PKF

Accountants
business advisers

Doing business in Mexico

Contents

Foreword

This booklet has been produced as a service to the clients of PKF International Limited and as an introduction to the fiscal and commercial environment of Mexico for those that are considering business within its jurisdiction. The contents of this booklet are not intended to be exhaustive, and should not be used as the basis for any decision in the complex areas of Mexican commercial and tax laws. Mexican laws are in a constant state of change, both legislatively and judicially and, therefore, clients are advised to seek specific professional advice from any member firm of PKF International Limited before proceeding with any activities involving Mexico.

It is a key component of doing business in Mexico to understand the various aspects and complexities of Mexican laws. The business environment may be significantly different than that of other countries. The complexity and, in many ways, uniqueness of the tax laws, as well as the variety of legal aspects and the treatment of human resources, are challenging for a foreign client with intentions to come into the country, but the Mexican member firms of PKFIL firmly believe that the experience will be rewarding.

We have had long experience in giving business a helping hand. As one of the leading firms of accountants and business advisors in Mexico, with offices in most of the major business centers, we can provide a comprehensive range of services to inbound investors. We are a member firm of the PKF International Limited network of legally independent firms, which operates in over 100 countries around the world. We are, therefore, ideally situated to service your needs, whatever these may be or wherever you are located.

Introduction

Doing Business in Mexico

This booklet is designed to provide an overview of the business environment in the Republic of Mexico. It discusses varied considerations involved in establishing a business enterprise in Mexico. The rapidity of the change and the complexity of our interrelated world mean that consultation with professional advisors is indispensable and, therefore, while every attempt to keep this brochure current and concise will be made in the future, it will never represent a valid alternative to such professional consultation. The highly skilled and dedicated professionals of the Member Firms of PKF International Limited will be very happy to work with you in order to implement your business plans. Whether it is with one of our Member Firms in Mexico or with any of PKF International Limited's member firms around the world, we are all committed to responsiveness and dedicated to excellence.

Although the greatest possible care has been observed in drawing up this publication, the possibility always exists that certain information has in time become outdated or is no longer correct. Therefore, consultation with a professional advisor remains necessary at all times.

Major Considerations for Doing Business in Mexico

- *If you are coming from overseas, do not bring assets and people into Mexico unless they are essential. You must consider all the implications of doing so.*

- *Take good and trustful professional advice from the beginning. It is less expensive in the long run.*

- *All significant decisions should be considered with reference to the net tax effect in the country of residence of the parent company or ultimate owner.*

- *There are withholding taxes which are payable in Mexico on most payments made to corporations or individuals resident overseas. The applicable withholding tax is usually reduced if Mexico has a treaty to avoid double taxation with the country to which the funds are being sent.*

- *Tax legislation in Mexico is unique in the sense that the basic accepted documentation supporting transactions is the invoice issued by the supplier. All invoices in Mexico have to be printed by a printer duly authorized by the tax authorities and are required to include a facsimile of the issuing company's tax registration number. When invoices are issued by a supplier, apart from other pertinent data, they must show the name, address and the tax registration number of the company to whom the invoice is being issued. Banks in Mexico do not return paid checks and, for tax purposes, checks are not recognized as valid support for an expense.*

- *Labor law in Mexico is complicated and definitely oriented to the employee's benefit. Seniority and indemnity payments have a very special treatment in the law. When acquiring a participation in Mexican companies, the total potential labor liability for indemnities should be taken into consideration, since it is rarely reserved in a company's books.*

- *The effects of inflation have been recorded in the past for accounting and tax purposes in Mexico. Today, these effects are recorded in the accounting books only if the aggregate inflation of the last three years exceeds 26%. Inflation continues to be taken into account in the determination of taxes to be paid.*

- *Employee profit sharing, which is roughly 10% of taxable income, has to be paid over and above the income tax rate, which is presently 29%.*

- *Over and above employee profit sharing, fringe benefits paid by a corporation on behalf of its employees, including social security, usually amount to between 20% and 30% of the total payroll expense.*

Demographic and Environmental Overview

Geography and Population

The total area of Mexico is 1,972,550 square kilometers (758,249 square miles), bordering to the north with the United States of America and to the south with Guatemala and Belize. It is the northernmost and the westernmost country of Latin America and stretches more than 1,875 miles from the Northwest to the Southeast. Its width varies from more than 1,250 miles in the north to less than 137 miles at the Isthmus of Tehuantepec in the south. The official name of the country is United Mexican States (Estados Unidos Mexicanos). The term State of Mexico (Estado de México) does not refer to the country but only to one state within Mexico, which is highly industrialized and is located in the center of the country, adjacent to the Federal District where the capital of the country, Mexico City, is located.

