

## DOING BUSINESS IN MEXICO

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Mexico.

### 1. BACKGROUND

#### 1.1 Brief description of Mexico.

Mexico is a democratic republic; it has 31 states and a Federal District. The executive power is elected every six years.

In Mexico there are 120 million inhabitants who are mainly concentrated in the big cities. Mexico City, the capital, has 21 million inhabitants. Spanish is the official language; almost 97% of the population is catholic.

#### 1.2 Mexican economy.

Mexico has two main sources of wealth: oil and tourism which represents almost 30% of the Gross Domestic Product (GDP). The manufacturing industry (maquiladoras) is significant, and commerce and services are continuously growing.

The average inflation for the last few years has been less than 4% annually.

The official currency is the Mexican peso and the most convertible currency is the US dollar. The exchange rate has been very steady in the last 5 years: around 11 pesos per one USD.

#### 1.3 Infrastructure

A broad border with United States allows continuous traffic to and from production and consumption centers. Ports located on the coasts have enough infrastructures to deal with international trade.

Railroad tracks, however, have had practically no development in decades. Digital communication networks allows Mexico be in great level to satisfy any national and international necessities.

### 2. CHOICE OF LEGAL FORM

Legal frameworks are established through statutes, the General Mercantile Societies Law and other applicable special laws.

Corporations are constituted through a public instrument which creates a juridical personality. This public instrument is notarized and registered before the Public Registry of Commerce.

The society's legal representative acts on behalf of the entity with a notarized power of attorney granted by the shareholders.

Any of the societies mentioned below may be constituted with fixed or variable capital.

The fiscal year coincides with the calendar year.

### **2.1 Limited Liability Company (Sociedad de Responsabilidad Limitada)**

As with the S.A., the S. de R. L. is one of the most widely used for doing business in Mexico.

Partners are responsible up to the amount of their contribution, unless they are part of the Board of Directors or be Statutory Auditors.

### **2.2 General Partnership**

Not in use in Mexico.

### **2.3 Limited Liability Partnership**

Not in use in Mexico.

### **2.4 Limited Partnership**

Not in use in Mexico.

### **2.5 Branch or representative office.**

A branch and a representative office can operate in Mexico only if their offices are registered before the Public Registry of Commerce; constitutive instrument, by laws (estatutos sociales), powers of attorney, must be authenticated by authorities of their home country, in Spanish (or accompanied by an official Spanish translation), protocolized before a Notary Public here in Mexico.

One must apply to the Ministry of Foreign Affairs to obtain permission to carry out transactions in Mexico.

Each year the entity must present and publish its Balance Sheet audited by an independent certified public accountant.

This type of entity is not ideal, since it is subjected to a tax regimen as a corporation constituted according to Mexican law, a subsidiary company is the best option.

### **2.6 Sole Proprietorship**

These societies are prohibited in Mexico. A company must be formed by a minimum of two partners, however 99% of capital stock can be owned by one individual.

### **2.7 Offshore Legal Entities**

Yearly, the location of offshore countries is approved. All operations performed with these countries need to be informed to the authority, mainly for tax purposes.

## **2.8 Subsidiary**

They are constituted using the before mentioned form, and operate as legal societies constituted in Mexico.

## **2.9 Public Limited Company**

A public entity is that which trades on the security exchanges. Any society which is solvent may quote in the security exchange issuing obligations or special shares series fulfilling provisions in the Law.

In Mexico, a public entity is constituted with the Mexican government participation of up to 51% of the capital stock when the society's activity is strategic for Mexican's development or 100% of the capital stock when the society's activity is fundamental for Mexico. In both cases, stockholders can only be Mexican individuals or societies with a charter restricting foreign investors.

## **2.10 Joint Venture**

This is an association that can be between individuals, businesses or a mix of them. Same rules, rights and obligations apply to all its signatories.

The Association in Participation Agreement (Asociación en Participación) is a temporary association conformed for commercial purposes through a contract signed by one or more silent partners ("asociados") who give goods or services to an active partner ("asociante"), both pursuing a common objective, grants participation in profits and losses of the business. The active partner will appear before third parties and the silent partner will not.

