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MEXICO TAX GUIDE FOR INVESTORS & BUSINESSPERSONS



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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, S. de R.L.) 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 enterprise are subject to the same laws that apply to Mexican businesses as well as special regulations governing foreign investment.


a. Sociedad Anónima (S.A.): Sociedad Anónima de Capital Variable (S.A. de C.V.). The S.A. 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.

b. Sociedad Anónima Promotora de Inversión: The S.A.P.I. is a special investment corporation similar to the standard corporation in Mexico; the S.A.P.I. provides more rights to minority shareholders and is mostly used by entrepreneurs. From the legal perspective, S.A.P.I.s are business entities that protect the initial investors/shareholders. From the tax perspective, S.A.P.I.s don't provide incentives.

c. Sociedad de Responsabilidad Limitada (S. de R.L.): The S. de R.L. 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.

d. Asociación en Participación (A. en P.): The A. en P. is a joint venture which is formed by the execution of a joint venture contract. This is a taxable entity for Mexican tax purposes.





e. Sucursal de Sociedad Extranjera: This is a branch of a foreign corporation. It must be registered as such with the Mexican government before commencing business in Mexico.

f. Fideicomiso: A Fideicomiso 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. In addition, taxable income of Fideicomisos is calculated similarly to U.S. partnerships, in which each partner (beneficiary) reports his or her attributable income.

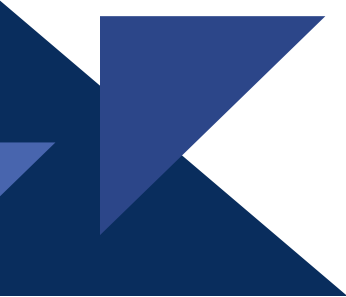
g. Other Business Entities: Sociedad en Nombre Colectivo (S. en N.C.). The S. en N.C. is a general partnership which, like U.S. general partnerships, results in unlimited liability to its partners for partnership obligations. Sociedad en Comandita (S. en C.). The S. en C. is a limited partnership similar to a limited partnership in the U.S. While the S. en N.C. and the S. en C. exist, in practice, these forms of business entities are not often used.

2. MEXICAN TAXATION

A U.S. Taxpayer generating income in Mexico is subject to both federal and state taxes. In addition, these U.S. Taxpayers are subject to Mexican federal income tax, and may be subject to value added taxes, import and export taxes, and a federal taxation on wages. Generally, local taxes on payroll are payable by the employer. The Ministry of Finance and Public Credit is in charge of interpreting the Federal Revenue Law and Regulations. In addition, the Ministry's Audit Division audits tax returns filed with the Ministry.

a. Form over Substance: In the United States the substance of a transaction generally prevails over its form for purpose of determining the appropriate tax treatment for the transaction. In 2020, Mexico included a business purpose test to its regulations—which aims to help determine the appropriate tax treatment of transactions. In Mexico, absent fraud, the form of a transaction will generally prevail over its substance. In other words, if a transaction was conducted with the intent to defraud and/or avoid taxation, such transaction will likely be taxable. If a transaction is properly documented, the form of the transaction specified in the documents will be respected for purposes of Mexican taxation. However, if Mexican authorities determine a transaction was conducted with the intent to avoid 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 rates of maximum of 30%. Generally, corporations principally administered from within Mexico and those organized under Mexican law are treated as Mexican corporations. Therefore, certain non-resident corporations with registered branches in Mexico operating through permanent establishments in Mexico may be treated as Mexican corporations. Foreign corporations operating in Mexico which are not treated as Mexican 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 which is important in terms of what will be taxed under the United States-Mexico income tax treaty. If a permanent establishment exists, the business profits of the permanent establishment are attributable to the enterprise located in the other country are taxable under the treaty. 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 regularly 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. 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 physical residents and non-residents alike. When dividends are paid between resident entities, such dividend income is not taxable. It is recommended to evaluate the Tax Treaty provisions—which could help reduce or eliminate tax liability.

