

International Tax and Business Guide

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Mexico





Mexico International Tax and Business Guide

Tax professionals of the member firms of Deloitte Touche Tohmatsu have created the Deloitte International Tax and Business Guides, an online series that provides information on investment conditions, tax regimes and regulatory requirements, along with information for executives working abroad. The Guides are supplemented by the Highlights series, an at-a-glance summary of basic information, including tax rates, for over 120 jurisdictions.

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1.0 The investment climate

Mexico's political system is presidential, bicameral (Senate and Chamber of Deputies) and federal (32 states).

1.1 Economic Structure

The economy has undergone a transformation since the 1980s. While foreign trade has more than doubled, agriculture's share of GDP has fallen, but it remains an important employer. Although exports have become more diversified, public finances remain heavily dependent on oil.

Economic activity is concentrated in Mexico City. The six northern border states are home to much of the country's manufacturing, particularly maquiladoras (in-bond assembly for re-export factories) producing goods that are then sold in the U.S.

1.2 Banking and financing

Large foreign financial groups dominate Mexico's financial system. Their affiliates compete with independent financial firms operating as commercial banks, brokerage and securities houses, insurance companies, retirement fund administrators, mutual funds and leasing companies. Other important institutions include savings and loans, credit unions, government development banks, bonded warehouses, bonding companies and foreign exchange firms.

Mexico City is the country's main financial center, although Guadalajara, and especially Monterrey, the country's second- and third-ranked cities, respectively, are important financial, industrial and commercial centers.

1.3 Foreign trade

Mexico's economy is driven by external trade. Export earnings are fueled by manufacturing, although petroleum, tourism, agriculture and mining also contribute to revenue.

The U.S. remains Mexico's largest trading partner, due to its geographical proximity and the benefits of the North American Free Trade Agreement (NAFTA). Despite increasing competition from China and India, many foreign firms still choose Mexico for their assembly plants and other operations. Other major export markets include Canada, Spain and Japan. Major importers include Germany, Japan and Korea.

Mexico is a member of the World Trade Organization (WTO) and has eliminated most export permits, substantially reduced export taxes and direct export subsidies, and eliminated fiscal incentives for exports. A variety of export incentive programs, including special temporary import programmes, are in place to encourage export sales. The legislation promoting in-bond facilities in Mexico (maquiladoras) makes the country an attractive place to manufacture goods for export to the U.S.

2.0 Business regulations

2.1 Registration and licensing

Technology contracts do not require official registration or approval. Royalty arrangements can be negotiated without restrictions between contracting parties, although prevailing market rates for equivalent technology should be followed to avoid issues with the tax authorities.

2.2 Price controls

Mexico generally does not have price controls.

2.3 Monopolies and restraint of trade

Mexico's antitrust law prohibits monopolies and certain horizontal restrictive practices deemed to be "absolute monopolistic practices". Price fixing, restrictions of production and distribution, market sharing and concerted bidding in public tenders are strictly prohibited.

The law also prohibits the following practices by firms that have substantial power in the marketplace and that restrain or intend to restrain competition: vertical market sharing; restrictions on resales; tie-ins; exclusivity contracts; refusal to deal; boycotts; and certain other practices. Substantial market power is subject to a case-by-case investigation based on factors such as: market participation of the economic agent and whether it has the unilateral power to

fix prices; presence of barriers to market access; existence and market power of competitors; access of the economic agent and its competitors to inputs and other raw materials; and recent market performance.

Although the law technically prohibits monopolies *per se*, in practice focus is placed on abuse of monopoly power. The president of the Federal Competition Commission and other officials have made it clear that the law will be applied only against companies that engage in prohibited practices, not against those that merely have the potential to exercise monopolistic powers.

2.4 Intellectual property

The Federal Copyright Law provides for the National Copyright Institute (INDA), an independent agency of the Ministry of Education, responsible for the administrative enforcement of copyright laws. The INDA is authorized to conduct investigations, request inspections, enjoin copyright violations and impose sanctions.

The law grants an author both “moral” and “patrimonial” rights (moral rights recognize the author as the first and sole perpetual owner of the rights of his/her works; patrimonial rights allow the author to “exploit the work exclusively or authorise others to exploit the work”). Penalties apply for violations of the copyright law.

2.5 Mergers and acquisitions

The Federal Law on Economic Competition requires that large mergers be reported in advance to the Federal Competition Commission.

