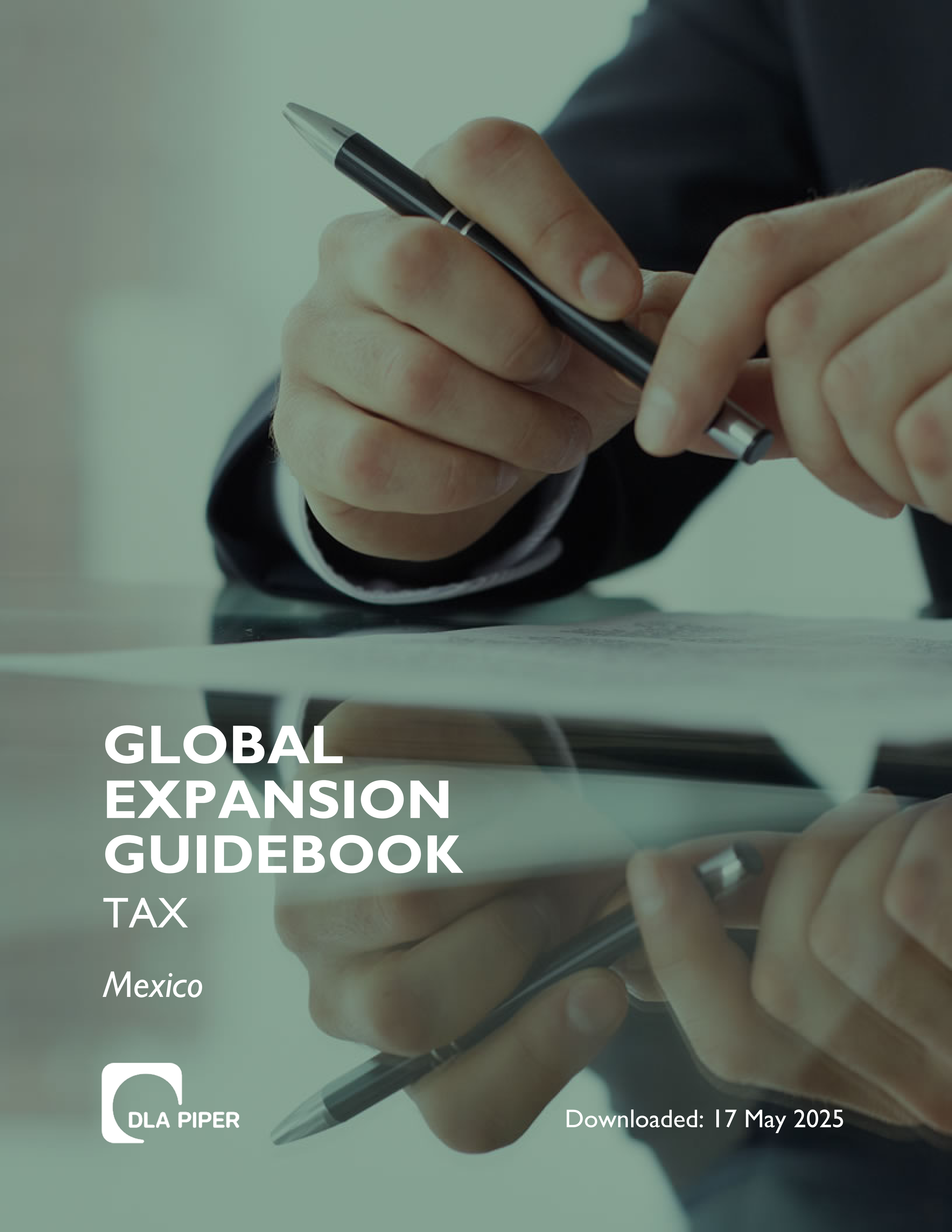

GLOBAL EXPANSION GUIDEBOOK

TAX

Mexico

DLA PIPER

INTRODUCTION

Welcome to the 2024 edition of DLA Piper's *Global Expansion Guidebook – Tax.*

GLOBAL EXPANSION GUIDEBOOK SERIES

Many companies today aim to scale their businesses globally and into multiple countries simultaneously. In order to help clients meet this challenge, we have created a handy set of global guides that cover the basics companies need to know.

