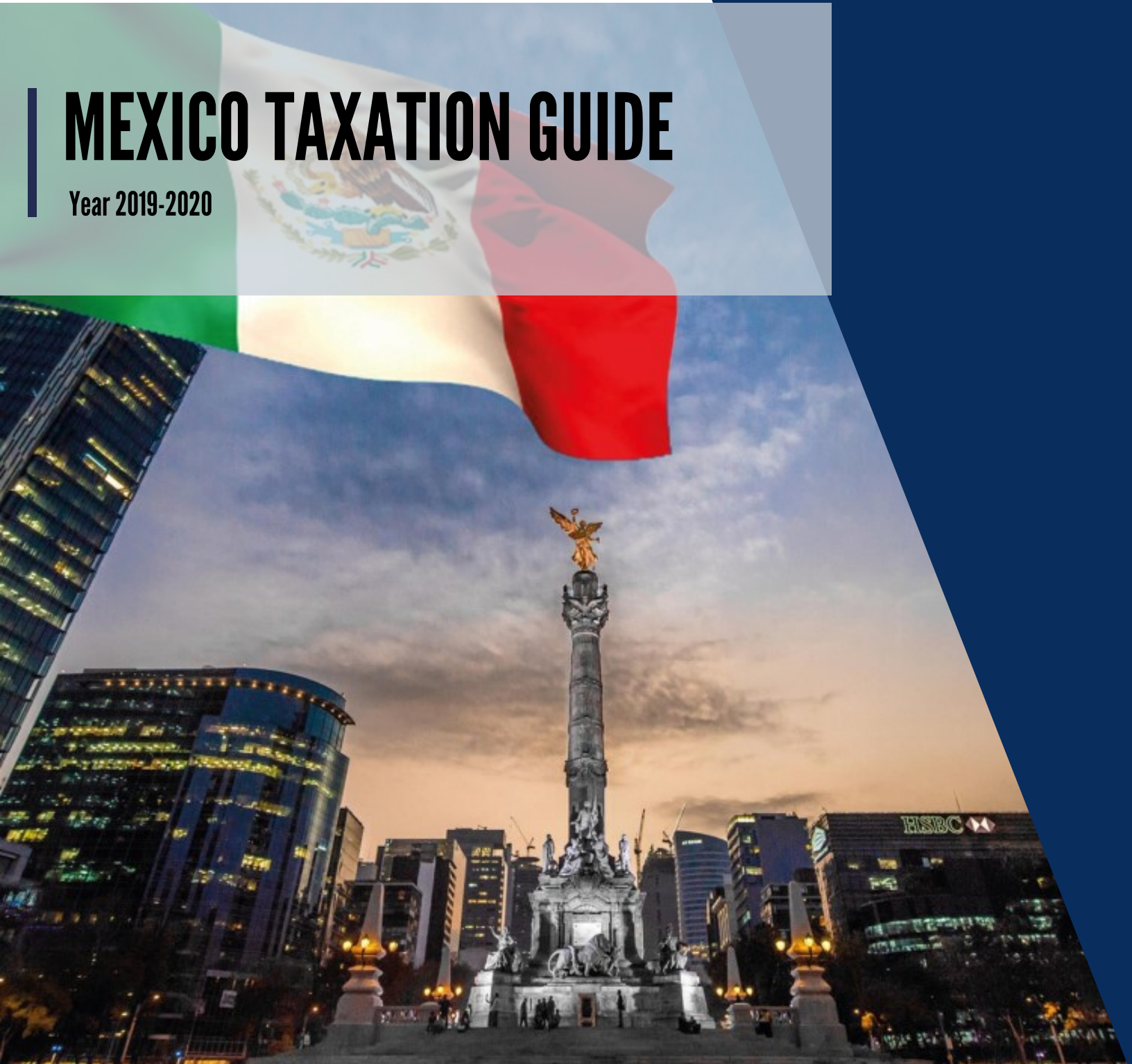


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ATTORNEYS & ADVISORS

MEXICO TAXATION GUIDE

Year 2019-2020





I. RECOGNIZED MEXICAN BUSINESS ENTITIES

Mexican law recognize several forms of business entities, including corporations (*sociedades anonimas*, S.A.), corporations with variable capital (*sociedades anonimas de capital variable*, SA de CV), limited liability companies, (*sociedades de responsabilidad limitada*, SdeRL) branches and foreign corporations, general and limited partnerships, and joint ventures. Due to formations, operation, and taxation considerations, most foreign investors form one of the first three types of business.

Foreign owned enterprises are subject to the same laws that apply to Mexican businesses as well as special regulations governing foreign investment.