3.0 Foreign investment

3.1 Foreign investment incentives and restrictions

The Mexican government has curtailed the use of direct tax incentives for investment. The most significant tax incentive still available is the accelerated depreciation allowance for investments in production facilities, which allows same-year deductions for up to 92% of an investment’s value, which may vary by industry or type of assets. The accelerated depreciation allowance applies only to new assets. Many state governments are pursuing foreign investment through state tax incentives.

Mexico offers no tax holidays for local or foreign investors; the country’s accession to the General Agreement on Tariffs and Trade and to its successor, the WTO, has eliminated nearly all import duty exemptions. The government has lowered duties dramatically, with trends suggesting further reductions, particularly with respect to U.S. and Canadian trade.

Foreign investment has been simplified by amending the relevant regulations, reducing legal and administrative bureaucracy, reducing local content requirements, modifying ceilings on foreign equity, eliminating most import license requirements and overhauling intellectual property legislation.

Foreign investment is permitted in all areas except those explicitly limited to the Mexican government. Foreign investors may hold up to 100% of the capital stock of any Mexican corporation or partnership, except in areas limited under the law. Where an investment is in a classified or regulated sector such as banking, railways or telecommunications, approval is required from the Foreign Investment Commission.

3.2 Exchange controls

There are no restrictions on domestic or foreign currency held locally by nonresidents, and no official guarantees against inconvertibility. Although bank accounts in dollars are not permitted for individuals, they are for companies.

4.0 Choice of business entity

4.1 Principal forms of doing business

Mexico has several forms of business organization, including the stock company (*sociedad anónima*—SA) and the limited liability company (*sociedad de responsabilidad limitada*—SRL), both of which can be forms of variable capital (CV).

The SA and the SA de CV are the most frequently used forms for foreign investors. The SA most closely resembles the public limited company or corporation. Foreign investors with wholly owned subsidiaries that want added flexibility in increasing or decreasing capital have favored the SA de CV. The only difference between the SA and the SA de CV is the variable portion of an SA de CV's capital stock, which is usually unlimited and not subject to notary certification upon fluctuation.

Requirements of an SA in Mexico

Capital. Minimum MXP 50,000, at least 20% of which must be initially paid in. Shares payable in kind must be paid in full immediately and remain on deposit with the corporation for two years; if the assets represented by the shares decline in value by more than 25% during that period, the shareholder must pay in the difference. Companies must place 5% of their profits in a legal reserve until the reserve equals 20% of authorized capital.

Shareholders. Minimum two shareholders (a shareholder may hold only one share).

Management. One individual manager may be appointed (sole administrator) or a board of directors (minimum of two). A minority that holds 25% or more of shares (10% if the company shares are traded on Mexico's stock exchange) has the right to appoint one member of the board. There are no residence or nationality requirements for board members.

Labour. There is no requirement that labour be represented on the board. Firms must distribute 10% of their pretax profits to employees. Only 10% of the workforce may be foreigners.

Disclosure. Corporations must be supervised by examiners who are appointed at the annual shareholders' meeting (a 25% minority can name additional examiners). Additionally, there are no publication requirements (except for companies listed on the stock exchange).

Taxes and fees on incorporation are minor, but legal fees might be substantial. In accordance with the Mexican Income Tax Law, corporations with gross income exceeding MXP 34.8 million, assets exceeding MXP 69.6 million or those with more than 300 employees must file a special report ("*dictamen fiscal*") prepared by an independent public accountant with the tax authorities.

Types of shares. Only nominative shares are permitted. For purposes of "Mexicanization", shares are often classified as "A" or "B", with "A" shares restricted to Mexican ownership. "T" shares exist for companies that own agricultural land. Special labour shares may be issued. Founders may receive up to 10% of the corporation's profits every year during the first 10 years of existence by means of founder bonds, provided the shareholders have received at least a 5% dividend each year. Shares may be common or preferred. Preferred shares carry limited voting rights (exercisable only during actions to transform, merge, dissolve or make other major changes) and receive a cumulative dividend (usually 5%, sometimes less) before the common shares may participate in the corporation's profits.

Control. A simple majority of shareholders has control, unless bylaws establish a larger majority (as is frequently the case for major decisions). Annual general meetings are required; representatives of one-half of the corporate capital constitute a quorum. For extraordinary meetings (i.e., those undertaking major changes in the corporation), 75% of capital is necessary for a quorum on first call and 50% thereafter. Decisions are determined by a simple majority.

