change of shareholders representing more than 10% of the voting shares occurs.
3. When during the suspension period, the taxpayer changes its principal activity.

## ***Asset tax paid in previous years***

Taxpayers required to pay the income tax during the tax year will be able to request a refund of the unrecovered asset tax paid in the 10 previous tax years, in accordance with specific rules.

The asset tax refund cannot be greater than the difference between the income tax of the applicable carry-forward tax year, and the smallest amount of the unrecovered asset tax paid in taxable years 2005, 2006 or 2007, although the refund is limited to 10% of the total unrecovered asset tax as of December 31, 2007.

The asset tax paid in the tax years from 2005 through 2007 will not be reduced by the effect of the immediate deduction of fixed asset acquisitions or the reduction granted to the primary sector established by Article 23 of the Regulations of the Asset Tax law. The recoverable asset tax may also be applied against the amount of flat tax that exceeds the income tax.

## ***Presidential decree addressing new Mexican Flat Tax may benefit certain taxpayers***

### ***Net operating losses triggered as a consequence of accelerated depreciation and/or deduction of land***

There will be an additional Flat Tax credit for unused net operating losses (for regular income tax purposes) generated in calendar years 2005, 2006 and 2007 and available at December 31, 2007. This credit will be available to the extent that the net operating losses are made up of accelerated depreciation (lump-sum deductions) and/or deductions of land, in the case of real estate developers.

The credit will be allowed for a 10-year period, starting in 2008, calculated each year by multiplying 5 percent of the following amounts by the Flat Tax rate:

The excess of any accelerated depreciation claimed on assets acquired during 2005, 2006 and 2007 over the regular depreciation, computed in accordance with the provisions of the Mexican Income Tax Law.

The income tax deduction attributable to land acquisitions (where the land is developed for sale by real estate developers) made in 2005, 2006 and 2007.

The resulting credit will be spread over a 10-year period starting in 2008.

This rule will not apply to any new assets acquired between September 1, 2007 and December 31, 2007 for which the election has been made to deduct the cost of those purchases on a straight-line basis over three years.

## ***Installment sales***

Taxpayers who entered into installment sale agreements (which defer taxable income for regular income tax purposes) prior to 2008 will not be subject to the Flat Tax on installment income collected after 2008 to the extent that the regular income tax calculation (for purposes of comparing this amount to the Flat Tax) is determined without including the installment sale income.

## ***Additional deduction for taxpayers who do business primarily with the general public***

A transitional rule currently disallows a Flat Tax deduction in 2008 for payments relating to inventories acquired prior to 2008. However, for those taxpayers that derive at least 80 percent of their income from transactions with the general public, the Decree allows a deduction for accounts payable that arise between November 1, 2007 and December 31, 2007 on the acquisition of finished goods (excluding fixed assets). However, the finished goods should not be in the balance sheet on December 31, 2007 (i.e., the goods must have been sold prior to that date).

## ***Inventory as of December 31, 2007***

Taxpayers with inventory on hand at December 31, 2007 will be entitled to an additional credit against the Flat Tax. This credit will equal 6 percent of the inventory balance on that date, multiplied by the Flat Tax rate. This credit will be available over a 10-year period starting in 2008, with inflationary adjustments permitted in the credit's computation.

The inventory balance at December 31, 2007 must be determined in accordance with inventory valuation methods allowed for Mexican income tax purposes, and will include land if it is held as inventory in the ordinary course of the taxpayer's business (e.g., land held by real estate developers).

## ***Additional benefit on advance payments***

As stated in the May 7, 2009 presidential Decree, when the advance payments of flat tax turn out to be greater than the provisional payment amount corresponding to the computation period, taxpayers may credit the excess against the provisional payment of Income Tax for the same period; this credit would be considered as own Income Tax paid. However, this benefit is only applicable through the 2009 tax year.

## ***Maquila*** (see INMEX in Chapter 23)

According to the Income Tax Law, the Maquila regime has several tax benefits; a presidential decree was issued on November 5, 2007 for Maquila companies as a countermeasure in order to compensate for the absence of a deduction for the sum of salaries and wages plus the employer portion of social security contributions paid out by a Maquila company.

The Maquiladora tax credit will be available from 2008 to 2011.

Moreover, a Maquiladora will be obligated to file the following information with the Mexican Tax Authorities in order to apply such credit:

1. Flat tax according to the procedure mentioned in Article 8 of the Flat Tax Law.
2. Total accumulated income for Flat Tax purposes.
3. Total authorized deductions for Flat Tax purposes.
4. Income tax generated in the period.
5. Total accumulated income for income tax purposes.
6. Total authorized deductions for income tax purposes.
7. Total value of assets, including assets provided free of charge.
8. Total amount of costs and expenses.
9. Tax profit according to the transfer pricing rules contained in the Income Tax Law.

This credit may not be greater than the Flat Tax payable.

### ***General requirements for authorized deductions***

Deductions for flat tax purposes should comply with the following requirements:

- The expenses should correspond to the sale of goods, rendering of independent services or the granting of temporary use or enjoyment of assets for which flat tax must be paid, even when such operations are carried out by persons exempted for flat tax purposes. When operations are carried out abroad or when the payments are made to foreign residents without a PE in Mexico, they must be considered as deductible payments if they would have been deductible if carried out or made in Mexico.
- As for income tax purposes, the expenses should be considered as strictly indispensable for the conduct of the activities subject to flat tax. Additionally, they should be adequately documented by supporting evidence, in the name of the taxpayer, other than credit card charge notes, and duly recorded in the accounting records.
- Deductions must have been effectively paid, even for the advance payments. In this regard, when paid by check, the expense is considered to be effectively incurred on the date on which such check is charged by the bank. Also, an expense is considered to be effectively incurred when the taxpayer delivers credit certificates subscribed by a different person and when the obligation is extinguished through compensation by delivery of goods or assets as payment.
- If the payment is made in installments, the deduction may be claimed in the month and tax year each installment is paid.
- The expenses incurred by the taxpayer must comply with deductibility requirements established by the Income Tax Law. When expenses are partially deductible for income tax purposes, the same proportion or limit must also be applied for flat tax purposes.

Customs duty regulations must be complied with for goods of foreign origin and compliance with the regulations covering the importation of such goods into Mexico must be demonstrated.



---

# **Chapter 23**

## Value-added tax

### ***Investor considerations***

- VAT is levied on transfers of goods and services at a standard rate of 16 percent (11 percent in the border regions) and at zero rate for some transactions. Certain other transactions are exempt.
- Imported goods and services are subject to VAT.
- Charges for the use of assets (e.g., rentals and royalties) are subject to VAT.
- Credit against VAT liability (which may result in overpayment and refund) may be taken for VAT paid on all imports and purchases, except as noted.
- Credit for VAT paid may not be taken in proportion to revenues that are exempt from VAT or for VAT paid in goods and services that do not represent deductible expenses under the income tax law.
- With the exception of certain qualified convention expenses, there is no mechanism to recover the VAT paid by non-residents.

### ***Scope of Value-Added Tax***

The federal value-added tax (VAT, IVA in Spanish) represents a one-time tax, payable by the ultimate consumer of all types of products and services. However, each business entity involved in the process from the sale of raw materials to the production and distribution of finished products to the ultimate consumer is generally required to bill its customers the tax on its products (output tax) and to pay the tax to its suppliers on its purchases of goods and services (input tax), crediting the amounts so paid against the amounts due on its own activities. The taxpayer is required to remit the excess of the VAT collected from its customers over the VAT it paid to its suppliers to the tax authorities on a monthly basis. If the amount paid exceeds the amount collected, a refund can usually be requested for the difference, or credited against other tax obligations.

In general, VAT does not represent an additional cost to most business enterprises, because even though all types of business enterprises, including government departments and agencies, are required to accept charges of the tax by suppliers on their purchases of goods and services, such amounts will normally be eligible for offset against the liability of the business enterprises for the tax collected on their billings to customers.

There will be some exceptions, principally when the sales of an enterprise are “exempt” from VAT, in which case the enterprise is treated as the last consumer and will have to absorb any charges for VAT (input taxes) on its purchases, except insofar as its activities are subject to the zero rate, as mentioned below. However, input tax paid on goods or services used to produce items that are exempt from VAT, may be deducted for corporate income tax purposes (see “other deductions” in chapter 15).

VAT is a cash basis tax in the sense that only the receipt of payment for goods or services triggers the output VAT liability, and an input VAT credit can be claimed only when the taxpayer pays VAT to its suppliers of goods and services or when the liability to a creditor is satisfied through any other form of extinction or compensation.

Thus, the net amount payable by each enterprise will generally be the difference between the tax that was effectively paid and the tax that was effectively collected.

### ***Taxable transactions***

In general, VAT is payable on all sales of goods, independent services, rentals, and imports of goods and services, although a number of significant exceptions are provided in the law, as well as certain defined activities which are taxed at the zero rate (See Appendix XII).

## ***Sales of goods***

The law defines a sale as any transmission of tangible or intangible goods, including those made on a conditional basis or through irrevocable trusts. The taxable amount of a sale includes the sales price as well as all other amounts charged to the purchaser for other taxes, duties, interest, or charges of whatever nature.

### ***Services***

Taxable services are considered to be those rendered within Mexico by one person to another on an independent basis, transportation of persons or goods, insurance and reinsurance, agency activities, technical assistance, and transfers of technology. The taxable amount includes not only the price of the service, but also charges to the customer for other taxes, living allowances, expenses, reimbursements, interest, etc.

As an exception, when the interest arises from loans granted by financial system companies, from loans granted under credit lines or financial leasing transactions, the VAT related to such interest will be paid as the interest is accrued, instead of when paid or collected.

### ***Rental of goods***

For purposes of VAT any type of rental of tangible property in exchange for a fee is taxable, regardless of the legal form utilized, subject to certain specified exceptions. Rentals of real property for residences and property used for agricultural purposes are exempt.

### ***Imports***

VAT is payable by the importer to the customs authorities on all imports, in addition to normal import duties. The taxable value of imports of tangible goods is the value declared for import duties, plus the amount of the duties.

The VAT paid to customs authorities upon importation of goods is treated in the same way as VAT paid to Mexican suppliers and offsets the VAT liability collected from customers in determining the net amount owed to the government.

Any tax payable on importations is entirely the responsibility of the resident importer, and in the case of imports of tangible assets, VAT must be paid before withdrawing these assets from customs.

Imported services are also taxed. The purchase or licensing of intangible assets from non-residents for use in Mexico is a taxable import.

In the case of importations of intangible assets or services, no VAT is actually paid, although the tax forms reflect a “virtual” payment or cashless transaction with an offsetting credit in the same monthly return, except when the taxpayer also has “exempt” VAT sales output tax transaction in which case there could be a net cost to the company after reflecting the tax effect of deducting the VAT paid.

Services rendered by non-resident commission agents outside Mexico (commissions) on exports of merchandise are not subject to VAT. In other cases, imported services are subject to VAT as described above.