The official language of the country is Spanish and there are over 60 native dialects which are still used by small portions of the population. Mexico is the most populous Spanish-speaking country in the world. The last official population census, dating from the year 2000, was 101,879,171 inhabitants and as of 2005 the population was estimated at 107,029,000.

Political System

Mexico entered into a war of independence from Spain on September 16, 1810, which ended on September 27, 1821 with the granting of the country's separation from the kingdom of Spain. A Federal Republic was established, which consists of 31 states and a Federal District. The Federal District is a special political division in Mexico where the national capital, Mexico City, is located. Each state elects a Governor as well as representatives to their respective state congresses. The 1917 Constitution of Mexico provides for a federal republic with powers separated into independent executive, legislative and judicial branches. Historically, the executive has been the dominant branch, with power vested in the president, who promulgates and executes the laws of the Congress. However, since 1997, Congress has played an increasingly important role when opposition parties first formed a majority in the legislature.

Economics

According to the World Bank, Mexico ranks 12th in the world in regard to GDP and is firmly established as an upper middle-income country. Mexico has a mixed economy that recently entered the trillion dollar class. It contains a mixture of modern and outmoded industry and agriculture, increasingly dominated by the private sector. The number of state-owned enterprises in Mexico has fallen from more than 1,000 in 1982 to fewer than 200.

In prior years, the country had entered an era of macroeconomic stability. After a 4.1% growth in 2004, real GDP grew 3% in 2005. After several years of record-low inflation, low interest rates, a lower external debt and a stronger peso, the recent economic collapse in 2009 has entirely modified the situation, statistics, etc.

It is too soon to adequately evaluate the actual situation and the time it will take for the economy to bounce back. As usual, much depends on the economy of the United States of America.

Communications and Transportation

The country has a reasonable network of both internal and external communications systems. The transportation network for the movement of goods within the territory is also reasonable. Incoming flights reach Mexico City, the major industrial cities and most of the tourist resorts. Otherwise, air transportation with other destinations in the country should connect through Mexico City. Paper maps are readily available for purchase, but Web-based companies such as Google, MapQuest and Yahoo, have extensive online mapping capabilities to provide address locations.

Services and Exchange Controls

Mexico has international financial centers in Mexico City, Monterrey and Guadalajara. There are no exchange controls. There are several major banks in the country, but the opening of an account for new and foreign corporations or individuals can be cumbersome. Foreign corporations can freely do business throughout the country.

Should foreign investment represent the majority of the corporation of joint venture capital stock, certain information requisites have to be met.

Finance

The Mexican banking market comprises various financial institutions such as commercial banks, investment banks, savings and loan associations and credit unions. There are also other specialized institutions, such as leasing, finance and factoring companies.

Commercial banks are the most important suppliers of funds to businesses. Short-term financing can, in some cases, be arranged as a line of credit. Medium and long-term financing is also available. As a condition of these loans, a bank usually requires the executions of notes and formal loan agreements which may restrict the borrower's decision-making powers through special covenants. Personal guarantees and audited financial statements are usually required. Frequently, lenders ask simply for a guarantee from the parent company to grant a loan to a majority-owned subsidiary. Investment bankers are also called on to arrange financing through commercial paper.

Grants and Incentives

The federal government provides equal treatment to domestic and foreign investors, refraining from imposing any specific discriminatory tax burdens. There are various tax incentives available, usually offered by the different states or local governments and tied to investment in specific jurisdictions. There are also incentives on research and development expenses and the related investment in machinery and equipment. When Mexico negotiates tax treaties, it generally agrees to reduce withholding tax rates on interest, royalties and other payments made to foreign entities or individuals.

Regulatory Environment

The regulatory environment of Mexico is one of open competition. The Constitution grants the federal government the right to own certain industries which are considered "basic", the more important of which are the exploration and refinement of oil and its by-products and the production and distribution of electrical energy. There are also restrictions of ownership by foreigners of land next to the sea lines and borders. There are no price or currency controls, but a minimum wage for employees is established by each different state and the Federal District.

Anti-Trust Measures

Monopolies, monopoly practices and state monopolies are prohibited by the Mexican Constitution. The complete regulations are included in the Federal Law of Economic Competition (Ley Federal de Competencia Económica).

Acquisitions and Mergers

The merger and acquisition process is regulated by the General Law of Mercantile Societies. This law, under certain conditions, prohibits mergers and acquisitions that might have the effect of substantially lessening competition and result in a form of monopoly. Once the merger or purchase agreements are achieved and the merger contract signed, these have to be registered with the Public Register of Commerce. Publication of the merger has to be made in the Official Federal Journal (Diario Oficial) and in local newspapers.