The *Global Expansion Guidebook* series reviews business-relevant corporate, employment, intellectual property and technology, global equity and tax laws in key jurisdictions around the world.

TAX

Multinational companies continue to expand globally at an ever faster pace. Successful expansion depends, in part, on strategic and effective tax planning and compliance. This guide, brought to you by DLA Piper's Tax group summarizes the key features of tax laws in 41 popular jurisdictions.

This guide addresses common tax questions, by jurisdiction, including:

- Taxation of resident companies and non-resident companies
- Availability of tax holidays, rulings, and favorable tax regimes
- Ability to use losses to offset income
- Anti-deferral (ie CFC) rules
- Withholding taxes
- Employment tax issues

With more than 300 tax lawyers and economists in offices throughout the Americas, Europe and Asia Pacific, DLA Piper's global tax advisory services help multinational companies address the complex challenges of international commerce and business operations as well as manage and resolve tax audits. Our global tax group also assists clients in structuring a wide range of transactions, from private equity deals to corporate acquisitions and disposals. We provide these tax services across our global platform, while at the same time offering clients the benefits of the attorney-client and work-product privileges.

The information in this guide is an accessible, high-level summary of the tax laws in each jurisdiction. This is not a substitute for legal or tax advice. If you have specific questions or require detailed advice, we encourage you to contact one of the attorneys listed in the contributors section of this guide.

We hope that you find this guide valuable and we welcome your feedback.

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This is a general reference document and should not be relied upon as legal advice. The application and effect of any law or regulation upon a particular situation can vary depending upon the specific facts and circumstances, and so you should consult with a lawyer regarding the impact of any of these regimes in any particular instance.

DLA Piper and any contributing law firms accept no liability for errors or omissions appearing in this publication and, in addition, DLA Piper accepts no liability at all for the content provided by the other contributing law firms. Please note that tax law is dynamic, and the legal regime in the countries surveyed could change.

MEXICO

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RESIDENCE AND BASIS FOR TAXATION

Legal entities that are residents of Mexico are subject to Mexican taxation. For this purpose, legal entities that have their effective seat of management in Mexico are considered residents of Mexico. Resident taxpayers are subject to Mexican income tax with respect to income from whatever source derived.

Domestic

An entity resident in Mexico for tax purposes is subject to Mexican taxation on its worldwide income, regardless of the source of income.

Foreign

Foreign entities are subject to Mexican taxation when:

- They have a permanent establishment (PE) in Mexico
- They do not have a PE in Mexico, but income is generated from a Mexican source.

Whether Mexican source income exists or not depends on the nature of the income received, and income tax treaties entered into by Mexico may be able to reduce or eliminate Mexican taxes.

TAXABLE INCOME

Domestic

In general terms, taxable income is determined on an accrual basis, and taxpayers are allowed to deduct most business expenses. There are certain exceptions on expenses that can be deductible, among them:

- Penalties and unauthorized donations.
- Increases to reserves for bad debts, obsolescence, contingencies and indemnities, and exempt salaries (percentage may be decreased to 47 percent if the exempt salaries are not reduced from previous year), among others.

- Certain payments to tax havens or hybrid entities.
- Outsourcing personnel payments for the outsourcing of services related to *activities that form part of the main corporate purpose or economic activities* of the service recipient.

Foreign

A foreign company with a PE in Mexico is taxable in Mexico on all income attributable to the PE. Basically, income is considered attributable to a PE if it derives from the activities of the PE. Foreign-source income is subject to Mexican taxation if it is derived by a Mexican PE, because domestic rules do not limit the "attributable" concept to income from Mexican sources. A foreign tax credit is also allowed for PEs with foreign-source income.