According to the Mercantile Societies General Law this association has no juridical personality and acts through the individual who associates, assumes the responsibilities generated by the contract before authorities, individuals and third parties.

The associates have no responsibilities in the before mentioned.

However, for tax purposes, the contract does have juridical personality and is subjected to tax law like a mercantile society.

## **2.11 Sociedad Anónima (S.A.) (Corporation)**

This type of corporation is the most widely used for doing business in Mexico. Our financial system is based on this corporation type.

The responsibility of the shareholders is limited to the amount of their contribution, with the exception made of the legal representative or the members of the Board of Directors and the Board of Oversight.

To constitute this type of corporation at least two individuals are required.

## **2.12 Trust / Foundation**

Trust can only be formed with authorized Trust Houses.

Foundations (Instituciones de Asistencia Privada) are born with the aim of perpetuity. They are ruled by local entities (Junta de Asistencia Privada).

Civil societies are organizations whose partners contribute work and resources toward an economic result with no commercial speculation. Their regulations are included in their bylaws and the Civil Code. Included in this type of societies are professional, cultural and social services.

## **2.13 Sociedades Anónimas Promotoras de inversión (SAPIs)**

It's a new corporate model that the objective is attract capital and investors. It has also been the kind of entity of choice for hungry-for-public-funding companies targeting the stock market.

This new legal figure allows:

- More freedom for the company to have a single document that regulates its shareholder's relation, instead of having the bylaws and multiple contracts between them.
- Modalities on how shares may be issued.
- Special clauses for setting conditions of partner's exclusion, as restriction or termination of share sales.
- The implementation of mechanisms for agreements achievement among shareholders.

## **3. AUDITING REQUIREMENTS**

### **3.1 Requirements and Thresholds**

Tax audit - enterprises fulfilling any of the following three requirements are subjected to the compulsory tax auditing whose results are filed with tax authorities in May of the following year:

- Revenues greater than US \$ 2.6 million
- More than 300 workers
- Assets greater than US \$ 5 million

Financial audit – medium, large companies, all financial institutions, as well as public and state institutions are usually audited and reported to its government body.

Special audits – local authorities, social security and housing institutions force certain companies to be audited for special purposes.

## **4. TAXATION**

The most significant taxes caused according to the amounts collected are income tax; value added tax and the new business flat tax..

### **Taxes caused by societies**

#### **4.1. Corporation Taxes**

##### **Business Flat Tax**

An alternative minimum tax now called "Impuesto Empresarial a Tasa Única" IETU (Business Flat Tax). This new tax shall be paid by Mexican-resident entities and individuals on their worldwide income received as compensation for the sale of goods, for independent services rendered and for leased goods. Non-residents with a permanent establishment in Mexico shall also be subject to this tax.

The tax shall be determined on a cash-flow basis at a rate of 17.5%. As a transition, a 16.5% rate will be applicable in 2008 and 17% rate will apply in 2009. The alternative minimum tax shall be determined on an annual basis, with monthly estimated payments. The basis of the alternative minimum tax for almost all taxpayers shall be determined by subtracting all deductions from the aggregate taxable income.

##### **Income Tax.**

All entities revenues, cash, goods, services, credit or any other type, including those obtained abroad are taxed according to income tax law. Its maximum rate is 28%; as such it is applied to some activities and for corporate tax. Individuals pay this tax with a progressive table from 0% to 28%.

The fiscal losses of preceding years are subjected to the following provisions:

- They will be decreased of tax profits only in the following ten years.
- Tax losses will be updated with inflation factors.
- When the taxpayer is entitled to deduct tax losses and fails to do so, the right to deduct the amount not decreased shall be forfeited.
- The right to deduct tax losses cannot be transferred in the case of a merger; it can only be transferred when corporations divided.

##### **Tax on Cash Deposits (IDE)**

It is calculated at a 2% rate on the deposits made in cash to an account maintained with Mexican financial institutions, and which will be applicable when the aggregate deposits exceed MXN \$25,000 in each month. The tax shall be collected by the institutions receiving the deposits, who shall issue the corresponding certificates of withholding to the taxpayers.