1. **Sociedad Anónima (S.A.); Sociedad Anónima de Capital Variable (S.A. de C.V.):** it is a regular corporation and the S.A. de C.V. is a regular corporation with variable capital (i.e., its capital can be increased by resolution of its board of directors). These are the most common types of business entities utilized in Mexico by both domestic and foreign investors.
2. **Sociedad de Responsabilidad Limitada (S. de R.L.):** it is a limited liability company similar to limited liability companies in the U.S. The U.S. Internal Revenue Code and regulations allow for this entity to “check the box”, ie., to select to be either a partnership or C-corporation for U.S. tax purposes.
3. **Sociedad en Nombre Colectivo (S. en N.C.):** it is a general partnership which, like U.S. general partnerships, results in unlimited liability to its partners for partnership obligations.
4. **Sociedad en Comandita (S.en C.):** it is a limited partnership similar to a limited partnership in the U.S.
5. **Asociación en Participación (A. en P.):** it is a joint venture which is formed by the execution of a joint venture contract. This is a taxable entity for Mexican tax purposes.
6. **Sucursal de Sociedad Extranjera:** it is a branch of a foreign corporation. It must be registered as such with the Mexican government before commencing business in Mexico.
7. **Fideicomiso:** it is a trust organized under the banking laws of Mexico. It must have a bank as its trustee and it can conduct business in Mexico. It is a conduit for Mexican tax purposes and its beneficiaries account directly for their share of its tax attributes. However, the trustee is responsible for determining the tax liability of the trust’s beneficiaries and for making advance payments for any tax liability.

II. MEXICAN TAXATION

A U.S. Taxpayer's operations in Mexico will be subject to both federal and state government taxes. The most significant taxes are those imposed by the federal government in the form of income taxes, the value added tax, import and export taxes, and a federal payroll tax on wages. State and local governments generally impose taxes on real property and some states levy taxes on salaries and wages. Generally, local taxes on wages are payable by the employer. Federal taxes are established by the legislature which annually adopts the Federal Revenue Law imposing federal taxes for the year. The Ministry of Finance and Public Credit is empowered to issue regulations interpreting the Federal Revenue Law and its Audit Division audits tax returns filed with the Ministry.

A. Form over Substance

In the U.S. the substance of a transaction generally prevails over its form for purpose of determining the appropriate tax treatment for the transaction. In Mexico, absent fraud, the form of a transaction will generally prevail over its substance. If a transaction is properly documented, the form of the transaction specified in the documents will be respected for purposes of Mexican taxation.

B. Business Entity Taxes

The corporate income tax rate on Mexican corporations and other business entities is imposed on a world-wide income at rate of 30%. Generally, corporations principally administered from within Mexico and those organized under Mexican law are treated as resident corporations for tax purposes. Therefore, certain non-resident corporations with registered branches in Mexico operating through permanent establishments in Mexico may be treated as resident corporations. Foreign corporations operating in Mexico which are not treated as resident corporations are taxed only on their Mexican source income.

C. Permanent Establishment

A permanent establishment is a fixed place of business through which the business of an enterprise is carried on. A permanent establishment includes: a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources, and a building or construction site. It may also include the office or place of business of an agent authorized to enter into contracts on behalf of the foreign entity. Generally, a permanent establishment does not include a facility used for storage, display or delivery of goods or merchandise, a purchasing or information collection office, or a fixed place of business used solely for advertising, scientific research, loan placements or for supplying information.

D. Dividends

Mexico has a hybrid integrated corporate/shareholder income tax. That is, income earned by a corporation is taxed at the corporate level at 30%. Dividend payments made by a Mexican corporation out of income which was taxed at the corporate level is subject to a 10% withholding tax at the shareholder level, for residents and non-residents alike.

E. Accounting Method

In general, taxpayers are required to recognize income using the accrual method of accounting. For example, income interest must be accrued as it becomes due whether or not paid.





Income on long-term contracts, that is, contracts for the construction of buildings or machinery, is includable as work if approved by the customer and invoices are submitted for payment. Expenses incurred in connection with such contracts are deductible in the year in which they are incurred. Costs incurred to acquire, fabricate or manufacture inventory (other than real property) are capitalized. Fixed assets are depreciated on a straight-line basis.

F. Inflation Adjustment

Income is calculated by including gains and losses resulting from inflation. Therefore, depreciation and interest expense, for example, must be adjusted by changes in the purchasing power of the peso. Only the net expense is deductible. Historically, this has resulted in lower deductions for indexed items and therefore, reduces the desirability of heavily leveraged operations in Mexico. Also, if the adjustment results in a gain, such gain must be included in taxable income. Similarly, monetary assets such as bank balances, receivables and other investments must be indexed for inflation and gain or loss reflected in taxable income. Taxable income from the sale of capital assets and machinery and equipment is fully taxable but is also determined after indexing historical cost for inflation.

G. Mandatory Profit Sharing

Mexican business entities must pay 10% of their taxable income to their employees in the form of a mandatory profit sharing plan. This profit sharing payment is not deductible in calculating the payer's tax liability. The holding company has employees because dividends received by a holding company from its subsidiaries, although free of income tax, are subject to mandatory profit sharing payments.