Importations under the temporary regime are exempt from VAT. For example, the importation of raw materials and fixed assets for in-bond processing companies operating under the IMMEX program (previously termed maquiladora or a PITEEX program - see Chapter 4) are generally not subject to VAT. In addition, assets can be imported for varying periods under the temporary regime on an exempt basis.

### ***Exports***

Exports are zero rated, and consequently VAT is not payable on exports, including exports of in-bond processing companies, commissions or mediation fees and technical fees for services provided to foreign residents when the benefit is received abroad, and rights to intangible assets. Even though the exporter does not collect VAT on export sales or these services, it has the right to recover VAT charges on its purchases of goods and services by means of a credit or refund.

Additionally, a zero rate applies to independent personal services provided by residents in Mexico that are used solely by and for the benefit of persons abroad without a permanent establishment in Mexico.

Port services are also zero rated for export shipments.

### ***Rate of tax***

VAT is payable on all types of operations at a general rate of 16 percent, except for almost all food products and medicines, which are taxed at the zero rate.

Goods and services imported by border residents are subject to VAT at 11 percent, provided these goods or services are used or received in the border regions. Taxpayers residing in the border zones apply the 11 percent rate on sales of goods and services delivered or rendered within those regions. However, the 16 percent rate applies to the sale of real property (structural components) in these zones, except for the value of the land, which is not subject to VAT in Mexico.

To credit the 11 percent VAT paid on imports of tangible goods in the border zones, the taxpayer is required to demonstrate that the goods are subsequently used or sold within the border regions. For these purposes, the border regions include, in addition to the 20-kilometer area along the northern and southern international borders, those other areas deemed as the border zone for tax purposes and which include Baja California Norte and Baja California Sur and the State of Quintana Roo, as well as a portion of the State of Sonora.

Taxpayers are authorized to take full credit against their liability for the tax on other types of income for the amounts of tax billed by suppliers of goods and services used in producing and selling the items subject to the zero rate.

## ***Payments of tax***

The excess of VAT effectively collected from customers over VAT effectively paid to vendors (or to the customs authorities on imports) is generally required to be remitted to the tax authorities on a monthly basis as a definitive payment.

The procedure for determining VAT payable consists of crediting directly against VAT due (effectively collected), the tax effectively paid for expenses related to acquisitions of goods and services, as well as expenses related to the temporary use of assets (i.e. rentals). Such expenses should be those that are indispensable for realizing taxable activities, including those that are taxable at the zero rate.

When taxpayers carry out mixed activities (taxable, exempt or not taxable), they should identify VAT effectively paid for each item, in order to determine the amount not creditable paid on non-taxable items, as well as determining the proportional amount not creditable, from items not identifiable.

## ***Taxpayers subject to VAT withholding***

Certain taxpayers are required to withhold VAT on payments to suppliers of goods and services, including payments made to parties resident abroad for purchases or leases, among others.

Some examples that might require VAT withholding by the payor for the asset or service include, payments to foreign persons for leased assets in Mexico, and purchases from foreign residents of inventory located in Mexico when such foreign resident does not have a permanent establishment within Mexican territory,

## ***VAT Refunds and overpayment certification process***

Favourable balances in VAT returns must either be claimed by the taxpayers as a credit against to tax due in subsequent months, until such balance is used up, or request their refund as long as such refund, is requested for the total balance of the overpaid VAT. If the taxpayer files the refund request along with a certification by an authorized Public Accountant, the refund process can be more expeditious. The certification must be ratified by the external auditor in his final tax audit report.



---

# Chapter 24

## Other indirect taxes

### ***Investor considerations***

- A specific tax is levied on transfers of real property and the rights thereto.
- Excise tax is levied on certain items (e.g., alcoholic beverages, cigarettes, gasoline), often at substantial rates.
- Various state and municipal taxes are levied, generally at much lower rates than federal levies.

### ***Tax on acquisition of real estate***

A local tax on the acquisition of real estate is levied on all types of transfers of real property and the rights thereto. In general terms, subject to the review of each state law or the Federal District Financial Code, this tax is payable by the person or entity that becomes the owner of the property, whether by purchase, donation, inheritance, contribution, merger, spin-off, liquidation, in trust, or otherwise.

Real estate is defined as land or as land and the structures attached thereto. In the Federal District, the tax is calculated at a progressive rate; the maximum rate is about 4.5 percent, aside from the respective notary fees and other transfer costs. The tax base is the highest of the transfer price, the fair market value and the appraisal value of the property. Notary fees and other transfer costs often increase the purchase price by two or more additional points.

### ***Federal excise and vehicle taxes***

The Production and Service Tax Law levies often substantial federal excise taxes on alcoholic beverages, cigarettes and other tobacco products, gasoline, and, in certain circumstances, soft drinks.

In general terms, exports of goods are exempt from excise tax and excise tax paid on the acquisition of exported goods cannot be credited.

Federal taxes are also levied on the ownership of motor vehicles, as well as on the acquisition of new vehicles.

## ***State and municipal taxes***

Taxes levied by states and cities in Mexico are much lower than the federal levies, and in most cases are also lower than those of comparable entities in the United States and other countries, principally because public education is largely financed by the federal government in Mexico. Municipal taxes are usually of minor importance. The states and municipalities may not tax transactions subject to Federal VAT, of which they receive a substantial portion from the federal government. Other activities may also not be taxed by them, such as banking. Brief general comments regarding state taxes are given below.

### ***Property taxes***

Annual taxes on real property are levied by the Federal District and all the states at widely varying rates applied to values shown in the property tax records, which in some cases are based on rental income from land and buildings held for rent to third parties. Assessed values have been increased substantially recently in the Federal District and some other areas.

### ***Title transfer taxes***

As stated above, the transfer of real estate is almost without exception subject to a variable transfer tax at rates averaging 3 to 4 percent. The tax is levied by most states and the Federal District.

### ***Taxes on earned income***

Some Mexican states levy a relatively low tax on salaries and other income earned by employees, which in most cases is payable by the employer (e.g., Mexico City imposes a 2 percent payroll tax payable by the employer).

### ***Tax opinion for Federal District taxes***

In the case of Mexico City and other States, a special purpose statutory tax opinion on the status of state taxes issued by an independent public accountant is required by the local authorities.

---

# Chapter 25

## Tax treaties

### ***Investor considerations***

- Mexico has tax treaties and agreements to exchange tax information with several countries and is in the process of negotiating others.
- Mexico's tax treaties follow the OECD model.
- Tax treaties provide more flexibility in the type of activities that can be conducted in Mexico without being considered a permanent establishment.
- These treaties reduce or eliminate certain withholding taxes.

### ***Tax treaty policy***

A number of tax treaties have been executed with Mexico's most important trade and investment partners.

### ***Treaty models***

Mexican treaties are modeled after the 1977 OECD Model Convention. Mexico has registered some reservations about the OECD commentaries.

### ***Treaty provisions***

Treaties mainly restrict the definition of a permanent establishment and reduce or eliminate certain withholding taxes. See Appendices V and VI.

### ***Exchange of information***

Mexico has executed agreements to exchange tax information with several countries. It is the stated intention of the Mexican government to execute similar agreements with other countries as a prelude to signing comprehensive tax treaties. See Appendix VI.



---

# Chapter 26

## Introduction to PwC

### ***PricewaterhouseCoopers worldwide organization***

PricewaterhouseCoopers ([www.pwc.com](http://www.pwc.com)) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for our clients and their stakeholders. More than 163,000 people in 151 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

PricewaterhouseCoopers and PwC refer to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL). Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm.

### ***PricewaterhouseCoopers in Mexico***

The Mexican firm of PricewaterhouseCoopers, with more than a century of accumulated experience, is a professional firm that provides a full range of business advisory services. These services include audit, accounting and tax advice; management, information technology and human resource consulting; financial advisory services including mergers and acquisitions, business recovery, project finance; business process outsourcing services; and legal services. Clients include businesses of all sizes, representing both domestic and foreign investment, government entities, nonprofit organizations, and individuals.

PricewaterhouseCoopers Mexico currently consists of more than 3,547 professionals in eighteen offices, covering the entire country and organized geographically and by industry. Addresses and telephone and fax numbers are listed on the inside front cover of this Guide.

PricewaterhouseCoopers Mexico is internationally oriented. A large number of our clients have international connections, either through international trade or because they are subsidiaries of foreign corporations located throughout the world.

PricewaterhouseCoopers Mexico is organized so that decisions affecting clients are made by partners who have full professional authority. Clients deal directly with these decision makers. Each client is assigned to a partner, who is directly responsible for coordinating all work performed for the client nationwide and worldwide. The benefit of this approach is service that is efficient, timely and well managed.

Our professionals take seriously the responsibility that comes with leadership, playing an active role in public and private sector organizations that address public policy issues and taking aggressive stances on these issues. For example, firm representatives frequently assist private-sector organizations in their discussions with government officials regarding tax, trade and investment issues, and work with industry and accounting associations to develop professional standards.

Clients base their confidence in us on our professional capabilities and experience, our tradition of independence and integrity, our commitment to the highest ethical standards, our worldwide service capabilities, and our approach to understanding their business and their requirements, so as to bring timely and practical solutions and support for their business needs.

# Appendix I

## Corporate tax rates

### ***Corporate tax rates***

#### ***General rate***

The tax rate for corporate taxpayers is 30%.

#### ***Special industry rates***

Agriculture, livestock, fishing, timber

Taxpayers engaged exclusively in these industries may obtain a 25% reduction from the corporate tax rate, so their corporate tax rate would be 23%.

## Appendix II

### Tax depreciation rates

Maximum annual rates of depreciation for income tax purposes, calculated on a straight-line basis only.

Type of asset	Rate per annum %
Deferred charges	5
Deferred expenses and intangible fixed assets, including certain payments for patents, trademarks, technical assistance, or transfer of technology	15
Preoperating expenses	10
Fixed assets normally used by business enterprise:	
Buildings and other construction	5
Railways	5
Railroad cars, locomotive and ships	6
Furniture and office equipment	10
Airplanes, except for aviation companies and airplanes used for crop-dusting	10
Heavy-duty trucks and trailers, buses, automobiles, and light trucks	25
Bulletproofing for automobiles	25
Airplanes for crop-dusting	25
Computers and peripheral computer and punch-card equipment	30
Equipment for control of pollution	100
Equipment for research and product development	35
Tools and dies	35
Equipment for conversion to consumption of natural gas	100
Specialized cash registers for tax compliance	100
Machinery and equipment for the following activities:	
Production and distribution of electricity	5
Electric transportation equipment	10
Processing grain products, sugar and sugar products, edible oils, ocean, river and lake transportation companies	5
Manufacture of products derived from coal; primary production of metals; tobacco products	6
Petroleum and natural gas; production of paper and similar products	7
Manufacture of motor vehicles and parts; railroad and ship construction; manufacture of metal products; scientific and professional machinery and instruments; production of food and beverages (except grains, sugar, edible oils and their products)	8
Tanning and manufacture of leather products; chemical and petrochemical products; manufacture of basic products for plastics; rubber products; printing and publishing; pharmacobiological products	9
Manufacture of clothing and textiles; finishing, dyeing and stamping of textile products	11
Construction of airplanes	12
Overland transportation companies (freight and passenger); mining industry	12
Air transportation companies	16
Radio and television transmission and telegraph	16
Construction industry	25
Farming, timber	25
Fishing, cattle raising	25
Restaurants	20
Other types of activities not specified above	10

**Note:**

In the case of enterprises whose operations include more than one type of the business activities mentioned in the law, the rate of depreciation to be used will be that provided for the principal activity, determined on the basis of the relative volume of income in the previous year.