## **Asset Tax Law**

It is was abrogated January 1, 2008

### **4.2 Small companies' rate**

Small businesses are limited and not geographically centered in big cities. (See below paragraph "Incentives and Development Programs").

### **4.3 Dividend Payments**

Dividends are tax free when the society paid taxes previously. Otherwise, income tax needs to be integrated by gross up.

### **4.4 Branch Profits Tax**

Same rules as Corporation Tax apply.

### **4.5 Personal Income Tax**

Mexican Income Tax Law taxes individuals' revenues obtained from the following concepts:

- Wages and subordinated personal services
- Business and professional activities
- Leases
- Sale of assets
- Purchase of assets
- Interest revenue
- Prizes
- Dividends
- Other

Besides authorized deductions for each individual's taxed revenues there are personal deductions described below:

- Medical and hospital fees
- Funeral expenses
- Donations
- Interests on mortgage loans
- Complementary contributions to the retirement plans
- Allowances major medical expenses insurance
- Compulsory school transportation

A deduction of fiscal losses is authorized only to individuals with revenues from business activities in the following terms:

- Fiscal losses are compensated against taxable profits of the next ten years
- Tax losses shall be updated according inflation factors
- When a taxpayer who is entitled to deduct fiscal loss in a fiscal year and fails to do so, the right to deduct the amount not compensated for, shall be forfeited.

#### **4.6 Capital gains tax**

This revenue is tax exempted until realized when earnings is computed and tax caused is paid.

#### **4.7 Land tax**

Possession of real estate is taxed based on the government estimation of value.

#### **4.8 Value Added Tax**

VAT is applied to the value increased through the productive chain, taxing the ultimate price of goods and services that is paid by the final consumer.

All individuals and entities engaging in the activities listed below are required to pay Value Added Tax:

- Sale of assets
- Rendering of independent services
- Grant of temporary use or sale of assets
- Import of goods or services

Taxpayers have the right to deduct the VAT payable by them when purchasing goods or services corresponding to the main activities of their business.

#### **4.9 Sales Tax**

Not applicable as the VAT is a federal tax in Mexico.

#### **4.10 Local Taxes**

Local governments can and actually collect special taxes on: payroll, education, etc. Base is usually 2% on payroll/education, etc or a minor VAT percent locally defined.

#### **4.11 Tax treaties**

Mexico has more than 80 international treaties, which means an advantage to foreign investments in avoidance of double taxation.

#### **4.12 Transfer pricing rules**

All companies in Mexico, dealing with related parties, need to perform a Transfer Pricing Study under the international rules, a trusted database is searched and applicable items are compared under the “arms’ length” principle.

The above has higher enforcement with international related parties.

### **5. Allowances**

#### **5.1 Depreciation**

Financially, depreciation is made according to the assets’ useful life. For tax purposes the common practice is to apply the maximum rates authorized by tax laws which generally anticipate expenses.

#### **5.2 Investment allowance**

Sporadic investment facilities are declared to promote investment (domestic and foreign) in certain non developed or damaged regions and cities.

#### **5.3 (Tax Credits) Incentives and development programs**

In general terms, investment incentives in Mexico are as follows:

- Importation of raw materials and machinery and equipment used for production of goods for export, free of tariffs and taxes.
- The possibility of immediate depreciation of fixed assets
- The possibility of purchasing land in some states of the Republic
- Access to venture capital from development banks.

### **6. EMPLOYMENT**

Minimum wages are applied with consideration of geographical areas made up of municipalities and states. Minimum wage is the name for the salary a worker earns in established geographical areas.

Salaries are paid weekly for physical work and biweekly for all others.

Workers earn an annual bonus and participate in 10% of the profits of the enterprise.

#### **6.1 Social security / unemployment**

Social security guarantees the right to health, medical care, protection of the means of subsistence, and the necessary social services for the workers’ welfare, as well as a retirement pension guaranteed by the federal government when legal requisites are fulfilled. Execution of social security is the responsibility of public dependences, federal or local, as well as decentralized organizations.

The Instituto Mexicano del Seguro Social (IMSS) is a decentralized public Institution with its own juridical personality and patrimony, founded in 1944, in charge of organization and management of social security for social and private sectors.