TAX RATES

The corporate income tax rate is 30 percent and, for individuals, it is progressive up to a 35 percent rate.

There is also a value-added tax (VAT) of 16 percent on transfers of goods, rendering of independent services, leasing of goods and importation of goods or services into Mexico.

Further, there is an excise that intends to reduce consumption of harmful products (*eg,* tobacco, alcohol, pesticides) and limit the use of resources (*eg,* gasoline, energy).

TAX COMPLIANCE

Mexican entities shall file annual income tax returns on a calendar-year basis. Taxes must be calculated and paid in pesos. The return for a given tax year must be filed no later than March 31 of the following year, and the balance of any income tax liability (less estimated tax payments made during the tax year) must also be paid at that time. There is no ability to request an extension on the filing date for annual tax returns.

In addition to filing annual income tax returns, legal entities also are required to file estimated monthly tax returns and make the applicable estimated tax payments for income and VAT purposes. Legal entities must make estimated income tax payments on a monthly basis on the 17th day of each subsequent month.

A Mexican publicly traded company is obligated to complete a tax report of the financial statements if its taxable revenue is MXN876 million (USD43.8 million) or more. If thresholds are not met, filing a tax report is optional.

Tax report shall be filed on May 15 of the following year.

ALTERNATIVE MINIMUM TAX

Not applicable.

TAX HOLIDAYS, RULINGS AND INCENTIVES

Tax holidays

In the past, there have been tax amnesty programs, generally when a new administration takes office. The last available program was in 2013.

Tax rulings

It is possible to obtain a private letter ruling from the Mexican tax authorities (Hacienda) on specific technical tax issues. Generally, private rulings are effective only during the tax year for which they are granted and only apply to the specific taxpayers that requested them.

Tax incentives

As of 2017, there is a tax incentive on research and development (R&D) activities, which consists of a credit of 30 percent for qualifying R&D expenses, aimed at encouraging investment in this area. A tax incentive is applicable to taxpayers that use diesel. There are also incentives for real estate investment trusts (ie, FIBRAS), movies, theater productions and high-performance sports. For 2023, tax incentives to exporters in certain industries are granted with an accelerated depreciation deduction in capital expenditures in certain fixed assets and/or the possibility of applying in the annual tax return of FY2023 to 2025 an additional deduction equal to 25 percent to the increase in training expenses for employees. These industries include:

"*manufacturing or production of electric components, batteries, power cables, plugs, contacts, fuses and accessories for electrical installations, gasoline, hybrid and alternative fuel engines for cars, vans and trucks and electrical and electronic equipment, steering systems, suspension, brakes, transmission systems, seats, interior fittings and stamped metal parts for automobiles, vans, trucks, trains, ships and aircraft.*"

In addition, during 2023, a Decree promoting investment by taxpayers who carry out productive economic activities within the Isthmus of Tehuantepec was granted, consisting of a tax credit equivalent to 100 percent of the income tax triggered in the fiscal year, during the first 3 fiscal years. Th tax credit will then be 50 percent of the income tax in the 3 subsequent years, or up to 90 percent in case the minimum employment levels are exceeded. A tax credit equivalent to 100 percent of the Value Added Tax (VAT) will be paid by taxpayers who carry out within the Isthmus of Tehuantepec the alienation of goods, the provision of independent services or the granting of the use or temporary enjoyment of goods. To persons who carry out productive economic activities within the territory, the tax credit can be applied for 4 years from the entry into force of the Decree. Immediate deduction of 100 percent of the original amount of certain investment of new fixed assets that they use in the Isthmus of Tehuantepec to carry out their productive economic activities is applicable during the first 6 fiscal years.