## Appendix III

### Corporate income tax and employee profit sharing calculations

2010

	Taxable income	Profit-sharing base
Net income per books before taxes, profit sharing	Ps 10,000,000	Ps 10,000,000
Add- Nondeductible expenses:		
Excess provision for bad debts over specific losses deductible	180,000	180,000
Entertainment and other miscellaneous nondeductible expenses (Note 1)	920,000	920,000
Inflationary annual adjustment (Note 2)	200,000*	
Taxable inventory (Note 3)	1,400,000	
	12,700,000	11,100,000
Deduct:		
Adjustment to tax cost of capital gains	100,000*	
Depreciation of fixed assets, adjusted for inflation, in excess of book depreciation	300,000*	
Taxable income	12,300,000	11,100,000
Corporate income tax (12,300,000 x 30%)	3,690,000	
Employee profit sharing 10% of 11,100,000		1,110,000

\* Items related to the recognition of inflation for tax purposes; not taken into account in determining the profit sharing base.

Notes:

1. Includes nondeductible travel expenses and automobile depreciation that do not meet all deductibility requirements.
2. Inflationary annual adjustment is calculated on an annual basis taking the monthly average of accounts receivable and liabilities and applying the annual increase in the National Consumer Price Index.
3. As from 2005, the deduction of purchased merchandise was replaced by a deduction of the Cost of Goods Sold. Such cost will be deductible in the year in which the income arising from the sale of goods is recognized. Special provisions apply for the inventory that was acquired before December 31, 2004 (See Chapter 15).

## Appendix IV

### Withholding taxes-

### Taxation of shareholders

#### ***Dividend/profit distribution tax rates***

A dividend or profit distribution must be grossed up by a factor of 1.4286, if are in excess of the after-tax earnings account (Cuenta de Utilidad Fiscal Neta or CUFIN), as consequence, the company paying the dividend is subject to a corporate tax at an effective tax rate of 42.86 percent.

#### ***After-tax earnings account (CUFIN)-determination of balance***

In broad terms, the CUFIN account represents a Mexican company's net taxable income less reinvested earnings, income taxes, profit sharing contributions, dividends paid and other nondeductible items. The annual taxable income (i.e., Utilidad Fiscal, "UFIN") is a concept that attempts to reflect the true economic earnings of the company.

The starting point in determining the annual UFIN of a company is the company's net taxable income for the year after any deductions for net operating loss carryforwards and the paid profit sharing contributions of the prior year. The company's net taxable income is then reduced by income taxes, profit sharing of the year and, in general, certain other nondeductible expenses incurred by the company during the year, to arrive at the company's UFIN for the tax year. Upon the determination of this amount, the resulting amount is then added to the accumulated CUFIN balance (adjusted for inflation) from previous years.

For 2010, the determination of the balance of CUFIN must be carried out as follows:

Balance of after-tax earnings account of the previous year (Note 1)

**Plus:**

After-tax earnings of the current fiscal year.  
 Dividends received from Mexican entities.  
 Dividends received from a Preferred Tax Regime (Tax Haven).

**Less:**

Dividends paid by the company  
 Capital Redemptions.

**Equals:**

Ending balance of the after-tax earnings account.

**Note 1:**

Prior to adding the UFIN of the year, the beginning balance in the CUFIN account is adjusted for inflation from the date of the last inflation adjustment up to the last month of the current tax year; the current year UFIN, however, is not included in the adjustment. If a dividend is distributed during the year, the CUFIN account is adjusted for inflation from the beginning of the period up to the month in which the dividend is distributed.

The CUFIN is then increased by the amount of dividends received from other companies resident in Mexico, by the amount of distributions from a joint venture arrangement and by previously recognized income, dividends or gains received from investments in preferred tax regimes. In turn, any deemed and actual dividends or other income distributions made in cash or in kind along with any capital reductions which in accordance with the Mexican Income Tax Law affect CUFIN are subtracted from the company's CUFIN balance. For purposes of this calculation, dividends and other distributions which are reinvested in the company as a capital contribution within 30 days of the date of distribution are not included. Dividends received from other Mexican companies generally increase CUFIN regardless of whether or not such dividends are attributable to the distributing company's CUFIN account.

In determining the amount of the CUFIN account that exists at the date of a distribution, the balance as of the end of the prior tax year is used. However, such amount is adjusted to take into account any dividends received (an upward adjustment) or paid (a downward adjustment) by the corporation during the period of time between the close of the prior tax year and the payment date of the dividend, plus an inflationary adjustment for that same period. As such, current year earnings are not taken into account for purposes of determining whether there is a sufficient CUFIN account balance to cover the distribution. Annual earnings are only included once the annual return is filed, usually by March 31 following the end of the fiscal year.

**Computation of after-tax earnings**

Taxable Income

**Less:**

Income Tax due for the year.  
 Non-deductible expenses, except general reserves and provisions and the Employees Statutory Profit Sharing Paid.

**Equals:**

After-tax earnings

## Appendix V

Withholding taxes-

Payments

to nonresidents

Income tax must be withheld from payments to nonresidents, both corporations and individuals, by resident corporations and individuals. The tax is applicable to gross income in each case unless otherwise indicated in the notes following the table.

<b>Withholding tax rates</b>	<b>%</b>
Professional fees for services rendered in Mexico	25
Members of boards of directors and advisory boards	25
Lease payments:	
Lease of real property	25
Lease of containers, airplanes, and ships authorized by the Mexican Government to be commercially exploited in the transportation of goods or persons	5
Lease of personal property	25
Time-sharing services (1)	25
Charter agreements	10
Sales:	
Real property located in Mexico (1)	25
Shares of Mexican companies (1, 2)	25
Transfers of ownership of Mexican public debt by other than the original creditors (intended to cover debt-for-equity swaps) (1)	25
Derivative transactions:	
On capital (1)	25
On debt (3)	Same rates applicable to interest
Interest (4):	
Paid to foreign government financing entities, to duly registered foreign banks and other entities that provide financing with funds obtained by issuing publicly traded debt instruments abroad, registered with the Ministry of Finance (5)	10
Interest on debt instruments placed abroad (6)	4.9
Interest payments to specific foreign financial institutions (7)	4.9
Other interest payments (not otherwise included above) paid by Mexican financial institutions to residents abroad	21
Paid to foreign suppliers of machinery and equipment, to others to finance purchases of such assets or inventory or working capital loans, if the lender is duly registered	21
Paid to reinsurance entities	15
Other interest payments (11)	30
Financial leases (on the portion deemed to qualify as interest or finance charge)	15
Dividends	Nil
Royalties (8):	
For the use of railroad cars	5
For the use of copyrights on scientific, literary, or art works, including motion pictures and radio and television recordings, as well as software and payments for the transmission of video and audio signals via satellite, cable, optical fiber, and similar media	25
On patents, invention or improvement certificates, trademarks, brand names, and advertising (11)	30
For the use of drawings or models, plans, formulas, or procedures, and of scientific, commercial, and industrial equipment; on amounts paid for information regarding scientific, commercial, and industrial experience.	25
Technical Assistance	25
Short-term construction, and the respective installation, maintenance, technical direction or supervision (9)	25
Reinsurance premiums	2
Income obtained by athletes and artists (1)	25
Income derived from prizes (e.g., lottery tickets or raffles) (10)	1, 21
Other income (forgiven debts, indemnifications, rights to participate in business, investments, etc.) (11)	30

*Notes:*

1. The non-resident may elect to pay tax at a rate of 30% in 2010 (see note 11 below for the rate applicable thereafter) on the net taxable profit, in the case of (i) time-sharing services, (ii) share sales, (iii) sales of real property, (iv) activities of sportsmen/artists, and (v) debt for equity swap transactions and to the extent that the following specific requirements are met:
  - i. For time-sharing services, the resident legal representative must keep the audited financial statements of the taxpayer available for inspection by the Mexican Tax Administration.
  - ii. For share sales, a tax opinion issued by a registered public accountant is required and the foreign taxpayer should not be a resident of a country classified as a tax haven or a country with a preferred tax regime. It should be noted that there is an option to defer Mexican income tax arising from the sale of shares within the same group due to a corporate reorganization provided certain pre-closing requirements are met (i.e. previous authorization from the tax authorities is required). No legal representative is required for sales of real property by public deed.
  - iii. A tax rate of 40% on the net gain would apply in debt for equity swap transactions provided that the non-resident recipient of the income has a legal representative resident in Mexico, and this election is available if the income obtained by the foreign taxpayer is not subject to a preferred tax regime.
2. The sale of shares through the Mexican Stock Exchange and government securities are exempt from income tax withholding provided certain rules are satisfied.
3. The applicable withholding rate (based on the withholding tax rates for interest) for debt-derivative transactions is applied on a net basis, that is, gross income less authorized deductions. However, if the transaction is liquidated in kind, the applicable withholding rate (on the same net basis) is 10%.
4. Interest payments to non-residents are exempt from Mexican income tax when they are paid on the following.
  - i. Loans to the federal government or to the Bank of Mexico (Central Bank) or bonds issued by the latter organization to be acquired and paid abroad.
  - ii. Loans for three or more years granted or guaranteed by duly registered financial entities that promote exports through special financing.
  - iii. Preferential loans granted or guaranteed by foreign financial entities to institutions authorized to receive tax-deductible donations in Mexico, provided these institutions are properly registered and use the funds for purposes consistent with their status.
  - iv. Loans derived from bonds issued by the Federal government or the Bank of Mexico placed on a recognized national stock exchange, to the extent the beneficial owner is a foreign resident.