From a tax point of view, there are some considerations and obligations with which the merging companies must comply.

Securities

The Securities and Banking National Commission (Comisión Nacional Bancaria y de Valores - CNBV) is the federal agency that regulates the offering of securities in Mexico. One of its primary functions is to assure full and accurate disclosure of financial information with respect to companies whose shares are listed on the Mexican Stock Exchange (Bolsa Mexicana de Valores, S.A. de C.V. - BMV).

The BMV is a private institution, which operates through a concession granted by the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público - SHCP), under the Law of Securities Market (Ley del Mercado de Valores).

All companies whose shares are listed on the Stock Exchange are required to file periodic reports with the CNBV and publish their financial statements in newspapers of significant circulation. The financial statements of these companies must be audited annually and reviewed by independent public accountants on a quarterly basis.

Consumer Protection and Special Industries

There are a number of consumer protection laws which are enforced by the Federal Consumers Agency (Procuraduría Federal del Consumidor - PROFECO). Companies should take notice of various agencies which have the authority to regulate specific industries because of the nature of their activities.

Legal Protection for Intangibles

Mexican law extends legal protection for certain intangible assets or intellectual property through certain legal instruments such as patents, trademarks and copyrights. A patent protects an invention. Copyrights protect an original artistic or literary work and a trademark is a word, phrase, symbol or design that distinguishes a good of one party from those of another. A patent will be effective for 20 years from the date of application. A trademark will have a duration of 10 years starting at the date of the petition form. The registration of industrial designs has a non-extendable duration of 15 years. These registrations have various periods of lapse for nonuse.

Import and Export Controls

Mexico has been a formal member of the General Agreement on Tariffs and Trade (GATT) since 1986, and is currently one of the most open countries in the world. Mexico has participated in GATT as an observer since the organization was founded, and has closely followed the evolution of the principles governing world trade by adjusting commercial policies accordingly, while bearing in mind the internationally accepted principles.

In accordance with the GATT, all parties must mutually agree to trade with the nations that can most benefit from such trade. However, the GATT does make certain exemptions to this principle. These apply to customs unions, free trade zones, the Latin American Integration Association (ALADI) and specific terms between neighboring countries to facilitate border trade.

The North American Free Trade Agreement (NAFTA) between Canada, The United States of America and Mexico constitutes one of the biggest markets in the world.

The NAFTA came about when the integration of the United States of America and Canada begins to materialize in 1965 with the signature of the Automotive Agreement. At the same time Mexico and the United States of America began such integration, also in 1965, when the in-bond industry program in northern Mexico was established.

In 1990, Mexico and the United States of America decided to begin negotiations of a comprehensive free trade agreement. During the same year, Canada demonstrated interest in becoming part of the agreement.

On January 1, 1994, the NAFTA, creating a North American free trade zone, went into effect. The Main objectives of the agreement, as described therein, are:

1. Promote conditions for fair competition.
2. Increase investment opportunities.
3. Provide adequate protection to intellectual property rights.
4. Establish efficient procedures for the application of the NAFTA and for controversy solutions, and
5. Eliminate trade barriers between Canada, the United States of America and Mexico by stimulating economic development and allowing each participating country equal access to their respective market places.

Forms of Business Organizations

Fixed Capital Corporation (Sociedad Anónima - S. A.)

This corporation or legal entity is incorporated by a notary public under the Law for Mercantile Societies (Ley de Sociedades Mercantiles - LSM) and has certain rights and obligations. Its capital stock is divided into nominative shares. The basic corporate laws of an S. A. are similar to those of most Mexican corporations. At inception, it has to be registered in the Public Register of Commerce (Registro Público de Comercio). It can exist under any name, followed by the letters S.A. It must have at least two stockholders, with a minimum fixed capital of 50,000 Mexican pesos. Stockholders are liable only to the extent of their investment. The fixed capital is specified in the articles of incorporation (public document) and the by-laws. Any subsequent increase or decrease of capital requires the modification of the public documents and by-laws.

Registration by a notary public will automatically subject the corporation to taxation, with different grace periods for each type of tax. These corporations calculate and pay their applicable taxes similar to all other types of corporations in Mexico. There are only minor differences between the tax treatments of each.

Variable Capital Corporation (Sociedad Anónima de Capital Variable — S.A. de C.V.)

This form of organization is the most commonly used by foreign investors. Its capital stock is also divided into nominative shares and the stockholders are also liable only to the extent of their investment. It must have at least two partners, with a minimum fixed portion of the capital of 50,000 pesos and an unlimited variable portion.