4.2 Establishing a branch

Although a few companies have established branches, they are at a disadvantage for several reasons. Branches may not own real estate, and they may not deduct payments to the head office for interest, royalties, fees or other services. Establishing a branch takes more time and money than establishing a corporation, and branch charters usually contain more restrictions than corporation charters. Because branch offices are not legally separate from the head office, the head office can be held responsible for the liabilities of a branch.

Approval from the Ministry of Foreign Affairs is not required for a foreign company to open a branch office in Mexico. Instead, newcomers deal exclusively with the Ministry of Economy.

4.3 Setting up a company

As mentioned above, Mexico has all the usual forms of business organization, including the stock company and the limited liability company. Several other forms of organization are

suitable only for small operations, such as a general partnership. The permit for establishing a company requires inclusion of the “Calvo clause” in the bylaws and on share certificates. This clause waives the right to invoke foreign diplomatic intervention and relinquishes any claim to treatment different from that accorded to Mexican nationals.

Organizing a local corporation can take four weeks or longer, depending on the complexity of the project. A permit must be secured from the Ministry of Foreign Affairs. A minimum of two shareholders must appear before a notary public to sign the deed of incorporation, which must contain the names, nationalities and other particulars of the founders; the name, domicile, purpose and duration of the company; a breakdown of its capital and a statement of the founders’ contributions and their value; a description of the manner of administration; names of directors, managers and supervisors; the manner of liquidation; and all other special agreements that will regulate the operation. As noted above, at least 20% of the capital shares must be paid immediately, and the remainder within one year.

5.0 Business taxation

5.1 Overview

Companies doing business in Mexico typically are subject to corporate income tax, value added tax, tax on real property, social security contributions on behalf of their employees and the flat tax. Some taxes are levied at the state and municipal levels. There is no excess profits tax.

With effect from 1 January 2008, the flat tax replaced the asset tax. Under the flat tax, corporations (including permanent establishments of non-Mexican entities) and individuals pay the sum of the income tax computed under the Mexican Income Tax Law and the excess of the flat tax over the income tax, if any.

Under mandatory profit sharing rules, employers are required to distribute and pay 10% of their “adjusted” taxable income to employees. The actual distribution of profits must be paid within 60 days after the corporate income tax return has been filed (and no later than 31 May of the following year).

The tax collector in Mexico is the Tax Administration Service (SAT).

5.2 Taxable income and rates

The corporate tax rate is 28%.

A company is resident in Mexico if its place of effective management is in Mexico. Residents are taxed on their worldwide income. Companies not domiciled in Mexico are taxed only on their Mexican-source income (see also 5.6 below). Income is deemed to derive from Mexican sources when the assets or activities are in Mexico or when the sales or contracts are carried out in the country, regardless of where title passes.

The gross income of a resident legal entity includes all income received in cash, in kind, in services or in credit, including income derived from abroad. This includes all profits from operations and income from investments not relating to the regular business of the corporation, and capital gains.

The taxable income on which the corporate income tax rate is applied is the difference between taxable revenue and expenses. The revenue and expense recognition is on an accrual basis.

Corporate capital gains or losses arising from the sale of fixed assets are treated as ordinary income or losses, taxable at the normal corporate rates. In calculating the taxable gains arising from the sale of land, buildings, equity shares and other capital interests, companies may apply an official schedule of inflation adjustments to the acquisition cost of the asset.

Deductions

Business expenses are deductible if they are properly documented and supported. The following deductions are permitted:

- Returns received or discounts or rebates granted in the tax year;
- Cost of goods sold;
- Expenses net of discounts, rebates or returns;

- Investments (depreciation on a straight line method, adjusted for inflation);
- Bad debt credits and losses resulting from acts of God;
- Profit sharing paid to employees;
- Contributions for the creation or increase of employee pension or retirement funds; and
- Accrued interest, subject to the thin capitalisation rules.

Dividends are not deductible by the distributing corporation or included in the gross income of the recipient (although they are included in the income base for calculating profit sharing).

Other nondeductible items include:

- Items that do not meet formal invoicing requirements;
- Income tax or VAT payments;
- Interest and inflation adjustments made due to extemporaneous tax payments;
- Provisions for employee liability and indemnity reserves; and
- Goodwill.