5. In 2010, 4.9% is applicable when the interest is paid to registered banks resident in countries with which Mexico has signed a tax treaty. This is a provision that has been issued on a yearly basis for many years.
6. The 4.9% withholding rate applies provided the placement is handled through banks or brokerage firms resident in a country with which Mexico has signed a tax treaty, if there is compliance with the information requirements established in the general rules issued by the Ministry of Finance. If there is failure to comply with these requirements, the 10% withholding rate applies. The 4.9% and 10% withholding rates mentioned in the preceding paragraphs do not apply, and instead a 30% (see note 11 below for the rate applicable thereafter) withholding rate is applicable to interest, when the direct or indirect beneficiaries of the interest, either individually or jointly with related parties, receive more than 5% of the interest arising from the instrument in question, and are either (a) holders of more than 10% of the voting shares of the issuing company, either directly or indirectly, either individually or jointly with related parties, or (b) business entities holding more than 20% of their shares, either directly or indirectly, either individually or jointly with parties related to the issuer.
7. The 4.9% tax withholding rate is applicable to interest payments made to foreign financial institutions in which the Mexican federal government or the Mexican Central Bank has an equity participation.
8. The withholding tax rate is applied to the gross amount of the payment.
9. The non-resident taxpayer may elect to pay 30% tax on the net profit in 2010 (see note 11 below for the rate applicable thereafter), if the taxpayer has a resident legal representative and so advises the customer, who then makes no withholding. When business activities last for more than 183 days, the foreign taxpayer is deemed to have a permanent establishment in Mexico for tax purposes and is taxed in the same manner as a local resident corporation.
10. The 21% federal rate is applied only in the case of non-qualifying prizes (i.e., income derived from prizes that is subject to a state taxation that exceeds a rate of 6%).
11. A 30% income tax withholding rate is applicable for the period 2010 to 2012. As from 2013 the rate will be reduced to 29% and back to 28% as from 2014. The statutory withholding rates mentioned above may be reduced by applying tax treaty provisions, discussed below.

## Payments to residents of treaty countries

During the last decade, Mexico has embarked on a policy of negotiating a network of tax treaties with its principal trading and investment partners, these treaties provide reduced tax withholding rates. These include the following:

	Dividends			
	Portfolio	Substantial holdings	Interest	Royalties
	%	%	%	%
Australia	15	0 (1)	10, 15 (23)	10
Austria	10	5 (4)	10	10
Barbados	10	5 (1)	10	10
Belgium	15	5 (2)	10, 15 (15)	10
Brazil	15	10 (6)	15	10, 15 (25, 26)
Canada	15	5 (4)	10	10
Chile	10	5 (6)	5, 15 (24)	10 (26)
China	5 (7)	5 (7)	10	10
Czech Republic	10 (7)	10 (7)	10	10
Denmark	15	0 (3)	5, 15 (16)	10
Ecuador	5 (7)	5 (7)	10, 15 (15)	10
Finland	Nil	Nil	10, 15 (22)	10
France	0, 5 (9)	0, 5 (9)	5, 10 (26, 16)	10 (26)
Germany	15	5 (1)	5, 10 (16)	10
Greece	10 (7)	10 (7)	10	10
Iceland	15	5 (1)	10	10
India	10	10	10	10
Indonesia	10 (7)	10 (7)	10	10
Ireland, Rep. of	10	5 (4)	5, 10 (16, 26)	10
Israel	10	5 (10)	10	10
Italy	15 (7)	15 (7)	10 (26)	15
Japan	15	5 (8)	10, 15 (23)	10
Korea, Rep. of	15	0 (1)	5, 15 (16)	10
Luxembourg	15	8 (11)	10	10
Netherlands	15	Nil (12)	5, 10 (20)	10
New Zealand	15 (7)	15 (7)	10	10
Norway	15	Nil (3)	10, 15 (15)	10
Panama	5	7.5	5 (16), 10	10
Poland	15	5 (3)	10, 15 (17)	10
Portugal	10 (7)	10 (7)	10	10
Romania	10 (7)	10 (7)	15	15
Russia	10 (7)	10 (7)	10	10
Singapore	Nil	Nil	5, 15 (16)	10
Slovak Republic	Nil (13)	Nil (13)	10	10
South Africa	5 (4)	10	10	10
Spain	15	5 (3)	5, 10, 15 (19, 20, 26)	10
Sweden	15	5 (5)	10, 15 (15)	10
Switzerland	15	0 (1)	10, 15 (15)	10
United Kingdom	Nil	Nil	5, 10, 15 (19, 21)	10
United States	10	5 (4, 14)	4.9, 10, 15 (21, 18)	10
Uruguay	5	5	10	10

The numbers in parentheses refer to the following numbered Notes. The applicable tax rates on dividends paid abroad in accordance with the tax treaties executed by Mexico are detailed below. However, please note that dividends paid from Mexico to parties resident abroad are not subject to withholding tax in Mexico under domestic law.

There are certain specific cases of interest paid to parties resident abroad that might be exempted by certain tax treaties (e.g., interest paid to a pension fund or paid by a bank, interest paid on certain loans granted or guaranteed by certain entities for exports under preferential conditions, etc.), which are not detailed in the information below.

1. This rate applies when the recipient corporation that is the beneficial owner of the dividend (except for civil partnerships) directly owns at least 10% of the capital of the distributing corporation. The Swiss treaty extends the benefit to indirect shareholding
2. This rate applies where the company that is the beneficial owner of the dividends directly or indirectly owns at least 25% of the capital of the distributing company.
3. This rate applies where the company that is the beneficial owner of the dividends (except for civil partnerships) directly owns at least 25% of the capital of the company distributing dividends. In the case of Norway, the taxation is limited to the country of residence of the party receiving the dividends, provided the aforementioned substantial holding rule is satisfied.
4. This rate applies where the recipient corporation that is the beneficial owner of the dividend owns at least 10% of the voting shares of the paying corporation (capital in the case of South Africa).
5. This rate applies where a company that is the beneficial owner of the dividends (except for civil partnerships, although limited liability partnerships are included) directly owns at least 10% of the voting shares of the company distributing the dividends.
6. This rate applies where a company that is the beneficial owner of the dividends owns at least 20% of the voting shares of the company paying the dividends.
7. This is the maximum withholding rate for dividends, with no distinction for substantial holdings. In the case of Ecuador, the tax payable on dividends paid to residents in Mexico must not exceed a limit established in the treaty once applied some specific credits.
8. The 5% rate applies when a company that is the beneficial owner has at least 25% of the voting shares of the company paying dividends during the six months prior to the end of the tax period in which dividends are paid. Under certain particular rules and provided this ownership requirement is complied with, dividend payments are only subject to tax in the country of residence of the recipient of the dividends.

9. No withholding applies when more than 50% of the shares of the recipient corporation are owned by residents of France or Mexico or when the beneficial owner of the dividend is a resident individual. Accordingly, withholding tax applies to dividends when more than 50% of the recipient corporation's shares are owned by residents of other countries. However, the tax withholding must not exceed 5% when the party receiving the dividend is the beneficial owner of said dividend. Dividends paid by a company resident in France to a resident of Mexico, other than a company which directly or indirectly holds at least 10% of the capital stock of the first-mentioned company, may also be taxed in France, in accordance with the law of France, but if the recipient of the dividend is the beneficial owner, the tax thus charged must not exceed 15% of the gross amount of the dividend.
10. The 5% rate applies where the company that is the beneficial owner of dividend directly or indirectly owns at least 10% of the capital of the company distributing the dividend. There is a 10% tax rate that applies when these same ownership requirements are complied with, but the company paying dividend is a resident of Israel (provided dividend are paid from earnings taxed in Israel at a tax rate lower than the regular corporate tax rate in Israel).
11. The applicable tax rate on the gross amount of the dividends when the recipient company (beneficial owner) (except for civil partnerships) directly holds at least 10% of the capital of the corporation paying the dividend must not exceed 5% in the case of Luxembourg, and 8% in the case of Mexico. The protocol of the Mexico-Luxembourg tax treaty states that this rate might be reviewed in the future by the contracting states if withholding tax is not fully creditable, and can be adjusted under the principle of avoiding double taxation, provided the adjusted withholding rate is not lower than 5%.
12. Dividends paid by a company resident in Mexico to a company resident in the Netherlands (which is the beneficiary of said dividends) are subject to a maximum tax of 5% on the gross amount of the dividends, if the beneficial owner is a company that directly or indirectly owns at least 10% of the capital of the company paying said dividends. However, as long as a company resident in the Netherlands is not subject to Dutch income tax on dividends received from a company resident in Mexico in the terms of the Dutch income tax law and any future amendments thereto, the dividends mentioned in the preceding paragraph may only be taxed in the Netherlands (not in Mexico).
13. The exemption on dividend withholding tax is not applicable in the case of deemed dividends.

14. To the extent certain requirements provided in the Protocol are met, the withholding tax may be reduced to 0%.
15. The 10% rate applies to loans from banks.
16. The 5% withholding tax rate is applicable to interest paid to banks.
17. The 10% rate applies to interest on loans from banks, insurance companies, and securities regularly and substantially traded on a recognized national stock exchange.
18. The 4.9% rate applies to interest on loans from banks and insurance companies and to interest on securities regularly and substantially traded on a recognized national stock exchange.
19. In the case of the Netherlands the 5% rate applies to interest on loans from banks and to interest on securities regularly and substantially traded on a recognized national stock exchange. In the case of Spain and the UK the 5% rate extends to interest paid to insurance companies.
20. The 10% rate applies to interest paid by financial institutions and interest paid to the original seller of machinery and equipment.
21. The 10% rate on interest applies in the case of interest paid to the original seller of machinery and equipment and interest paid by banks.
22. The 10% rate applies to interest on loans from banks and to interest derived from bonds or securities that are regularly and substantially traded on a recognized securities market, as well as to interest paid by the purchaser of machinery and equipment to a beneficial owner that is the seller of the machinery and equipment.
23. The 10% rate applies to interest on loans from banks and insurance companies, to interest on securities regularly and substantially traded on a recognized national stock exchange, to interest paid to the original seller of machinery and equipment in a sale on credit and to interest paid by banks.
24. The 5% rate is applicable to interest on loans granted by banks and insurance companies, securities traded on a recognized securities market, and the sale on credit of machinery and equipment.
25. It is understood that the definition of royalties applies to any type of payment received for the provision of technical assistance services. The 15% rate applies to royalties arising from the use of, or the right to use, trademarks.
26. Reduced withholding rate resulting from the application of the most favored nation clause.