To increase or decrease the variable portion of the capital, there is no need to modify the public documents and the by-laws. In all other aspects, the S.A. de C.V. is identical to the S.A.

Limited Liability Corporation (Sociedad de Responsabilidad Limitada - S. de R. L.)

This company is similar to the S. A. The responsibility is limited to the investment of the stockholders. There is a maximum limit to the number of shareholders, which should not exceed 50. This type of organization requires only 3,000 pesos of capital investment, which is divided into "participation units" instead of shares. This organization is used more frequently by U. S. investors than by Mexicans. The main reason for this is the slightly more flexible managing of the by-laws and the tax planning it has in the United States of America. It is an organization that has limited responsibility and pays taxes as a Mexican Corporation, but may be considered as a partnership for U.S. tax purposes.

Branch of a Foreign Corporation

A foreign corporation may establish a Mexican branch, which has to be incorporated in a similar manner as a domestic corporation. Branches also compute income tax in the same manner as corporations in Mexico, and are entitled to deduct expenses incurred both abroad and in the country, provided that the adequate supporting documentation is obtained. Remittances sent abroad in the form of payments of interest, royalties, reimbursement of expenses or for any reason other than the payment of purchases of goods or fixed assets, are subject to withholding taxes ranging from 10% to 30% and, if adequately supported, are deductible for income tax purposes. The percentage of withholding taxes on payments made abroad may vary depending on the tax treaties entered into with different countries.

Partnership

Partnerships in Mexico are civil organizations that usually associate professionals for the purpose of rendering a professional service, such as accountants, lawyers, architects, etc. Partnerships are incorporated in the same manner as corporations, may have any number of partners and a minimum capital of 50,000 pesos.

Partners are jointly responsible for the partnership's operations and have unlimited personal liability. Except for the recognition of income for tax purposes, in which case partnerships compute using the cash method rather than the accrual method, taxes are paid in the same manner as any form of corporation.

Accounting

Conducting business in Mexico requires the establishing of an appropriate method of record-keeping that will allow adequate reporting of the results of the business operations. The accounting function enables complete and adequate disclosure of the financial condition which complies with the applicable accounting principles, laws, rules and regulations.

The Securities and Banking Commission, which regulates all publicly traded securities in Mexico, requires that the Mexican Financial Reporting Standards (MFRS), equivalent to the Mexican accounting principles, be observed. Mexican tax laws provide only general guidelines for the preparation of the appropriate tax returns, and the tax authorities also rely on the generally accepted accounting principles for the determination of the basic elements that are taken into account to determine taxes payable, except when otherwise indicated in the applicable tax laws.

Tax Accounting and Reporting

Private businesses are not required to publicly disclose the results of their financial operations. Based on their own requirements, banks and other lending institutions require businesses to issue annual or more frequent financial statements. Public companies are required to present annual audited financial statements to shareholders and publish their balance sheets and income statements in newspapers of significant circulation.

These companies are also required to comply with the rules and regulations of the Securities and Banking Commission, including the requirement of an annual external audit.

Accounting Principles

Generally accepted accounting principles are the recognized set of standards for the preparation of financial reports. The Mexican Financial Reporting Standards (MFRS) are the equivalent of these accounting principles and are no longer issued by the Mexican Institute of Certified Public Accountants, but by an organization specifically created for that purpose: The Mexican Council for the Investigation and Development of Financial Reporting Standards (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera, A.C. - CINIF).

These standards are widely recognized and supported by the Securities and Banking Commission, by the tax authorities and by banks and other lending institutions. These standards are very similar to the GAAP in the United States of America and to the IFRS. Beginning in 2012, all public companies will be required to apply the IFRS in effect at that moment.

Mexico's MFRS B-10 requires, to a certain extent, inflation accounting. Corporations are, therefore, required to record the effects of inflation in their official records if such inflation exceeds 26% the combined inflation of the last three years and prepare their financial statements accordingly. Whether or not further inflation is recognized, the inflation effects recognized and recorded in previous years can not be adjusted or cancelled. The calculation of taxes continues to be computed recognizing certain effects of inflation.

Expense Allocation

Even though all corporations are required to follow the accrual method of accounting, there are certain cases in which the tax authorities allow corporations to determine their income tax following the cash method. Payment of business operations are expensed in the year they are paid. Certain expenses can be capitalized as a part of fixed assets and depreciated during the useful life of the asset. Companies are required to use specifically established rates to depreciate their various assets for tax purposes. For book purposes, companies can use rates that reflect the actual useful lives of their assets.