The income tax law aims to recognize the “real” reduction in debt that occurs as a result of inflation and the corollary decrease in the return on assets. Under the law, any excess of the inflationary reduction in debt over the amount of interest paid is taxable as an “inflationary profit,” but any excess of the inflationary increase in the value of assets over the return on assets is tax-deductible. The system treats as interest both foreign exchange losses and net gains from the sale of financial instruments, such as petro-bonds.

Maquiladoras

Maquiladoras are foreign factories that assemble duty-free goods in Mexico for export and that receive preferential treatment under Mexican tax law. Foreign partners of maquiladoras are exempt from permanent establishment status in Mexico if the Mexican firm reports a safe harbour level of taxable income.

The Income Tax Law provides for two alternatives for a maquiladora to avoid creating a Mexican permanent establishment. A maquiladora may either: (1) adopt the safe harbour rules or prepare proper transfer pricing documentation; or (2) elect to obtain an advance pricing agreement (APA) via a private letter ruling. Under the safe harbour, a maquiladora must report taxable income corresponding to the higher of the following:

- 6.9% of the value of its assets (taking into account the value of all assets employed in its maquila operations, including foreign-owned assets (both fixed assets and raw materials/inventory)); or
- 6.5% of its costs and expenses (taking into account operating costs and expenses as computed under Mexican GAAP).

As an alternative to the safe harbour, a maquiladora may avoid triggering PE status by electing to prepare transfer pricing documentation and follow some particular procedures.

Flat tax

The flat tax is calculated on a cash-flow basis, with the tax base determined by reducing taxable revenue (primarily income derived from the sale of goods, the rendering of independent services and the leasing of tangible goods) with specific deductions. Interest, salaries and royalty payments are not deductible—with some narrow exceptions (e.g. royalties paid to independent third parties); a credit is granted to partially neutralize the impact of the nondeductible salaries. Under the flat tax rules, investments and inventory are fully deductible when purchased and paid, rather than being deducted under the depreciation or cost of goods sold rules. If deductions exceed revenue (“losses”), a credit is granted on such “losses” equal to 17% for 2009 (17.5% thereafter), which may be credited against the flat tax in the following years.

Taxpayers first compute their income tax liability and their flat tax liability for a fiscal year. Because the income tax liability may be credited against the flat tax liability, the flat tax is paid only to the extent it exceeds the income tax (i.e. the flat tax acts as a “minimum tax”). In contrast to the abolished asset tax, any flat tax paid is not creditable for Mexican income tax purposes in subsequent years.

Depreciation

Depreciation is calculated on a straight-line basis. The tax system offers the option of a one-time, present-value deduction for newly acquired assets, with the exception of investments in cars, trailers, buses and airplanes. Depreciation rates are set by the government and vary by industry and type of asset.

Losses

Tax losses are the difference between taxable income and authorised deductions when the amount of the deductions exceeds the income obtained in a particular fiscal year. Losses may be carried forward for 10 years. Losses not carried forward are forfeited.

5.3 Capital gains taxation

Capital gains arising from the sale of fixed assets, shares and real property are considered normal income and are subject to the standard corporate tax rate. Mexican law allows the proceeds from the sale of real property, shares and other fixed assets to be indexed to inflation.

5.4 Withholding tax

Dividends

Mexico does not impose a withholding tax on dividends. Income tax paid by a nonresident company that distributes dividends to another nonresident company, which, in turn, distributes dividends to a Mexican corporation, may be credited against the Mexican corporation's income tax liability provided the following conditions are satisfied:

- The dividend and the income tax are accrued by the Mexican corporation;
- The Mexican corporation owns at least 10% of the first-tier company;
- The first-tier company owns at least 10% of the second-tier company;
- The minimum combined ownership in the second-tier company is 5%; and
- The Mexican government has concluded a broad exchange of information agreement with the country where the second-tier company is resident.

Interest

Interest payments to foreign banks resident in tax treaty countries are subject to a 4.9% withholding tax. The rate is 10% if in the absence of a treaty. Financial leases are taxed at 21%. In all other cases, the withholding tax rate is 28%.

Royalties and fees

Payments abroad for technical assistance, know-how, use of models, plans, formulae and similar technology transfer are subject to a 25% withholding tax. Royalties paid to a foreign licensor of patents, trademarks and trade names—without the rendering of technical assistance—are subject to a 28% withholding tax, except where Mexico has a tax treaty with the relevant country.