## Appendix VI

### Tax treaties

#### *Tax treaties in force*

Australia	Ecuador	Italy	Romania
Austria	Finland	Japan	Russia
Barbados	France	Korea	Singapore
Belgium	Germany	Luxembourg	Slovak Republic
Brazil	Greece	Netherlands	South Africa
Canada	India	New Zealand	Spain
Chile	Iceland	Norway	Sweden
China	Indonesia	Panama	Switzerland
Czech Republic	Ireland	Poland	UK
Denmark	Israel	Portugal	USA

#### *Tax treaties signed but pending ratification*

Colombia

Kuwait

Uruguay

#### *Treaties under negotiation*

Bahrain	Lithuania	Pakistan
Hungary	Malaysia	Slovenia
Latvia	Morocco	Thailand
Lebanon	Nicaragua	Ukraine

## Appendix VII

### Individual tax rates

#### Calendar year 2010

#### Annual Tax rates

Lower Limit	Upper Limit	Tax on Lower Limit	% Tax on Excess Over Lower Limit
Ps	Ps	Ps	%
0.01	5,952.84	0	1.92
5,952.85	50,524.92	114.24	6.40
50,524.93	88,793.04	2,966.76	10.88
88,793.05	103,218.00	7,130.88	16.00
103,218.01	123,580.20	9,438.60	17.92
123,580.21	249,243.48	13,087.44	21.36
249,243.49	392,841.96	39,929.04	23.52
392,841.97	1,000,000,000,000.00	73,703.40	30.00

#### Sample computation of annual tax

Annual tax

Assumptions

1. Nontaxable benefits equal 20% of total remuneration.
2. Nonallowable portion of low-income subsidy is therefore 40%.

#### Computation

Annual Gross remuneration	Ps 100,300.00
Less—Nontaxable benefits (20%)	20,060.00
Taxable remuneration	80,240.00
Lower limit of bracket	50,524.93
Excess over lower limit	29,715.07
Marginal tax (29,715.07 at marginal tax rate of 10.88%)	3,233.00
Tax on lower limit	<u>2,966.76</u>
<b>Net tax liability</b>	<b><u>Ps 6,199.76</u></b>

## Appendix VIII

### Monthly individual withholding tax rates

#### *Calendar year 2010*

##### Monthly withholding tax rates

Lower Limit	Upper Limit	Tax on Lower Limit	% Tax on Excess Over Lower Limit
Ps	Ps	Ps	%
0.01	496.07	0	1.92
496.08	4,210.41	9.52	6.4
4,210.42	7,399.42	247.23	10.88
7,399.43	8,601.50	594.24	16
8,601.51	10,298.35	786.55	17.92
10,298.36	20,770.29	1,090.62	21.36
20,770.30	32,736.83	3,327.42	23.52
32,736.84	1,000,000,000.00	6,141.95	30

The above income brackets will be adjusted to reflect the increase in the National Consumer Price Index, once the index has increased more than 10% after the previous adjustment.

### Salary subsidy

A refundable credit that is capped applies to the income used to calculate income tax

Taxable Income		Monthly Salary Tax Credit
Lower Limit	Upper Limit	
Ps	Ps	Ps
0.01	1,768.96	407.02
1,768.97	2,604.68	406.83
2,604.69	2,653.38	406.83
2,653.39	3,472.84	406.62
3,472.85	3,537.87	392.77
3,537.88	3,785.54	382.46
3,785.55	4,446.15	382.46
4,446.16	4,717.18	354.23
4,717.19	5,335.42	324.87
5,335.43	6,224.67	294.63
6,224.68	7,113.90	253.54
7,113.91	7,382.33	217.61
7,382.34	1,000,000,000,000.00	0.00

### Sample computation of monthly net withholding tax

Assumptions

Nontaxable benefits equal 20% of total remuneration.

### Computation

Monthly Gross remuneration	Ps	78,000.00
Less—Nontaxable benefits (20%)		15,600.00
Taxable remuneration		62,400.00
Lower limit of bracket		32,736.84
Excess over lower limit		29,663.16
Marginal tax (29,663.16 at marginal tax rate of 30%)		8,898.95
Tax on lower limit		6,141.95
<b>Tax liability</b>	<b>Ps</b>	<b>15,040.90</b>

## Appendix IX

### Personal allowances

#### **Personal allowances**

As noted in Chapter 20, resident taxpayers may claim certain deductions in arriving at taxable income.

#### Expenses

The following expenses are deductible:

1. Certain medical expenses provided they have been actually paid to persons residing in Mexico, after subtracting amounts reimbursed by third parties, such as through insurance. These include medical, dental and hospital bills of the taxpayer, spouse or common-law spouse, descendants, parents, or grandparents, provided these individuals do not have taxable income of their own in excess of one year's minimum wage. Medical insurance premiums are also deductible.
2. Funeral expenses of the individuals mentioned above, up to an amount not in excess of one year's minimum wage (about US\$ 1,500).
3. Charitable contributions to tax-exempt organizations that are authorized to receive tax-deductible donations. A deduction for donations to charities in a tax treaty country might also be available.
4. Inflation adjusted interest, paid on mortgage for purchase of personal residence, subject to limitations
5. Complementary contributions to the Mexican government retirement plan (AFORE) or Mexican personal retirement account. This deduction is capped at ten percent of the individual's taxable income and the contributions must not exceed five times the year's minimum wage of the taxpayer's economic area (US\$7,500)
6. Mandatory school transportation, provided that the school obligates all its students to use the transportation, and a separate official receipt is given for the cost of transportation.
7. Contribution to personal retirement account, limited to a yearly total contribution of MxPs 152,000 or about US\$ 11,500.

#### **Credits**

##### **Foreign Tax Credit**

An individual may deduct from the Mexican tax payable the foreign income tax paid on foreign-source taxable income subject to certain limitations.

## Appendix X

### Individual income tax calculation

#### ***Calendar year 2010***

##### ***Assumptions***

The following assumptions are made in the tax computation below.

1. The taxpayer is a resident alien who earns a salary and who has a wife and two children. The latter have no income.
2. The husband's income is as follows:

	Mx Pesos
Salary, allowances and bonus	1,000,000
Certain fringe benefits	100,000
Investment income from abroad, on which a foreign tax of 30% (Ps 16,500) was paid to the foreign country on a non-resident basis	55,000
Long-term capital gains on sales of shares in Mexican stock market (exempt)	30,000
<b>Total income</b>	<b>1,185,000</b>

ww3. Allowable deductions comprise the following:

Medical expenses	30,000.00
Charitable contributions	15,000.00
	<b>45,000.00</b>

## Tax computation

	<b>Mexican Pesos</b>	
Income - Salary, allowances, bonus, and fringe benefits		1,100,000
Less - Earned income exclusions:		
Nontaxable fringe benefits	- 100,000	
Excludable portion of Christmas bonus	- 1,578	
Excludable portion of vacation premium	- 789	- 102,367
		997,633
Add - Foreign-source investment income		55,000
		1,052,633
Deductions:		
Medical Expenses	30,000.00	
Charitable contributions	15,000.00	45,000
Taxable Income		Ps 1,007,633
Income tax (Art. 177 MITL)		241,804
Less - Foreign tax credit (Note 1)		16,500
Net tax liability		Ps 225,304

### NOTES:

The foreign tax credit allowed is the lesser of the foreign tax paid on the foreign-source income (as in example) or the foreign tax credit limitation, which is computed by applying the regular tax tables to the foreign source income only.

## Appendix XI

### Social security contributions and benefits

#### Contributions

Percentage of wages	Employee	Employer
	%	%
Sickness, maternity:		
Benefits in kind:		
Fixed quota (3)	-	20.40 (1)
Additional quota (3)	0.40	1.10 (2)
Benefits in cash (3)	0.25	0.70
Benefits in kind for retired personnel (3)	0.375	1.05
Life and disability (3)	0.625	1.75
Retirement Savings Account (3)	-	2
Old age (3)	1.125	3.150
Day-care centers and social benefits (3)	-	1
Occupational risks (3)	-	(4)
Housing Fund (3)	-	5.00

#### Notes:

1. Multiplied by one minimum wage for Mexico City, regardless of the salary in question.
2. Applicable to the excess over three minimum wages for Mexico City.
3. Of the employee wage for social security purposes.
4. The percentage of the premium, which ranges from 0.50% to 15%, depends on the principal activity of the employer and its annual occupational risks.

#### Wage ceiling

The wage ceiling for purposes of applying the above percentages will be an amount equal to the Mexico City minimum wage for the period of employment, multiplied by 25.

The maximum annual social security contributions, using a minimum daily wage salary of Ps 57.46 and 2.5984% as occupational risk rate would be Ps 8,580.29 for the employer.

## Appendix XII

### Value-added tax –

#### Items subject to zero rate

The following groups are zero rated (i.e., no tax is payable on them) for VAT purposes. Nevertheless, business enterprises may take credit for VAT charged to them by suppliers of goods and services used in producing the income, or claim a refund.

1. Sales or other transfers of the following:
  - a) Animals, vegetables and fruits not industrialized; for these purposes, wood is considered not industrialized;
  - b) Patent medicines; specified basic foods, including meat, milk and eggs;
  - c) Natural water (except when presented in containers of less than 10 liters capacity) and ice;
  - d) Palm, istle and agave fiber;
  - e) Tractors exclusively used to operate farm equipment, except those with crawler treads; power cultivators for small areas, plows and harrows; cultivators to spread and deweed; harvesters, sprayers or applicators of liquid or solid fertilizers, pesticides, herbicides, and fungicides; mechanical, electrical or hydraulic farm irrigation equipment; planters, equipment for silos; cutters and packers of livestock feed; grainers, equipment to manure and fertilize fields; airplanes for fumigation; hand-operated power chain saws; and, with certain limitations, commercial fishing boats (the foregoing items are granted the zero rate only when sold as complete units);
  - f) Fertilizers, pesticides, herbicides, and fungicides if used exclusively in agriculture or livestock raising;
  - g) Hydroponic nurseries and related equipment to produce controlled temperature and humidity or to protect plants from the elements, and irrigation equipment;
  - h) Gold jewelry, flatware, and artistic and ornamental pieces with a minimum 80% gold content, not for retail sale; and
  - i) Books and magazines.

2. The following independent services:
  - a) Those furnished directly to farmers and ranchers for their agricultural and livestock activities and for well-drilling, lighting and the construction of reservoirs; electrical power for use in irrigation systems; land clearing and road building within their properties; agricultural irrigation and fumigation; harvesting, vaccination, sanitation, and insemination of livestock; and the capture and extraction of sea or freshwater species;
  - b) Grinding and milling wheat and corn;
  - c) Pasteurising milk;
  - d) Services rendered in hydroponic nurseries;
  - e) Cotton ginning;
  - f) Slaughter of cattle and barnyard fowl;
  - g) Reinsurance; and
  - h) Supply of water for domestic use.
3. The rental of the machinery and equipment referred to in items (1)(e) and (g) above.
4. The export of tangible and intangible goods and services of the following nature (Note):
  - a) Technical assistance and services and licensing or sale of intangibles;
  - b) Assembly operations of the in-bond processing companies (i.e. maquiladora fees);
  - c) Advertising;
  - d) Commissions and intermediary fees;
  - e) Insurance, reinsurance, bonding, and rebonding;
  - f) Financial operations;
  - g) Independent personal services provided to residents abroad without an establishment or fixed base in Mexico, provided the service benefits the non-resident entirely abroad;
  - h) Filming or recording, so long as the requirements set forth in the VAT regulations are met; and
  - i) Hotel services rendered to foreign tourists who visit Mexico to participate in conventions, expositions or trade-fairs.
5. International freight and related services.
6. International air passenger services.
7. Foodstuffs other than the following:
  - a) Beverages other than milk, even when classified as foods; this includes fruit and vegetable juices (with or without sugar) and concentrates, regardless of presentation, density or weight;
  - b) Syrups and concentrates for soft drinks sold in open containers using electrical or mechanical devices, as well as concentrates, powders, syrups, essences, and extracts used in making soft drinks;
  - c) Caviar, smoked salmon and eels;
  - d) Flavouring agents, microcapsules and food additives.

Note:

The general rates specified in Articles 1 and 2 of the VAT law (16% or 11%) are applicable to the sale of the foodstuffs referred to above when prepared for consumption at the location or establishment at which they are sold, even when there are no facilities in which to consume them.