Financial Reporting

Financial statements must follow accounting guidelines set forth by the Mexican Institute of Certified Public Accountants. Balance sheets reflect the status of the corporation's assets, liabilities and stockholders' equity at a specific date. Income statements reflect the results of operations for a specific period. In almost all cases, corporations will issue these statements for the current period, along with comparative information for the immediately preceding reporting period.

If such comparative information is presented, certain adjustments for inflation have to be made to the preceding period to make it comparable with the current period.

Companies are also required to include a statement of changes in stockholders' equity which reflects changes that occurred in these accounts during the reporting period. A statement of cash flow, which shows the cash generated and applied during the reporting period, is also required. Certain corporations, such as regulated industries and publicly-held corporations must adhere to additional specific reporting requirements.

Public corporations must have an annual financial audit conducted by an independent Certified Public Accountant (CPA). Many other organizations may require a similar audit or an annual review by an independent CPA as well. All audits are conducted in accordance with generally accepted auditing standards, as stated in the MFRS. The essential element of an audit is the opinion of the auditor that the information contained in the financial statements present fairly, in all material respects, the financial position, results of operations, changes in stockholders' equity and cash flow in accordance with the MFRS.

The Mexican tax authorities require all corporations whose sales, employees or investment in assets exceed a certain figure to hire an independent public accountant who will audit their financial statements and perform certain additional tests and analyses for the purpose of rendering a special tax report. In addition to the normal auditor's opinion rendered by the accountant on the fairness of the financial statements, the accountant will state that, to the best of his knowledge, the corporation calculated and paid all taxes resulting from its operations during the period under review, or indicate what taxes, and the amounts, have not been paid at the date of the report. The mandatory year-end date for financial statements is December 31 of every year, or period being reported on. These reports are mandatory and are filed with the tax authorities by the external auditor and the legal representative of the corporation, using pre-assigned electronic codes and through the internet. This filing is due on June 30.

Taxation

Mexican tax legislation contains different laws related to each tax. The taxes are related to income, cash flow and certain specific transactions. The fundamental legal structure for taxes is defined within the Mexican Constitution which establishes procedures, and the Congress enacts the tax laws. In addition to specific tax laws, there are some basic laws that refer to general tax administration, such as the Federal Income Tax Law and the Federal Fiscal Code. Most tax laws have a series of regulations or by-laws that are issued by the tax authorities and provide for procedures and interpretations.

Taxpayers, both businesses and individuals, are obligated to request a tax I.D. number when they register with the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público - SHCP), which is responsible for administering the tax laws. Its mission includes interpreting tax laws, auditing taxpayers (through a mandatory tax audit performed by an independent public accountant) and collecting the revenue.

The Mexican individual tax system is a self-assessment scheme which requires withholding of tax from employees' salaries and certain other payments. When a taxpayer is required to withhold taxes on payments made to another person, the taxpayer must remit the withheld taxes to the government. In addition, businesses and individuals are required to make monthly provisional payments on all different taxes.

Payment of all taxes in Mexico is made monthly through the internet, transferring the taxes being paid from the taxpayer's bank accounts to government accounts. Income Tax, Value Added Tax, Flat Rate Business Tax and all withholding taxes are paid monthly in this manner.

After the close of a tax year, which is December 31 in all cases, taxpayers must file a tax return which reports all taxable income and allowable deductions. The income tax is computed on net taxable income, less advance payments made during the year. An information return is filed, covering other taxes such as Value Added Tax (VAT), Flat Rate Business Tax when applicable and various taxes withheld, which theoretically were totally paid during the year.

Administration of the Law

A constant thread in the administration of Mexican tax laws is that, in any given transaction, the letter of the law takes precedence over the intention of the law. The complexity and rapidity of statutory and economic changes result in a dichotomy between economics and taxation. Therefore, transactions can often be structured in several different ways and, as a consequence, the tax results may vary. Proper tax planning is essential in this environment.

Transfer Pricing

Since 1997, the Mexican tax authorities have implemented rules for Mexican taxpayers with regards to procuring and maintaining transfer pricing documentation demonstrating that the amounts of taxable income and deductions used in transactions performed with related parties are similar to the prices or amounts that the taxpayer would have used with independent parties in comparable transactions.

In addition, since that date the Mexican tax authorities have amended the transfer pricing rules and included the requirement to perform a transaction-based analysis for the evaluation of the intercompany transactions.

There are special transfer pricing rules for Maquiladoras (In-bound and contract manufacturer corporations)

To mitigate controversies in transfer pricing, the Mexican tax authorities suggest that a study of transfer prices, based on the overall experience of the market in the specific industry being studied, be undertaken and a written report be prepared by an independent professional, hired by the taxpayer who is engaged in foreign transactions. This study, which should be available on a yearly basis, is to be held by the taxpayer for the authorities to review whenever they deem it appropriate.