Business enterprises that pay fees or make rental payments to individuals for property must withhold a 25% tax on the interest portion of the lease payments. The tax and a statement including information about the payments made must be filed with tax authorities in February of the following year.

5.5. Foreign income and tax treaties

Mexico grants a foreign tax credit for tax paid on income earned from abroad up to certain limits, against the amount of Mexican tax due.

Mexico has concluded tax treaties with more than 30 countries. As noted above, Mexico does not tax dividend distributions to nonresidents as long as the dividends are paid out of net (i.e. after-tax) income. Accordingly, the table below does not reflect withholding tax on dividend payments.

Withholding tax rates under Mexico's tax treaties			
Treaty Partner	Dividends	Interest	Royalties
Australia	0	10/15	10
Austria	0	10	10
Belgium	0	10/15	10
Brazil	0	15	10/15
Canada	0	0/10	0/10
Chile	0	15	15
China	0	10	10
Czech Republic	0	10	10
Denmark	0	5/15	10
Ecuador	0	10/15	10
Finland	0	10/15	10
France	0	5	10
Germany	0	10/15	10
Greece	0	10	10
Iceland	0	10	10
Indonesia	0	10	10
Ireland	0	5/10	10
Israel	0	10	10
Italy	0	10	15
Japan	0	10/15	10
Korea	0	5/15	10
Luxembourg	0	10	10
Netherlands	0	5/15	10
New Zealand	0	10	10
Norway	0	10/15	10
Poland	0	10/15	10
Portugal	0	10	10

Withholding tax rates under Mexico's tax treaties			
Treaty Partner	Dividends	Interest	Royalties
Romania	0	15	15
Russia	0	10	10
Singapore	0	5/15	10
Slovakia	0	10	10
Spain	0	5	10
Sweden	0	10/15	10
Switzerland	0	10/15	10
United Kingdom	0	5/10/15	10
United States	0	4.9/10/15	10

5.6 Transactions between related parties

Transfer pricing

Transactions between related parties must be at arm's length or they may be adjusted by the SAT. Mexico's transfer pricing rules, which generally follow the OECD Transfer Pricing Guidelines, provide for the comparable uncontrolled method (this method must be the first one to be analyzed), the resale price method, the profit split method, the residual profit split method and the transactional net margin method. APAs are available and documentation must be maintained.

Thin capitalisation

Under the thin capitalisation rules, interest paid on loans granted in cash by related parties in excess of three times stockholders' equity may not be deducted. The thin capitalisation rules are not applicable to taxpayers that obtain an APA from the tax authorities, subject to certain requirements, or to financial institutions.

Controlled foreign companies

Companies, individuals and resident foreigners must pay tax on all earnings from companies or accounts in low-tax jurisdictions. Foreign-source income is deemed to come from a low-tax jurisdiction if it is not subject to taxation abroad or if it is subject to an income tax that is less than 75% of the income tax computed under Mexican tax legislation.

Passive income (i.e. dividends, interest, royalties and capital gains) derived directly or indirectly by a Mexican resident through a branch, entity or any other legal entity located in a preferential tax regime will be subject to taxation in Mexico in the year in which the income is derived. Specific rules apply that permit the nontaxation of active income in certain cases. Taxpayers earning income from a preferential tax regime must file an annual information return in February.

Consolidated returns

Mexican law allows corporate groups to be taxed on a consolidated basis. The filing of a consolidated return has significant advantages, most notably the fact that the losses of some group companies may be offset against the profits of others. Also, dividends paid among companies of the group are not subject to tax, notwithstanding that dividends do not originate from the UFIN (net-of-tax profit) account, until the relevant profits are distributed from the group and there is a lack of consolidated UFIN. For tax purposes, a consolidated group consists of the Mexican holding company and the subsidiaries in which it has effective direct or indirect ownership interests in excess of 50% of the voting shares. Consolidation is on a proportionate

basis, based on the percentage owned directly or indirectly by the controlling company. Only companies resident in Mexico may be treated as holding companies.

Consolidated tax returns must be filed in the year following authorisation from the SAT. Once consolidation for tax purposes has been elected, it must be continued for at least five years.

Taxpayers must disclose in the tax report, issued by an independent public accountant, the amount of income tax that has been deferred as a result of electing to file a consolidated tax return. Failure to disclose this information will result in deconsolidation of the group.