Social security includes a compulsory and a voluntary regimen.

In the compulsory regimen, individuals secured are those who render permanent or eventually remunerated and subordinated services to other individuals or entities, and also to economic units with no juridical personality. Workers should have as beneficiaries of social security services the spouse or partner, as well as ascendants and descendants authorized by law.

Compulsory regimen includes insurance for the following:

- I. Job risks
- II. Illnesses and pregnancy
- III. Invalidity and life
- IV. Retirement, dismissal by advanced and old age
- V. Nurseries and social benefits

As a part of the obligations established in the Social Security Law, employers must register themselves and their workers in IMSS (see above), and communicate those who added or dropped from employments as well as any salary modifications.

Unemployment taxes are non existent in Mexico.

## **6.2 Employment of foreign personnel**

No aliens are allowed to work in Mexico unless a proper work permit is granted by the Secretaría de Gobernación (State Ministry).

## **6.3 Medical**

Medical expenses for workers are covered through social security as described above. As a usual policy, companies pay medical insurance policy for their officers as well.

## **6.4 Payroll taxes**

(See above in "Individual Taxes")

No deduction is allowed on minimum wage personnel.

An increasing rate from 0% to 28% is approved every year as income tax.

Social Security (housing, medical, retirement, motherhood, nursing, etc) is paid between the State, the employee and the employer.

Altogether personnel taxes for the employer can rise up to 2.3 times payroll.

## 7. WITHHOLDING TAXES

### 7.1 Interest

A flat rate is withheld in the financial institutions and paid on the name of the depositor if the rate is above certain level.

The financial institution issues a tax certificate to be used in the yearly annual return.

### 7.2 Royalties

A flat rate of 10% is calculated on all royalties paid. Special treatment applies to foreign paid royalties.

### 7.3 Dividends

No withheld tax is calculated on dividends that have already paid income tax. If dividends come from non-income-tax-net-profits, a rate of 29% is determined, withheld and paid by the entity on behalf of the shareholder.

## 8. MISCELLANEOUS

Development programs. Mexico has Programs for Export Development as described below:

**Maquiladoras with temporary imports for producing export goods (IMMEX):** Import of raw material, machinery and equipment, packs and crates, fuel, and spare parts with no payment of tariffs and VAT and other special fiscal benefits, the requirements being:

- The entity is dedicated to produce non-oil merchandise
- Export 10% of its sales as a minimum or US \$ 500,000 for importing material for production reported annually.
- At least 30% of the value of sales destined for export to benefit tax exemption corresponding to import of machinery and equipment. (during the validity of the program)
- Systemize the inventory processes, registering the entrances, decreases and leaves.

**High export enterprise (ALTEX):** a stricter version of IMMEX with more benefits and state and federal governmental supports.

Promotion for specific productive sectors. (PROSEC).

Imports of raw material, machinery and equipment, packs and crates, fuel, and spare parts with no payment of VAT and less amount of duties. (advalorem) without the obligation of export the final product.

**Drawback:** reimbursement of custom duties paid by production material imported for production of merchandise destined for sales abroad or required by export enterprises. To benefit with this system, the taxpayer should file the corresponding application before a year has elapsed after the import of material for production and within 60 days after the goods were exported.

**Immediate depreciation of investment:** the entities may choose to concentrate in one fiscal year (the first or second) the greater percentage of tax depreciation of fixed assets instead of applying the rate enacted in fiscal laws. Enterprises located in Mexico City, Guadalajara and Monterrey, and investments in transportation and office equipments are excluded this benefit.

**Facilitated real estate purchases:** some state governments evaluating project benefits give reductions in the price of real estate in order to attract foreign investment.

**Financing programs with venture capital:** The Banco Nacional de Comercio Exterior (Bancomext) and Nacional Financiera (Nafin) may temporally participate as minor stockholders in the investment projects of enterprises with foreign capital stock. Once the project progresses the development bank retires from the society, selling its stock to founding shareholders for the agreed price in the initial agreement or sell to third parties.

**This document is provided as a general overview of matters to be considered when setting up an overseas business in MEXICO. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided**

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