H. Real Property Transfers

Local states and municipalities in Mexico also impose a tax on transfers of real property located within their jurisdiction. The form of transfer is irrelevant. Thus, the tax applies to transfers by inheritance, by merger, by gift, by purchase or any other type of transfer. The tax rate is generally 2% to 5%. The tax is imposed on the transfer price for the real property unless the appraised value exceeds the transfer price by more than 10% in which case the tax is based on an appraised value.

I. U.S. Foreign Tax Credit Considerations

The mandatory profit sharing payments and the real estate transfer tax do not constitute income taxes for purposes of U.S. foreign tax credits. Consequently, U.S. foreign tax credits will not be available in connection with profit sharing payments or payments of real estate transfer taxes by a U.S. corporation doing business in Mexico.

J. Deductions

Taxable income is determined by deducting certain expenses from gross income. The U.S. concept of ordinary and necessary business expenses translates to "strictly indispensable" business expenses in Mexico. Thus, for a business expense to be deductible, it must be a strictly indispensable, fully documented expenditure. Among expenses that are deductible are bad debt losses, inventory purchases and cost, depreciation and amortization, rents, depletion, interest, royalties and service fees, technical assistance fees, employee compensation, certain insurance costs, research and development expenses and charitable contributions. No deductions are allowed for the value added tax or the mandatory 10% employee profit sharing payments.

K. Branch Taxation

A branch will be taxed only on its Mexican source income while a Mexican subsidiary will be taxed on world-wide income. Income taxed to a branch will not be subject to withholding tax then remitted to the home office. Historically, branches of the foreign corporations have been rare in Mexico because of the restrictions on foreign ownership and the desirability of having a Mexican joint taxpayer.

However, for U.S. income tax purposes, it may be desirable to do business in Mexico using a branch rather than a subsidiary so that the results of the branch can be consolidated for U.S. tax purposes. Although the U.S. consolidated return provisions allow consolidation with a “contiguous country” corporation, these provisions apply only if the Canadian or Mexican corporation is organized solely to comply with the laws of one of those countries. This restriction is strictly interpreted. Therefore, consolidation with a Mexican subsidiary for U.S. tax reporting purposes is rare. Many US corporation prefer to use an S de RL which may make the check the box election in the US.

L. Foreign Corporations Selling in Mexico

Foreign corporations making sales into Mexico are not subject to tax in Mexico unless the sales are made through a permanent establishment or a branch. Whether a foreign corporation has a permanent establishment in Mexico depends on the facts in each case. A branch or permanent establishment is taxed in the same manner as a Mexican Corporation.

M. Withholding Taxes

Mexican source income earned by a foreign corporation which does not have a permanent establishment in Mexico is subject to a flat withholding tax on the gross amount of the income earned. Business entities are required to withhold taxes on payments representing income to foreign business entities and individuals.

The withholding rates, which generally run from 15% to 30% are indexed for inflation. The withholding obligation applies to, among others, payments for personal services in Mexico (30%), interest (4.9%-40%), royalties (25%-40%), rent (5%-21%), real property sales (20%) and sales of shares in Mexican corporations (20%). Under certain circumstances, an election is available to be taxed on net income as if the taxpayer had a permanent establishment in Mexico.

N. Partnerships, Joint Ventures and Trusts

Partnerships and Joint Ventures in Mexico are taxable entities and are taxed in the same manner as corporations. Trusts, however, are conduits and their income is taxed to their beneficiaries.

A foreign taxpayer in a joint venture conducting business in Mexico or a foreign beneficiary of a trust conducting business in Mexico is deemed to have a permanent establishment in Mexico. The trustee of a Mexican trust must be a Mexican bank and the trustee is responsible for satisfying the tax liabilities of the trust’s beneficiaries. Real property transferred to a trust is treated as the property of the settlor unless the trust is irrevocable, in which case the settlor is treated as having sold the real property to the trust. If no consideration is received, the settlor will not be subject to tax on the transfer.

O. Value Added Tax

Mexico imposes a value added tax of generally 16% (0% for exports) on products and services sold in Mexico. Each business entity involved in the production of a product or the provision of a service is required to collect the VAT on the value added by that business entity. The tax applies to all sales of goods and services including manufacturing, rentals and imports. However, products for export are exempt from the VAT. Certain products have been assigned a zero-tax rate and, therefore, are currently exempt from the VAT. The most significant transactions exempt from the VAT are sales of land, books, credit instruments, equity shares, residential construction and materials, and financial and medical services. VAT paid on property which is exported can be recovered by a refund procedure.

P. Conclusion

The above matters are a summary of important tax topics in Mexico. Further consideration should be given to tax treaties, controlled foreign corporation rules and related party transactions which were not discussed in this report. Please contact us if you have questions, we can help you with your Mexican tax and business planning.





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ABOUT US

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