## Appendix XIII

### Financial Statements

X Company- Wholly-owned subsidiary of a foreign company.

#### **Balance sheet**

Assets

(In Mexican pesos – Note 2)

	December 31	
	2010	2009
Current assets:		
Cash and marketable securities	3,502,310	XX
Notes and accounts receivable:		
Trade	9,589,590	XX
Affiliated companies (Note)	1,023,430	XX
Other	229,760	XX
	10,842,780	XX
Less- Allowance for doubtful accounts	148,870	XX
	10,693,910	XX
Inventories:		
Finished goods	3,596,900	XX
Work-in-progress	1,587,750	XX
Raw materials	748,540	XX
Spare parts and supplies	3,330,130	XX
	9,263,320	XX
Less- Allowance for slow- moving inventories	76,790	XX
	9,186,530	XX
Prepaid expenses	686,040	XX
Total current assets	24,068,790	XX
Machinery and equipment (Note)	13,817,700	XX
Guarantee deposits and other assets	116,520	XX
Total assets	38,003,010	XX

The accompanying notes are an integral part of these financial statements.

**Balance sheet**

## Liabilities and stockholders' equity

(In Mexican pesos – Note 2)

	December 31	
	2010	2009
Current liabilities:		
Accounts payable to suppliers	6,432,030	XX
Current portion of long-term debt	1,719,880	XX
Other accounts payable and accrued expenses	3,055,550	XX
Income tax payable	132,650	XX
Value added tax payable	420,700	XX
Derivative financial instruments (note)	170,040	XX
Total current liabilities	11,930,850	XX
Long-term debt (Note)	2,346,310	XX
Deferred income tax	242,030	XX
Employee benefit obligations	937,330	XX
Total liabilities	15,456,520	XX
Stockholders' equity (Note):		XX
Capital stock	10,857,410	XX
Legal reserve	1,631,480	XX
Retained earnings	10,049,600	XX
	22,538,490	XX
	37,995,010	XX

The accompanying notes are an integral part of these financial statements.

**Income Statement**

(In Mexican pesos – Note 2)

	Year ended December 31	
	2010	2009
Net sales	86,647,340	XX
Cost of sales	58,186,230	XX
Gross profit	28,461,110	XX
Selling expenses	9,140,630	XX
Administrative expenses	9,997,930	XX
	19,138,560	XX
Operating income	9,322,550	XX
Other income (expenses), net (Note)	-62,770	XX
Interest-- Net		XX
Exchange losses	234,380	XX
	790,280	XX
Income before income tax	8,469,500	XX
Income tax (Note):		
Currently payable	2,020,510	XX
Deferred	287,620	XX
	2,308,130	XX
Net income for the year, same as comprehensive income	6,161,370	XX

The accompanying notes are an integral part of these financial statements.

## Statement of cash flows

(In Mexican pesos – Note 2)

	2010	2009
<b>OPERATING ACTIVITIES</b>		
Income before income tax	8,469,500	XX
Items relating to investment activities:		
Depreciation and amortization	1,523,580	XX
Interest expense	5,555,900	XX
Other	322,310	XX
	15,871,290	XX
Changes in working capital:		
Notes and accounts receivable	-2,922,520	XX
Inventories	-2,260,110	XX
Prepaid expenses	-230,560	XX
Accounts payable to suppliers	1,406,250	XX
Other accounts payable and accrued expenses	432,160	XX
Income tax paid	-368,080	
Other	128,120	XX
Net cash flows from operations	12,056,550	XX
<b>INVESTMENT ACTIVITIES:</b>		
Acquisition of machinery and equipment	-2,783,260	XX
Other	-53,170	XX
Net cash flows applied to investment activities	-2,836,430	XX
Excess cash to be applied to financing activities	9,220,120	XX
<b>FINANCING ACTIVITIES:</b>		
Repayment of long-term debt	-5,081,350	XX
Dividends paid	-1,500,000	XX
Net cash flows applied to financing activities	-6,581,350	XX
Net increase in cash and marketable securities	2,638,770	XX
Cash and marketable securities at beginning of year	863,540	XX
Cash and marketable securities at end of year	3,502,310	XX

The accompanying notes are an integral part of these financial statements.

### Statement of changes in stockholders' equity

(In Mexican pesos – Note 2)

	Capital stock	Legal reserve	Retained earnings	Total
Balances at January 1, 2009	XX	XX	XX	XX
Transfer to legal reserve		XX	XX	
Dividends declared			XX	XX
Comprehensive income for year			XX	XX
Balances at December 31, 2009	8,807,410	1,446,250	5,573,460	15,827,120
Increase in capital stock	2,050,000			2,050,000
Transfer to legal reserve		185,230	-185,230	
Dividends declared			-1,500,000	-1,500,000
Comprehensive income for year			6,161,370	6,161,370
Balances at December 31, 2010	10,857,410	1,631,480	10,049,600	22,538,490

The accompanying notes are an integral part of these financial statements.

## Appendix XIV

### Acquiring a business enterprise – A checklist

#### ***Investor's considerations***

##### ***History and current status of the enterprise***

- \_\_\_ What is for sale?
- \_\_\_ Entire business or only controlling interest (with possible minority problems) or assets?
- \_\_\_ Why is business for sale?
- \_\_\_ Evaluation of industry in which the enterprise operates, including growth potential and stability
- \_\_\_ Status of target business within its industry:
  - \_\_\_ Reputation
  - \_\_\_ Competitive position
- \_\_\_ Capital structure of entity:
  - \_\_\_ Business owned by a few or many shareholders?
  - \_\_\_ Major shareholders
  - \_\_\_ Analysis of different classes of equity
  - \_\_\_ Should business be restructured? If so, what form should be used?
- \_\_\_ Special trade arrangements
- \_\_\_ Record of profitability
- \_\_\_ Background of owners, directors, officers

##### ***Markets and competitors***

- \_\_\_ Markets served
- \_\_\_ Potential new markets
- \_\_\_ Effects on company's markets of any relevant current or pending legislation
- \_\_\_ Expanding market
- \_\_\_ Proposed new products
- \_\_\_ Main competitors

##### ***Capital required***

- \_\_\_ Working capital
- \_\_\_ Highly leveraged or cash-rich
- \_\_\_ Types of shares

**Location and premises**

- \_\_\_ Where located?
- \_\_\_ Leased or owned property
- \_\_\_ Space available for expansion
- \_\_\_ Accessibility of services
- \_\_\_ Transportation available
- \_\_\_ Professional valuation of premises (appraisal)

**Management evaluation**

- \_\_\_ Key employees information
- \_\_\_ Present salaries and other forms of remuneration
- \_\_\_ Details of service agreements and pension schemes
- \_\_\_ Industry experience
- \_\_\_ Turnover

**Production evaluation**

- \_\_\_ Standards for industry
- \_\_\_ Capacity utilization
- \_\_\_ Quality of plant and equipment, including buildings
- \_\_\_ Nature and amount of work subcontracted
- \_\_\_ Intangibles
- \_\_\_ Details of patents, tools and dies
- \_\_\_ Raw materials used and principal suppliers
- \_\_\_ Terms of purchases
- \_\_\_ Any significant forward purchase commitments?

**Workforce evaluation**

- \_\_\_ Number of employees and staff at each main factory and office
- \_\_\_ Qualifications
- \_\_\_ Labor relations with Unions
- \_\_\_ Salaries
- \_\_\_ Fringe benefits provided and costs thereof
- \_\_\_ Safety record

**Sales and marketing**

- \_\_\_ Analysis of current and potential situation
- \_\_\_ Share of market
- \_\_\_ Sales promotion methods
- \_\_\_ Export methods and distribution
- \_\_\_ Nature of relationship between company and its selling agents
- \_\_\_ Sales:
  - \_\_\_ By product
  - \_\_\_ By major customers
  - \_\_\_ By geographical market
- \_\_\_ Extent to which company is involved in fixed-price and long-term contracts
- \_\_\_ New product potential
- \_\_\_ Pricing of products
- \_\_\_ Governmental pricing controls

## ***II Legal counsel's considerations***

### ***Corporate, statutory and regulatory documents***

- \_\_\_ Articles of incorporation
- \_\_\_ Bylaws
- \_\_\_ Share certificates
- \_\_\_ Shareholders' Meetings Minute Book
- \_\_\_ Share Registry Book
- \_\_\_ Board of Directors' Meetings Minute Book
- \_\_\_ Capital Variations Registry Book
- \_\_\_ Description of shares or assets being acquired
- \_\_\_ Registration requirements (National Registry of Foreign Investments, Ministry of Finance and Public Credit, Public Registry of Commerce)
- \_\_\_ Antitrust provisions
- \_\_\_ Description of liabilities assumed
- \_\_\_ Lawsuits
- \_\_\_ Taxpayer identification number

### ***Contractual obligations***

- \_\_\_ Loan agreements
- \_\_\_ Government and/or long-term contracts
- \_\_\_ Property leases
- \_\_\_ Purchase or sale commitments
- \_\_\_ Licenses
- \_\_\_ Franchises
- \_\_\_ Mortgages
- \_\_\_ Insurance policies
- \_\_\_ Allocation of contractual obligations
- \_\_\_ Warranty obligations
- \_\_\_ Pledge
- \_\_\_ Professional Services
- \_\_\_ Administrative Services
- \_\_\_ Warrants and Guarantee Agreement
- \_\_\_ Commission Agreements
- \_\_\_ Other

### ***Management/labor obligations***

- \_\_\_ Union/ Individual contracts
- \_\_\_ Changes in labor picture that acquisition might bring about
- \_\_\_ Pension plan
- \_\_\_ Fringe benefits
- \_\_\_ Social security
- \_\_\_ Work guidelines
- \_\_\_ Mixed Commissions of Security and Health, Employees' Profit Sharing and Training

### ***Property titles and liens***

- \_\_\_ Real property
- \_\_\_ List and description
- \_\_\_ Appraisals
- \_\_\_ Title documents
- \_\_\_ Title insurance policies
- \_\_\_ Mortgages
- \_\_\_ Tangible personal property
- \_\_\_ List by category
- \_\_\_ Valuation
- \_\_\_ Existing liens

### ***Patents, trademarks and industrial property and copyrights owned by the business***

- \_\_\_ Expiry date of patents
- \_\_\_ Registration and ownership
- \_\_\_ Trademarks or Trade Names Registry
- \_\_\_ Improvement model
- \_\_\_ Business secrets
- \_\_\_ Copyrights
- \_\_\_ License agreements
- \_\_\_ Competitor's patents, trademarks, industrial property, and copyrights