Tax Treaties

Mexico enters into tax treaties with different countries for the purpose of eliminating double taxation. In recent experience, there have been no conflicts between existing treaties and Mexican tax laws.

Taxation of a Mexican Resident Corporation

A Mexican resident corporation is a company incorporated under the laws of Mexico and which has established the principal administration of their business in Mexico. The place where management is located and control is exercised is irrelevant. A resident corporation is taxed by Mexico on its worldwide corporate income, without regard to the source of that income. The resident corporation must have a tax identification number and must declare a detailed address as its tax residence.

Resident corporations are subject to several major taxes such as income tax, value added tax, flat rate business tax and tax on cash deposits.

The income tax rate applicable in 2010, 2011 and 2012 will be 30%. It will decrease to 29% in 2013 and to 28% in 2014 and thereafter.

The value added tax is required and collected on the value added to the goods or services in each stage of the production or distribution process and is paid one time by the final consumer on the added value in each level. The general rate is 16%, but there is also a 0% rate on the sale of patents, medicines and some nutritional products. There are also lower rates applied to certain locations in the country.

The IETU is a direct tax that replaces the tax on assets, which was repealed in January, 2008.

All legal entities residents in Mexican territory are required to pay this tax for the sale or the leasing of assets, the rendering of independent services or the leasing of goods, regardless of whether these activities are conducted or not in the national territory. Also, residents abroad with a permanent establishment in Mexico will pay IETU on those revenues generated by such establishment.

The tax is determined on a cash-flow basis according to the mechanism established for the computation of the VAT, which considers as taxable income and valid deductions certain transactions, such as extinction of debt, even if there is no cash-flow involved. All payments actually made, including investments and acquisitions of inventory, are deductible only in the year when paid in cash.

The Law excludes the deduction of certain expenses, which are later on available as a tax credit against the resulting IETU. The most important of these are those payments related to the payroll.

The IETU is calculated each year by applying the rate of 17.5% to the tax base obtained by subtracting the authorized paid deductions from collected revenues. Provisional payments of IETU, income tax paid and income tax withheld abroad can be credited against the annual tax.

The Law establishes certain tax incentives for the maquiladoras industry which have to be taken into account.

It is important to point out that many of the OCDE country members have already agreed to credit the IETU as a foreign tax credit against their domestic income tax. However many other countries, including the United States, have not yet issued statements accepting it as a foreign tax credit.

Mexican corporations are required to file monthly tax returns, generally known as "provisional payments", which include income tax (on the basis of the percentage of income of the preceding year), the net VAT resulting from the month's operations, the flat rate business tax and the various taxes withheld during the same period. These monthly returns are filed and paid through the internet, using special electronic devices given to the taxpayer by the tax authorities.

Resident corporations are also required to file an annual tax return for the previous calendar year on March 31, in which provisional payments are deducted from the final tax payable. Companies may credit their own income tax effectively paid in the year against the resulting IETU accrued in the same year. The remainder would be the tax payable. This crediting is also applicable to the provisional payments that must be made during the year.

Extensions of time to file tax returns are difficult to obtain and, therefore, many returns are prepared utilizing estimated financial information. Later on, when the actual figures are available, an amended return is filed.

Affiliated Companies and Consolidated Returns

Members of a group of Mexican corporations affiliated by at least 50% or more of direct ownership could elect to join in the filing of a consolidated income tax return. An affiliated group exists where one or more corporations are connected through share ownership with a common parent corporation. The common parent files one return combining the results of operations of the entire group. In turn, each corporation of the group files its own tax return and pays its applicable taxes, if any. The total taxes paid by all the companies in the consolidated group are then compared with the taxes that resulted in the consolidated return filed by the parent company. In most cases, the consolidated results of operation indicate a lower tax payable than the aggregate of all individual returns, in which case, the parent company either has the right to offset the excessive tax against future taxes of the group, or to obtain a refund from the government authorities.

Generally, it was advantageous to file a consolidated return in order to combine losses of some members with income of other members. Once a group elects to file on the consolidated basis, it must continue to do so unless the ownership chain is broken.

Up to 2009, the tax law required no payment of the income tax that was saved in the tax consolidation procedure. As of 2010, the tax authorities reduced the tax benefits of this regime by requiring that the tax related to the profits of the companies consolidated be paid in a period of five years, including the taxes related to prior years. As a result of this change, some companies that reduced their taxes payable in 2004 and prior years will have to pay these taxes in 2010 according to a calendar set forth by the tax authorities.

The Executive Branch of the federal government considers that this change does not violate the guarantee of non-retroactivity of the Mexican Laws, since the use of the tax consolidation was an optional regime for tax payers. Nonetheless, a large number of companies that used this option are legally defending their point since most legal advisers consider this change as unconstitutional.