5.7 Turnover and other indirect taxes and duties

A value added tax (IVA) applies to both goods and services at a standard rate of 15%. Interest on nonbusiness loans and credit card debt is also subject to IVA. The following are exempt: land and residential buildings, books and newspapers, share transfers, used chattels, tickets and other evidence permitting participation in lotteries, raffles, games of chance and competitions of every nature, national currency, foreign currency and gold and silver pieces, and alienation of goods among nonresidents or by a nonresident to a Mexican entity registered in an authorised programme to promote the export of goods. Exports are subject to a 0% rate. Imports of supplies for maquiladoras (IMMEX) are exempt if certain conditions are satisfied. Services utilised abroad are subject to the 0% rate on exports of services if the services are contracted and paid by a nonresident with a PE in Mexico.

Companies may credit IVA payments against income or other tax payments; if the excess cannot be credited in its entirety, the taxpayer may apply for a refund.

Companies must settle IVA on a monthly basis, making the IVA payments for the preceding month. IVA payments for installment sales may be made when principal and interest payments are actually received, rather than when the sale is invoiced, provided half the purchase price is paid after six months (35% of the price for final consumer sales). For imports, IVA is based on customs value plus tariffs. All companies should demand that IVA payable on their purchases be separated from deductible expenses.

5.8 Other taxes

A cash deposit tax at a rate of 2% applies on the amount of any cash deposits made in a taxpayer's bank accounts that exceed MXP 25,000, and only on the excess of that amount, determined by considering all cash deposits made in the same bank, even if in different accounts. The cash deposit tax will be creditable against other federal taxes.

A special tax on production and services is charged to manufacturers and wholesalers of certain goods, including alcoholic beverages, tobacco, among others. The tax rates vary by product.

The purchases of real estate are taxed at rates that vary by state.

5.9 Tax compliance and administration

Corporate taxpayers must make advance income tax payments on the 17th day of the month. Advance payments are based on the preceding five most recent fiscal years in which a profit could be calculated, even if there was a loss in the immediately preceding fiscal period. All corporations must use the calendar year for financial and tax purposes.

Corporations may apply for a reduction in advance payments, although any delay in making advance payments will result in interest charges. Higher charges are applicable for unauthorised delays.

Tax returns must be filed three months after the end of the tax year. The government may challenge tax returns up to five years and, in certain circumstances, up to 10 years after filing. In practice, however, the tax authorities generally examine returns for the most recent fiscal year and for the subsequent period through to the date of the examination. The authorities may audit a company's records for the previous 10 years in the following circumstances: upon discovery of errors in any single tax category that exceeds 5% of the tax liability; omissions of profit sharing distributions; failure to register to pay tax; or where false information has been provided. Taxpayers have five years to file amended returns when refunds are anticipated. Refunds not made within four months of filing are due interest.

Penalty interest for late payment of tax is assessed at 0.75% per month if an extension has been granted; otherwise, a 1.13% rate is imposed. Penalty rates are adjusted monthly. Penalty interest accrued from 1 January 1992 is deductible for income tax purposes.

6.0 Personal taxation

6.1 Residency

Mexican residents are taxed on worldwide income; nonresidents are taxed only on Mexican-source income. Foreign nationals permanently residing in Mexico enjoy the same rights as citizens (absent the right to vote) and they incur the same responsibilities. Resident status may be obtained after residing in Mexico for five years.

Nonresidents on temporary assignment working for firms or subsidiaries based in Mexico are exempt from income tax on the first MXP 125,900 of annual income; they are taxed at 15% on income of MXP 125,901-MXP 1 million. All income exceeding MXP 1 million is taxed at 30%, with no deductions allowed. Nonresidents on temporary assignment and that are paid by nonresident foreign firms are exempt from income tax. Tax rates may differ under tax treaties.

6.2 Taxable income and rates

Taxable income includes the following: remuneration for personal services, including salary, bonuses and special allowances (e.g. housing); benefits rents received; and interest and corporate dividends paid out of gross income. Pension benefits are tax-exempt up to nine times the legal minimum salary for the region. Severance payment benefits are exempt up to 90 times the daily base salary of the region multiplied by the number of years employed.

Taxpayers engaged in business activities are required to report transactions worth more than MXP 50,000 on their 50 largest clients, and the information must be available if there is an audit. Accounts of donations granted, payments made to Mexican banks abroad and joint operating agreements also must be kept on record.