### **III Accountant's considerations**

#### **Review of current situation**

- \_\_\_ Past trading results
- \_\_\_ Accounting policies, compliance with standards and the law and consistency of application
- \_\_\_ Financial statements:
  - \_\_\_ Balance sheet
- \_\_\_ Assets:
  - \_\_\_ Accounts receivable
  - \_\_\_ Inventory
  - \_\_\_ Land and building(s)
  - \_\_\_ Machinery and equipment
  - \_\_\_ Intangible assets
  - \_\_\_ Goodwill
- \_\_\_ Liabilities—short and long-term
- \_\_\_ Equity
- \_\_\_ Income statement
- \_\_\_ Gross profit ratio
- \_\_\_ Sales
- \_\_\_ Other income
- \_\_\_ Expenses
- \_\_\_ Gross profit
- \_\_\_ Profit and cash-flow forecasts and bases of assumptions
- \_\_\_ Statement of changes in financial position
- \_\_\_ Cash flow statement
- \_\_\_ Pension arrangements:
  - \_\_\_ Unfunded liabilities
- \_\_\_ Purchase commitments
- \_\_\_ Future prospects:
  - \_\_\_ Cash flow projections
- \_\_\_ Financing required

#### **Taxation**

- \_\_\_ All returns filed
- \_\_\_ Unpaid assessments
- \_\_\_ Adequacy of current provision for income taxes
- \_\_\_ Possible additional taxes for prior years
- \_\_\_ Statute of limitations
- \_\_\_ Characteristics of liabilities
- \_\_\_ Rulings requests in progress
- \_\_\_ Particulars of important matters in dispute
- \_\_\_ Court cases
- \_\_\_ Comments on adequacy of overall provision; estimated deficiency or surplus
- \_\_\_ Details of losses and allowances available to carry forward
- \_\_\_ Extent to which tax planning schemes have been used in the past and assessment of any resulting potential exposure
- \_\_\_ Value-added tax due or overpaid
- \_\_\_ Asset tax carryback and carryovers
- \_\_\_ Flat tax (IETU) due or credited

## Appendix XV

### Structuring an investment – A checklist

#### **Corporation**

##### ***Investor's considerations***

- \_\_\_ Limitations on foreign ownership, depending on activities
- \_\_\_ Advantages/disadvantages of incorporating
- \_\_\_ Limited liability
- \_\_\_ Pro rata expenses are nondeductible on subsidiaries
- \_\_\_ Hybrid entities/instruments
- \_\_\_ Incorporation and maintenance costs
- \_\_\_ Taxed as entity; amounts to be distributed tax free to shareholders
- \_\_\_ Statutory audit may be required
- \_\_\_ Financing through capital or debt
- \_\_\_ Minimum capital requirements
- \_\_\_ Dollar or peso loan
- \_\_\_ Advantages/disadvantages of liquidation

##### ***Legal counsel's considerations***

- \_\_\_ Type of entity
- \_\_\_ At least two shareholders
- \_\_\_ Applicable authorizations
- \_\_\_ Articles of incorporation
- \_\_\_ Bylaws
- \_\_\_ Name options
- \_\_\_ Registration requirements (National Registry of Foreign Investments, Ministry of Finance and Public Credit, Public Registry of Commerce)
- \_\_\_ Taxpayer identification number
- \_\_\_ Social security
- \_\_\_ Share certificates
- \_\_\_ Share Registry Book
- \_\_\_ Shareholders' Meetings Minutes Book
- \_\_\_ Board of Directors' Meetings Minutes Book
- \_\_\_ Capital Variations' Registry Book
- \_\_\_ Annual Shareholders' Meeting
- \_\_\_ Others

##### ***Accountant's considerations***

- \_\_\_ Tax advantages/disadvantages of incorporating
- \_\_\_ Tax regime
- \_\_\_ Tax planning opportunities
- \_\_\_ Financial statements filing requirements
- \_\_\_ Repatriation of capital and profits

## ***II Branch***

### ***Investor's considerations***

- \_\_\_ Advantages/disadvantages of operating as a branch
- \_\_\_ Foreign companies can set up branch operation
- \_\_\_ Limitations of foreign participation depending on their activities
- \_\_\_ Losses can be offset against income of nonresident parent
- \_\_\_ Reasonable pro rata expenses deductible
- \_\_\_ Parent company is liable
- \_\_\_ Remittances to the home office are non-deductible
- \_\_\_ Capital provided by parent
- \_\_\_ Repatriation of capital and profits
- \_\_\_ No exchange controls
- \_\_\_ Advantages/ disadvantages of closing a Branch office

### ***Legal counsel's considerations***

- \_\_\_ Requirements to establish branch
- \_\_\_ Authorization from the Ministry of Economy
- \_\_\_ Registration requirements (Public Registry of Commerce, National Registry of Foreign Investments)
- \_\_\_ Documentation

### ***Accountant's considerations***

- \_\_\_ Taxation of a branch
- \_\_\_ Branch profits tax considerations
- \_\_\_ Payment of remittances
- \_\_\_ Tax planning opportunities

### **III—Partnership**

#### ***Investor's consideration***

- \_\_\_ Limitations of foreign investment participation, depending on their activities
- \_\_\_ Requirements for partners
- \_\_\_ Advantages/disadvantages of operating as a partnership

#### ***Legal counsel's considerations***

- \_\_\_ Incorporation requirements
- \_\_\_ Authorization from the Ministry of Economy
- \_\_\_ Registration requirements (Public Registry of Commerce, National Registry of Foreign Investments)
- \_\_\_ Documentation

#### ***Accountant's considerations***

- \_\_\_ Taxed as conduit or entity
- \_\_\_ Tax planning opportunities

### **IV—Joint Venture (*Asociación en Participación*)**

#### ***Investor's considerations***

- \_\_\_ It's an agreement, not a juridical entity
- \_\_\_ Administration of a joint venture
- \_\_\_ Obligations in a joint venture (between parties, vis a vis third parties)
- \_\_\_ Term of a joint venture
- \_\_\_ Advantages/disadvantages of participating in a joint venture
- \_\_\_ Active partner and silent partner needed

#### ***Legal counsel's considerations***

- \_\_\_ Requirements
- \_\_\_ Drafting the agreement

#### ***Accountant's considerations***

- \_\_\_ Separate financial statements
- \_\_\_ Taxed as a corporation for tax purposes

## Appendix XVI

### Major events/changes

The Mexican economy is expected to grow 4 percent or more in 2010, after the world economic crisis of 2008-2009. Growth of the first quarter is 4.3%. Inflation has been cut by more than half this decade and at the same time international reserves have more than doubled. The markets reflect this optimism, with the Mexican stock index tending to high. GDP has doubled in a decade except for the years of world economic crisis, and Mexicans are again making long-term capital investments in Mexico.

Credit for this growth goes to the Mexican people and to sound government policies. Mexico has been on a reforming path for a number of years, privatizing, deregulating, and pruning the role of government. President Calderón's plan, which focuses on strengthening the rule of law, facilitating cross-border trade, and enhancing intellectual property rights protection, is a good example of the spirit of economic optimism that we increasingly see across Mexico.

Part of this reform process has been the increased internationalization of Mexico's economy, which is seen in our foreign trade, with more than US \$450 billion in goods and services crossing our borders (in and out). During 2010, the cross-border transactions are back on course. Total foreign investment for 2009 amounted to US \$20 billion. For 2010 it is expected to reach at least this amount only in direct foreign investment.

For Mexico, trade with the U.S. is greater than its trade with the rest of the world combined. For the U.S., trade with Mexico is larger than its trade with all of Latin America, including Brazil, Argentina, all of Central America, and all of the Caribbean, with enough left over to cover all its trade with India as well.

Mexico keeps the reform process going through the U.S.-Mexico-Canada Security and Prosperity Partnership, which tackles issues such as: protecting our societies against faulty consumer goods; managing infectious diseases; reducing wait times at borders; and combating fakes and counterfeits.

Indeed, according to the World Bank, Mexico has been a top economic reformer, leapfrogging more than 20 countries in the 2007 annual survey of economic reform, and was recognized by the IMF (International Monetary Fund) in 2009 as the 13th largest economy in the world. In areas of starting a business, protecting investors and paying taxes, Mexico has made exceptional progress.

Through April 2010, Mexico has a fiscal surplus. Oil income increased 13.9% and income from taxes grew 11.4%.

## Appendix XVII

### Business information services

#### *Government agencies and embassies*

##### **British Embassy**

Río Lerma No. 71  
 Colonia Cuauhtémoc  
 06500 México, D.F.  
 Telephone: +52 55 1670 3200  
 Fax: +52 55 1670 3224  
 e-mail: ukin.mexico@fco.gov.uk  
 www.embajadabritanica.com.mx

##### **Canadian Embassy**

Schiller 529  
 Colonia Polanco  
 11560 México, D.F.  
 Telephone: +52 55 5724 7900  
 Fax: +52 55 5724 79 81  
 e-mail: mexico.commerce@international.gc.ca  
 mexico.gc.ca

##### **Delegation of the European Union in Mexico**

Paseo de la Reforma 1675  
 Colonia Lomas de Chapultepec  
 11000 México, D.F.  
 Telephone: +52 55 5540 3345  
 Fax: +52 55 5540 6564  
 e-mail:  
 DELEGATION-MEXICO@eeas.europa.eu  
 www.delmex.ec.europa.eu

##### **Embassy of the United States**

Paseo de la Reforma 305  
 Colonia Cuauhtémoc  
 Telephone: +52 55 5080 2000  
 Fax: +52 55 5080 2005  
 e-mail: acsmexicocity@state.gov  
 mexico.usembassy.gov

##### **French Embassy**

Campos Elíseos 339  
 Colonia Polanco  
 11560 México, D.F.  
 Telephone: +52 55 9171 9700  
 Emergency: +52 55 9171 9707  
 Fax: +52 55 9171 9703  
 www.ambafrance-mx.org

***We at PwC are ready to assist you in resolving business matters in Mexico.***

##### **German Embassy**

Horacio No. 1506  
 Colonia Los Morales  
 11530 México, D.F.  
 Telephone: +52 55 5283-2200  
 e-mail: info@mexi.diplo.de  
 www.mexiko.diplo.de

##### **Japanese Embassy**

Paseo de la Reforma 395  
 Colonia Cuauhtémoc  
 06500 México, D.F.  
 Telephone: +52 55 5514 4507  
 Fax: +52 55 5514 1070  
 e-mail: sando@embjapon.com.mx  
 www.mx.emb-japan.go.jp

##### **Ministry of Economy**

Av. Alfonso Reyes 30  
 Colonia Hipódromo Condesa  
 06140 México, D.F.  
 Telephone: +52 55 5729-9193, 94  
 e-mail: primercontacto@economia.gob.mx  
 www.economia.gob.mx

##### **Netherlands Embassy in Mexico**

Vasco de Quiroga 3000  
 Edificio Calakmul, piso 7  
 Colonia Santa Fe  
 01210 México D.F.  
 PO Box: 10-656  
 11000 México D.F.  
 Telephone: +52 55 5258 9921  
 Telefax: +52 55 5258 8138  
 e-mail: mex-info@minbuza.nl

### **Private business entities**

#### **American Chamber of Commerce of Mexico**

Blas Pascal 205, 3er Piso  
 Colonia Los Morales  
 11510 Mexico D.F.  
 Telephone: +52 55 5141 3800  
 Fax: +52 55 5141 3835, 3836  
 e-mail: amcham.mx@amcham.com.mx  
 www.amcham.com.mx