Losses

Income tax losses in Mexico can be carried forward for ten years to offset taxable income of future periods. Following certain rules, tax losses can be restated for inflation through all the periods on which they can be used to offset income. Losses being carried forward for income tax purposes can not be used to reduce the basis for the computation of employee profit sharing. When a company is merged out of existence into another corporation, losses being carried forward by that company will be lost. Losses of the surviving company will still be available.

Accumulated income tax losses are not available as a loss carry-forward to offset taxable base for IETU purposes. However, losses incurred since 2008 are available as loss-carryforward for future payments of IETU in exactly the same manner as Income tax losses.

Computation of Taxable Income

Taxable income for income tax purposes is defined as gross income less all allowable deductions. Gross income includes business income, gains, interest and all other accretions of wealth, unless specifically excluded from taxation. Although gains would normally be taxed and losses deducted when realized, recognition may be postponed under tax law. Deductions of expenses and losses may be claimed only to the extent set forth in the Income Tax Law. A corporation is allowed to deduct the cost of sales, interest on indebtedness and other ordinary and necessary business expenses, provided that all these are adequately supported as prescribed by the law. Capital expenditures are not currently deducted, but the cost may be recovered under depreciation and amortization rules.

The base to compute IETU is, with certain exceptions, the positive cash-flow, that is the difference between revenues actually collected and investments and expenses actually paid. Since income tax payable is credited against IETU payable, except in certain rare cases, the tax paid is the higher of the two.

Timing Differences

In accordance with Mexican income tax law, income may be taxed or deductions allowed in tax periods that are different from the financial statement reporting periods. Some of these items are permanent differences between book and tax income, while some merely affect the timing of their recognition. Under generally accepted accounting practices, the effects of these timing differences have to be recognized in the financial statements.

The corporate income tax return and the compulsory report for tax purposes prepared and filed by an independent public accountant require reconciliation between book and taxable income, which include these timing differences. Differences may also arise between the bases of assets and liabilities reported for financial statements and those reported for tax purposes.

Depreciation and Amortization

Since capital expenditures may not be written off in the year when incurred, tax law establishes a system of depreciation in order for the taxpayer to recover its cost over the estimated life of the property. Tax law in Mexico indicates that tax depreciation is to be determined considering the effects of inflation in the investment of fixed assets and establishes statutory depreciation rates that are generally not in accordance with the useful lives of the assets. In many cases, this creates a timing difference between book and tax depreciation, since most companies prefer to use depreciation rates for financial statement purposes that are more in line with the actual useful lives of their assets.

Because of the high rates authorized for tax purposes, assets are usually depreciated much faster for tax than for book purposes.

Some capital expenditures are not covered under the depreciation rules and are handled through special statutory amortization rules. Expenditures such as organization costs, start-up costs, leasehold improvements and depletion of natural resources are recovered through amortization deductions. Capitalized cost of goodwill and other intangibles obtained in connection with the acquisition of a trade or business can not be amortized for tax purposes.

Capital Gains Tax

Capital gains or losses of corporations arising from the sale of fixed assets are treated as ordinary income or losses and taxed at the normal corporate rates. When determining taxable gains resulting from sale of land, buildings, equity shares and other capital interests, corporations may restate the acquisition cost of the assets for inflation. In certain cases, capital gains obtained by individuals from the sale of publicly traded shares are tax-exempt.

Dividends

Dividends paid are non-deductible in determining taxable income, and dividends received are not considered taxable income. There is no withholding tax on dividends. A corporation that declares and pays a dividend is obligated to pay the normal corporate tax rate on such dividend, but is allowed to credit such tax against income taxes payable in the year in which the dividend was paid and in the two subsequent years.

Tax on Cash Deposits

This is a new tax applicable to all individuals and corporate entities for all cash deposits, in national or foreign currency, in an account in any financial institution. Individuals and corporations exempt from this tax are as follows:

a) Government entities
b) Non-profit legal entities

c) Individuals and corporations who monthly accumulate cash deposits of $15,000 Mexican pesos or less in one or more financial institutions. Cashier checks are not included in this exemption.

d) Financial institutions that accept deposits in cash derived from its intermediation, or the purchase and sale of foreign currencies.

e) Foreign individuals for cash deposits made in their accounts, which are exempt for income tax purposes.

f) Individuals or corporate entities for cash deposits derived from loans granted by financial institutions.

The tax rate is 3% on taxable deposits, and will be withheld by the financial institutions. The tax paid during the year will be a credit against income tax payable.