Personal deductions include medical and dental fees and hospital expenses incurred by the taxpayer and the taxpayer's spouse or other dependents with income no higher than the annual minimum salary. Additionally, health insurance premiums and charitable donations are deductible from income. Mortgage interest payments and personal pension account contributions up to five minimum annual salaries are deductible. Payments made to parties in low-tax jurisdictions are nondeductible unless it can be demonstrated that they were set at market value.

Taxpayers whose income consists of professional fees may deduct normal and documented expenses, similar to those deductible by businesses. A simplified tax system for individual taxpayers that engage in business activities is available.

In calculating capital gains for tax purposes, individuals increase the historical cost by a factor to adjust for inflation and reduce the cost by accumulated depreciation at a rate varying with the type of asset. The difference between the result and the selling price constitutes the net gain. Based on the number of years the asset was held, a certain proportion of the net gain is added to other taxable income to determine the top tax rate payable. Capital gains resulting from an individual's sale of publicly traded shares are tax-exempt in certain circumstances.

The income tax rates are progressive up to 28%. The employer withholds provisional tax payments. Taxpayers must file personal income tax returns for the preceding year by the end of April.

Some states and the Federal District impose separate taxes on wages and salaries, which are usually an employer tax liability.

6.3 Special expatriate tax regime

There is no special regime applicable to foreigners.

6.4 Capital taxes

There are no capital taxes in Mexico.

7.0 Labour environment

7.1 Employees' rights and remuneration

Mexico's labour legislation is set forth in the Federal Labour Law and the country's constitution. This legislation regulates labour contracts, minimum wages, hours of work, legal holidays and

paid vacations, among other working conditions, as well as trade unions, strikes and dismissal compensation.

Regulations issued by the Ministry of Labour and Social Welfare outlines allowable workplace practices with a focus on assessing risk, preventing accidents and educating workers on potential hazards. The safety regulations emphasize self-regulation and allows private sector "certifiers" to conduct safety inspections.

Working hours

The work week consists of six eight-hour days for the day shift, seven-hour days for the night shift and seven and a half-hour days for a mixed shift, with a half-hour break in all cases. For every six-day work period, a worker is entitled to one day of rest with full pay. (Wages are calculated on a seven-day week.) Overtime is paid at twice the normal rate and may not exceed nine hours per week. Additional weekly work hours are forbidden and must be paid at triple the normal rate. Workers receive a 25% premium for Sunday work.

7.2 Wages and benefits

The National Minimum Wage Commission sets a three-tiered minimum wage (reflecting Mexico's three main regions). The commission is a tripartite group, comprising representatives of business, labour and government. Minimum wage increases have varied in size and frequency.

An average minimum wage hike of 4.5% was approved for 2009, the upper limit of which exceeds the government's annual inflation target. The variable increase is an attempt to equalize wages throughout the country, with the lowest percentage for Mexico City workers (since they receive the highest wages). The minimum wage is subject to a premium (often 60%-70%) for mandatory fringe benefits and premiums for work considered hazardous. Actual industry wages are higher than the legal minimum. Often, a salary of two to three times the minimum wage is considered acceptable in many industries.

The overall burden of fringe benefits is substantial as the costs are frequently in excess of 70%-100% of payroll, depending on salary levels. The most important employee benefit is profit sharing, under which all firms must distribute 10% of their pretax profits to employees.

Pensions

Employers must contribute a sum equal to 2% of payroll to the pension fund system, under which private sector fund manager oversees individual retirement accounts.

Social insurance

The social security system, administered by the Social Security Institute, provides many benefits. Its programmes cover work-related accidents and illnesses; non-occupational diseases and paid maternity leave; old age and various death benefits; and unemployment insurance. The cost of the system is shared among employers, employees and the government. The employer generally picks up most of the bill with its share roughly totalling 15% of payroll.

Other benefits

The labour legislation grants seven paid holidays annually, plus one for Inauguration Day every sixth year. Labour contracts call for another nine to 10 paid holidays. After working for a year, employees are entitled to at least six days' paid vacation, increased by two days for each of the subsequent three years. A bonus of 25% of normal pay during the vacation period is mandatory. A Christmas bonus of 15 days' pay is also obligatory and must be paid before 20 December. Companies must also contribute a sum equal to 5% of payroll to the national workers' housing institute (Infonavit); funds go into special accounts for workers.