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 is 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. Only net expenses are deductible. Historically, this has resulted in lower deductions for indexed items and therefore, reduces the desirability of heavily leveraged operations in Mexico. If an 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 the gain or loss should be 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; three times the employees' salaries; or the average profit sharing of the prior three years, whichever is higher. Profits effectively paid are deductible. Profits accrued within the current year are not deductible. 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% of the value of the property. 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. Unlike accrued expenses, expenses effectively paid during the taxable year are deductible. No deductions are allowed for the value added tax unless such activity is exempt from VAT (see paragraph O).




k. Branch Taxation: With certain exceptions, a branch of foreign corporation is generally taxed in the same manner as a subsidiary of the foreign corporation. One difference is that a branch cannot deduct royalties, fees, interest and commissions paid to the corporation's home office even though such payments are subject to Mexican withholding taxes. Generally, these payments are usually deducted through pro rata expenses. On the other hand, 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 U.S. corporations prefer to use an S. de R.L. which may make the check the box election.

l. Foreign Corporations Selling to Mexico: Generally, foreign corporations selling products or providing services to Mexican persons are not subject to tax in Mexico so long as such sales and services are not made through a permanent establishment in Mexico. Whether a foreign corporation has a permanent establishment in Mexico is determined on a case-by-case basis. Nevertheless, sales of real property or shares of stock of a Mexican corporation are deemed Mexican sourced income. As such, these types of sales are subject to taxation in Mexico.

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. Withholding rates generally range from 15% to 30%. The withholding obligation applies to, among others, payments for personal services in Mexico (30%), interest (15%-21%), royalties (15%-35%), 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. In addition, if the Tax Treaty applies, reduced retention rates may be available.





n. Partnerships, Joint Ventures, and Trusts: Partnerships in Mexico are taxable entities and are taxed in the same manner as corporations. Joint ventures and trusts, however, are conduits and their income is taxed to their joint ventures or beneficiaries. A foreign joint taxpayer in a 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 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 VAT. Certain products have been assigned a zero-tax rate and, therefore, are currently exempt from 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 goods and materials. exported can be recovered through a refund procedure. This procedure applies to direct export sales and sales by *maquiladoras*.

Should you need additional information it will be our pleasure to assist you. Do not hesitate to contact us if you have any questions.

Please note that this alert is not meant to give legal advice or counsel, you should consult your attorney about your specific situation.

Sincerely,
Ruben Flores, Attorney & CPA
The Flores Group



ABOUT US

The Flores Group provides professional services to individuals and companies doing business in the United States with a great emphasis on business in Mexico, South America and Europe.

Our goal is to help our clients achieve their legal and business objectives by providing innovative solutions with our in-depth, working knowledge of the industry.

We are highly proficient at creating legal strategies that result in you saving time and money. We also put measures in place that serve to protect what you have worked so hard to build.

FGA Attorneys & Advisors has an affiliate, FGA Compliance Center, which has a professional staff of experienced accountants and consultants who provide numerous financial, tax and accounting services. The goal is to offer an integral service to every client

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Our mission is to provide superior legal services for our numerous national and international clients. Our success is measured by your success. We can help you achieve a well thought out business plan no matter how simple or complex.

Goal

Our goal is to help our clients achieve their legal and business objectives by providing innovative solutions with our in-depth, working knowledge of the industry. Serving each client's unique legal and business needs is our highest priority. We remain dedicated to the tradition of a close working relationship between Attorney and Client to achieve a common goal.



THE PRESIDENT



Ruben Flores, Jr.

Attorney & CPA, President

Ruben Flores, Jr., CPA, JD, brings more than 35 years of experience in tax and business matters.

With a Business Administration degree, a Masters of Public Accounting in taxation, and a Juris Doctor, he specializes in both international and domestic business including the formation of international corporate structures, acquisitions and mergers between the United States and foreign companies, international tax planning for foreign investors, and estate planning for both United States and foreign persons.

We are the professionals you need when it comes to navigating the cumbersome complexities of every business matters



SCAN ME