Employee Profit Sharing

Corporations are obligated to pay their workers and employees a participation in their profits in the amount of 10% of their taxable income, plus and less certain items of income and expenses. The profit sharing that is paid to the employees is deductible for income tax purposes.

Tax losses being carried forward for income tax purposes do not reduce the basis for computing the employee profit participation. This participation has to be paid to the employees on May 31 of the year succeeding the end of the fiscal year.

New companies during the first year of operation are exempt from the payment of profit sharing.

Special Tax Audit and Report

In an effort to simplify the administration and control of taxpayers, on April 21, 1959, a presidential decree created the Direction of Fiscal Tax Audit (Dirección de Auditoria Fiscal Federal) and the register of independent certified public accountants who are to conduct tax audits of the financial statements of the taxpayers. The special report for tax purposes is mandatory for companies that have sales in excess of a certain amount, have employees in excess of a certain number or have investment in assets over a certain amount. These amounts and the number of employees are modified periodically.

The tax report is prepared and filed by an independent certified public accountant every year and is due on June 30, six months after the end of the fiscal year. The filing of the report is made through the internet, using certain electronic devices that the tax authorities provide for both the taxpayer and the independent auditor.

Foreign Personnel in Mexico

Entry into Mexico

Foreign nationals seeking entry into Mexico are required to obtain visas from the General Bureau of Immigration Services. Ordinarily, these visas are non-resident visas known as FM-3'S, effective for six months and subject to renewal almost indefinitely. Visas of this type for foreign hourly wage employees can be obtained, but proof must be offered that the person is truly a temporary immigrant and is needed for specific purposes such as training or supplying some technical service. For income tax purposes, foreign personnel in Mexico under an FM-3 visa are considered as non-resident aliens if they do not spend 183 or more nights in the country during a given calendar year. If they do, they automatically become resident aliens.

Taxation of Non-Resident Aliens

If non-resident aliens under an FM-3 are paid by a Mexican corporation, the corporation has to withhold a tax on such salary. This withholding tax will represent the total tax payable. The withholding tax is computed using an escalating rate, as follows:

Yearly income in Pesos	Rate of Withholding
Up to 125,900	None
From 125,901 to 1,000,000	15%
Over 1,000,000	29%

Taxation of Resident Aliens

A resident alien must report and is taxed on worldwide income in the same manner as a Mexican citizen. Should the alien's income be subject to double taxation, the foreign tax credit system is designed to mitigate such double taxation. It is possible that if the foreign country has a higher tax rate than Mexico, the full credit will not be available.

Income tax for individuals, in the case of employees, is withheld by the employer and paid monthly or, in the case of independent individuals, paid monthly directly by them. Year-end income tax returns of individuals are due by April 30 for income earned in the prior calendar year. Resident aliens are eligible to claim the same deductions as Mexican citizens.

The Mexican tax rate brackets are periodically adjusted to reflect inflation and other considerations. The minimum wage, which varies by the place of residence, is not subject to any tax. The income tax rates applicable in 2010, 2011 and 2012 will be 30%. It will decrease to 29% in 2013 and 28% in 2014 and thereafter.

Employees’ Rights

The Federal Labor Law (Ley Federal del Trabajo - LFT) was enacted by the federal government in 1931, based on Article 123 of the 1917 Constitution, which gave workers the right to organize labor unions and to strike, providing also protection for women and children, the eight-hour day and the living wage.

The LFT established for the first time Boards of Conciliation and Arbitration, made up of representatives of the government and the employees and unions. Additional benefits to employees have been added by different regulations and court decisions. The major benefits to employees, which represent restrictions to businesses, include the following:

- *Minimum wage and maximum hour rule*
- *Daily wage and fringe benefits*
- *Severance payments*
- *Employee profit participation*
- *Mandatory social security registration and benefits*
- *Workers housing*

The most financially significant of these programs is Social Security, which provides retirement, disability and health benefits. One third of the program is funded by amounts withheld by the employer from the employees' salaries and the other two thirds by contributions made by the employer. Resident aliens are subject to these payments.

Severance payments can also be financially significant. In accordance with the LFT, employees who are discharged under certain conditions are entitled to three months of their last salary, plus 20 days salary for each year of service.

These indemnity payments are in addition to the seniority premium payments provided by law.

In addition to the provisions of the Labor Law, the constitution establishes that all corporations are obligated to share their yearly profits with their employees. This employee profit participation will amount to 10% of yearly profits determined according to the Income Tax Law.

As a result, the 10% employee profit participation is computed on taxable income, plus and less certain specific items, the most important of which is tax losses being carried forward, which reduce taxable income for the year, but do not enter into the determination of the profit sharing base.

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