Companies with more than 100 employees must maintain a fully equipped infirmary under the direction of a qualified doctor; firms with more than 300 employees must establish hospital facilities. A mandatory worker-training programme has added to employer costs.

Besides the mandatory fringe benefits, most labour contracts provide for such "voluntary" benefits as savings plans, life insurance, lunches and vales de despensa (redeemable for food and general merchandise at supermarkets). Most large companies maintain a cafeteria on the premises which provides below-cost meals to employees. Many companies supply work clothes. Some employers set up additional incentive plans to stimulate production and sales. Fringe benefits must generally be provided to all employees to qualify for tax deductions.

7.3 Termination of employment

Unless dismissed for cause (such as dishonesty or excessive absenteeism), laid-off employees are entitled to three months' pay, plus 20 days' additional pay for every year employed. Workers employed for more than 15 years receive an additional 12 days' pay for every year of service, up to a ceiling of twice the minimum wage at the time of dismissal multiplied by 12 days and the number of years. An employee who wins a dismissal appeal receives full pay from the date of termination until the matter is judicially resolved.

Unjustifiably dismissed workers may choose between reinstatement and indemnification amounting to three months' severance pay. Employers may refuse to reinstate apprentices and workers with less than one year of service, but they must then add 20 days of pay for each year of service to the standard three months' severance pay or pay half the time worked, if less than a year.

7.4 Labour-management relations

Nearly 40% of Mexico's workforce is unionised; unions represent some 80% of industrial workers in establishments with more than 20 employees. Most of these workers belong to one of the nine national labour federations. Only about 20% of unionised workers belong to single-company unions; the remainder are members of nationwide organizations. Federal law requires that collective-bargaining agreements be renewed at least once every two years. Salaries must be reviewed annually.

Strikes are legal only when employers refuse to comply with a legal or contractual obligation (for example, to make or revise a union contract, to accept an award by an arbitration board or to make mandatory profit-sharing payments). A strike may also be called to support another strike, provided the majority of workers agree. Unions must follow specific procedures in instituting job actions.

7.5 Employment of foreigners

Under the NAFTA and as part of a Nationality Law, Mexico has agreed to permit temporary entry to four categories of non-Mexican North Americans: business visitors; traders and investors; intra-company transferees; and certain other professionals. The three NAFTA signatory countries have also agreed to provide access to nationals who hold professional licenses (e.g. lawyers, doctors and accountants).

The Federal Labour Law requires at least 90% of a company's skilled and unskilled workers be Mexican nationals. A special provision permits temporary employment of foreign technicians (up to 10%) if a company can prove that skilled workers are not available locally. The 10% limit does not apply to managers, directors and other key officers, who must secure special immigration permits. Operations along the border with the US are exempt from the personnel requirements.

Mexico has several categories of immigrants, but the following are of special interest to foreign investors.

- *Cargo de confianza* status (management employee) may be obtained by foreigners who fill key executive posts or other positions of responsibility in established corporations or institutions. The Ministry of the Interior will grant such status only if it is satisfied that the work is necessary and cannot be performed by a local national. Companies should apply for this status well in advance, since the process may take several months. Occasionally, a foreigner may qualify for initial non-immigrant status, which may subsequently be amended to immigrant status upon re-entry into the country.
- *Inversionista* (investor) status may be obtained by foreigners who invest in industrial activities that contribute to the economic and social development of the country. The one-year visa may be renewed up to four times and allows for multiple entries.
- *Técnico* (technician) status may be granted to persons who undertake research, technical or other specialized activities for which no qualified residents are available.

Mexico also provides immigrant status for scientists, professionals, persons with independent income, dependants of immigrants, permanent immigrants and retirees. Generally, to obtain immigrant status for employees, a company must file an application with the Ministry of the Interior and submit evidence of investment and tax payment. Some Mexican consulates grant visas directly, waiving filing requirement with the Ministry.

In general, a new company may not apply for permanent residence visas for its personnel unless the government considers its activity of importance to the nation and it has been operating for two years. If approved, the permit is granted provisionally for five years and reviewed every year.

8.0 Office locations

To find out how our professionals can help you, please contact us at the headquarters office listed below or through the “contact us” button on <http://www.deloitte.com/tax>.

Mexico City Office

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