#### **British Chamber of Commerce**

Río de la Plata No. 30  
 Colonia Cuauhtémoc  
 06500 México, D.F.  
 Telephone: +52 55 5256 0901  
 Fax: +52 55 5211 5451  
 e-mail: communicate@britchamexico.com  
 www.britchamexico.com

#### **Chamber of Commerce Mexico-Brasil, Latin America**

Fuente de Molinos 49-B.Mezannine Desp.1.  
 Lomas de Tecamachalco, Naucalpan  
 53950 Estado de México, México  
 Telephone: +52 55 5540 4326  
 Fax: +52 55 5540 4335  
 e-mail: info@camebra.mx  
 www.camebra.mx

#### **China Chamber of Commerce and Technology Mexico**

Varsovia No. 25-A  
 Colonia Juarez  
 06600 México, D.F.  
 Telephone: +52 55 5511 2011  
 www.chinachambermexico.org

#### **Colombian Chamber of Commerce in Mexico**

Av. Desierto de los Leones No. 1410, Casa 19  
 Colonia Tetelpan, Del. Alvaro Obregón, C.P.  
 01700 México D.F.  
 Tel/Fax: +52 55 5585 1126  
 e-mail: shenao@ccmexcol.com  
 www.ccmexcol.com

#### **Franco-Mexican Chamber of Commerce**

Protasio Tagle No. 104  
 Colonia San Miguel Chapultepec  
 11580 Mexico D.F.  
 Telephone: +52 55 5272 0960  
 Fax: +52 55 5515 3030  
 www.cfmci.com

#### **Israel Chamber of Commerce in Mexico**

Boulevard Manuel Avila Camacho No. 24,  
 Colonia Lomas de Chapultepec  
 11000 Mexico DF  
 Tel. +52 55 5576 9424  
 cmi.org.mx/cms

#### **Italian Chamber of Commerce in Mexico**

Presidente Mazarik 490 office 801  
 Colonia Polanco  
 11550 Mexico D.F.  
 Telephone: +52 55 5282 2500  
 Fax: +52 55 5282 2500 ext 102  
 www.camaraitaliana.com.mx

#### **Japanese Chamber of Commerce in Mexico**

Fujiyama 144  
 Colonia Las Aguilas  
 01710 Mexico D.F.  
 Telephone: +52 55 5593 2020  
 Fax: +52 55 5593 2121  
 www.japon.org.mx

#### **Mexican Council on Foreign Relation (COMEXI)**

Sierra Mojada 620, Oficina 502  
 Torre Magnum  
 Colonia Lomas de Chapultepec  
 11000 México, D.F.  
 Telephone: +52 55 5202 3776  
 www.consejomexicano.org

#### **Mexican- German Chamber of Commerce and Industry**

Av. Santa Fe 170 1.-4-12  
 Colonia Lomas de Santa Fe  
 01210 México, D.F.  
 Telephone: +52 55 1500 5900  
 Fax: +52 55 1500 5910  
 mexiko.ahk.de

#### **Spain Chamber of Commerce**

Homero 1430  
 Polanco  
 11510 México D.F.  
 tel: +52 55 5395 5281  
 fax: +52 55 5395 4803  
 e-mail: cam.espanola@comescom.com.mx  
 www.comescom.com.mx

Note: The larger commercial banks, such as Banamex, Bancomer, and Banco Santander, have foreign investment departments staffed to assist prospective investors in establishing business contacts and other matters.

---

## ***PwC Mexico Tax and Legal Experts***

### **Territory Tax and Legal Services Leader**

Mauricio Hurtado

mauricio.hurtado@mx.pwc.com

+52 55 5263 6045

### **Corporate tax**

Jose Alfredo Hernandez

jose.alfredo.hernandez@mx.pwc.com

+52 55 5263 6060

Luis Manuel Puente

luis.manuel.puente@mx.pwc.com

+52 81 8152 2005

### **Customs and international trade**

Hector Herrera

hector.herrera@mx.pwc.com

+ 52 55 5263 6110

### **Financial services (FSIP)**

Alejandro Solano

alejandro.solano@mx.pwc.com

+52 55 5263 6054

### **Indirect tax**

Ivan Jaso

ivan.jaso@mx.pwc.com

+52 55 5263 8535

### **International assignmet services (IAS)**

Claudia Campos

claudia.campos@mx.pwc.com

+52 55 5263 5774

### **International tax services (ITS)**

Carlos Montemayor

carlos.montemayor@mx.pwc.com

+52 55 5263 6066

### **Human resources services (HRS)**

Hector Castro

hector.castro@mx.pwc.com

+52 55 5263 6067

### **Mergers and acquisitions (M&A)**

Jose Alfredo Hernandez

jose.alfredo.hernandez@mx.pwc.com

+52 55 5263 6060

Jesus Chan

jesus.chan@mx.pwc.com

+52 55 5263 5766

### **Legal - Business law**

Mauricio Hurtado

mauricio.hurtado@mx.pwc.com

+52 55 5263 6045

Carlos Martinez

carlos.manuel.martinez@mx.pwc.com

+52 81 8152 2000

**Legal - Tax law and administrative litigation**

Eduardo Mendez

eduardo.mendez@mx.pwc.com

+52 55 5263 6064

**Legislative services**

Patricia Gonzalez

patricia.gonzalez@mx.pwc.com

+52 55 5263 6057

**Real Estate and Energy**

David Cuellar

david.cuellar@mx.pwc.com

+52 55 5263 5816

**Tax consolidation**

Gabriel Reyes

gabriel.reyes@mx.pwc.com

+52 55 5263 5813

**Tax controversy and dispute resolution (TCDR)**

Karina Perez

karina.perez.delgadillo@mx.pwc.com

+52 55 5263 5734

**Tax management and accounting services (TMAS)**

Jesus Chan

jesus.chan@mx.pwc.com

+52 55 5263 5766

**Transfer pricing (TP)**

Fred Barrett

fred.barrett@mx.pwc.com

+52 55 5263 6069

**Sustainability**

Arturo Mendez

arturo.mendez@mx.pwc.com

+52 33 3648 1013

**Value chain transformation**

Adriana Rodriguez

adriana.rodriguez@mx.pwc.com

+52 55 5263 8527

---

## ***Our network***

### ***Mexico City offices***

---

#### ***Mariano Escobedo***

Mariano Escobedo 573  
Colonia Rincón del Bosque  
11580 México D.F.  
Telephone: (55) 5263 6000  
Fax: (55) 5263 6010

#### ***Satélite***

Corporativo City Shops  
Boulevard Manuel Avila Camacho 3130, piso 8  
Colonia Valle Dorado  
54020 Tlalnepantla, Estado de México  
Telephone: (55) 1940 2500  
Fax: (55) 1940 2513

### ***Offices inside Mexican Republic***

---

#### ***Cancún***

Av. Bonampak 73  
Super Mz-3, Mz-10 Edificio Global  
Cancún Torre "B", depto. 501  
Colonia Benito Juárez  
77500 Cancún, Quintana Roo  
Telephone : (998) 287 5000  
Fax: (998) 287 5010

#### ***Chihuahua***

Edificio Punto Alto E-2  
Av. Valle Escondido 5500, int. 204 y 205  
Fraccionamiento El Saucito  
31125 Chihuahua, Chihuahua  
Telephone: (614) 425 3960  
Fax: (614) 425 3961

#### ***Ciudad Juárez***

Bldv. Tomás Fernández 8490  
Esquina con Camino Real SENECÚ  
Fraccionamiento Anglia  
32459 Ciudad Juárez, Chihuahua  
Telephone: (656) 892 2200  
Fax: (656) 892 2210

#### ***Guadalajara***

Av. Prolongación Américas 1905, piso 8  
Colonia Colomos  
Providencia Sector Hidalgo  
44660 Guadalajara, Jalisco  
Telephone: (33) 3648 1000  
Fax: (33) 3648 1002

#### ***Hermosillo***

Blvd. Solidaridad 335  
Edificio "A", piso 5  
Colonia Paseo del Sol  
83246 Hermosillo, Sonora  
Telephone: (662) 289 0202  
Fax: (662) 289 0200

#### ***León***

Paseo del Moral 502, piso 5  
Fraccionamiento Jardines del Moral  
37160 León, Guanajuato  
Telephone: (477) 717 2911  
Fax: (477) 779 4724

#### ***Los Cabos***

Plaza Peninsular local 4C  
Carretera Transpeninsular km 29.5  
Colonia La Jolla de los Cabos  
23405 San José del Cabo, Baja California Sur  
Telephone: (624) 173 9670

#### ***Mérida***

Calle 33-501-A, piso 7, deptos. 12-13.  
Por Prolongación Paseo de Montejo y 46A,  
Fraccionamiento Gonzalo Guerrero  
97118 Mérida, Yucatán  
Telephone: (999) 948 2958  
Fax: (999) 948 3150

#### ***Mexicali***

Calz. Justo Sierra y Laureles 1101-B Altos  
21230 Mexicali, Baja California  
Telephone: (686) 565 6720  
Fax: (686) 565 6720 ext. 20

---

**Monterrey**

Avenida Rufino Tamayo 100  
Colonia Valle Oriente  
66269 San Pedro Garza García, Nuevo León  
Telephone: (81) 8152 2000  
Fax: (81) 8152 2075

**Puebla**

Avenida 31 Poniente 4128, piso 8  
Colonia Ampliación Reforma Sur  
72160 Puebla, Puebla  
Telephone: (222) 273 4400  
Fax: (222) 273 4405

**Querétaro**

Edificio TEC 100  
Av. Tecnológico 100, piso 6  
Colonia San Ángel  
76030 Querétaro, Querétaro  
Telephone: (442) 290 6900  
Fax: (442) 290 6904

**San Luis Potosí**

Edificio MW  
Alberto Cossío 105, piso 12  
Fraccionamiento Tangamanga  
78269 San Luis Potosí, S.L.P.  
Telephone: (444) 817 9217  
Fax: (444) 817 8421

**Tampico**

Av. Hidalgo 5502 B, piso 4  
Esquina con Privada Hidalgo  
Colonia Laguna de la Herradura  
89364 Tampico, Tamaulipas  
Telephone: (833) 306 7000  
Fax: (833) 306 7010

**Tijuana**

Bld. Agua Caliente 4558-807  
Condominio Plaza Agua Caliente  
Colonia Aviación  
22420 Tijuana, Baja California  
Telephone: (664) 681 7728, 681 8233  
Fax: (664) 681 8040

**Torreón**

Paseo de la Rosita 780-1  
Colonia Campestre La Rosita  
27250 Torreón, Coahuila  
Telephone: (871) 721 9611, 721 9689, 720 5967  
Fax: (871) 721 9681

**Veracruz**

Bld. Adolfo Ruiz Cortínez 1600, piso 6  
Fraccionamiento Costa de Oro  
94299 Boca del Río, Veracruz  
Telephone: (229) 775 6000  
Fax: (229) 775 6010

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 161,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice. See [pwc.com](http://pwc.com) for more information.