CONSOLIDATION

A Mexican holding company may obtain an authorization to effectively compute income tax on a consolidated basis (called the integration regime as of 2014), but each company of the group is responsible for filing and paying the tax individually. This option is subject to several rules and limitations, including a recapture of benefits.

PARTICIPATION EXEMPTION

There is no participation exemption for dividends received from, or capital gain recognized on, the stock of foreign subsidiaries.

Mexican companies that own shares of another Mexican entity may receive dividend distributions that should not be subject to further taxes, to the extent the dividends come from the net tax profit account (CUFIN).

CAPITAL GAIN

Under domestic rules, capital gains obtained by Mexican companies are treated as ordinary income and taxed at the regular 30-percent tax rate. Non-residents are subject to a 25-percent tax rate on the gross proceeds, or a 35 percent rate on net gain realized to the extent that certain requirements are met. Capital gains derived from sales of publicly traded shares by individuals or non-Mexican residents are taxed at a rate of 10 percent. To determine the deductible basis for sales of real estate, fixed assets and shares, the law allows for indexation of the original cost for inflation.

DISTRIBUTIONS

Dividends that come from the CUFIN account should not be subject to additional tax at the level of the Mexican entity distributing the dividend. Otherwise, they should be subject to a grossed up tax rate of 42.8 percent.

The Mexican Income Tax Law (MITL) does not provide ordering rules with respect to how CUFIN balances are considered with respect to dividend distributions. However, it is assumed that older balances should be distributed first.

Under the MITL in force until 2013, dividends received by an individual or a foreign shareholder from a Mexican entity were not subject to withholding tax. The 2014 tax reform introduced a new withholding tax of 10 percent on dividends when distributed to a foreign shareholder or an individual. The new rules also broaden the definition of what should be considered a dividend, covering other transactions between the distributing company and its shareholders and/or related parties.

As part of the 2014 tax reform, CUFIN balances must be segregated between pre-2014 and post-2014 Mexican balances in order to determine the potential impact from the 10-percent withholding tax introduced that year.

With respect to post-2014 CUFIN which could be distributed in the future, the domestic 10-percent dividend withholding tax may be reduced to under available income tax treaties entered into by Mexico to the extent that the requirements provided in the treaty and the MITL are met.

For Mexican tax purposes, capital reductions are generally treated as a distribution in exchange for shares. The general purpose of these rules is to treat distributions made in a capital redemption as either a tax-free return of capital or a deemed dividend or distribution of earnings.

LOSS UTILIZATION

Net operating losses can be carried forward 10 years, but no carryback is allowed.

TAX-FREE REORGANIZATIONS

As mentioned before, the transfer of shares in a Mexican company generally constitutes a taxable event. However, in the case of a domestic corporate reorganization, it may be possible to obtain a ruling from Hacienda authorizing the transfer of the shares at tax basis, and thus avoiding a gain on the transfer. This type of ruling is allowed only where the seller is a Mexican resident and the transaction can be carried out with prior approval if the transfer is made in exchange for shares of another Mexican entity. A 2-year holding period requirement and various reporting requirements must be met.

In the case of a group restructuring where the transferor is a foreign resident, it is possible to transfer the shares of a Mexican subsidiary and defer the income tax due until those shares leave the group. However, a ruling (*ie,* GRA) must be issued by Hacienda before the transfer is made, and a notice has to be filed each year informing that the shares remain within the group.

Certain income tax treaties entered into by Mexico provide an exemption for capital gains tax derived from corporate reorganizations. However, there are requirements that should be met in order to qualify for a tax-free reorganization, and procedural fillings must be made with Hacienda before the transaction is carried out.

ANTI-DEFERRAL RULES

Mexican residents (and Mexican PEs of foreign residents) are required to pay income tax on income generated from investments in a jurisdiction with a preferential tax regime. For this purpose, an investment in a preferential tax regime is deemed to exist if the foreign entity is subject to an effective tax rate of less than 75 percent of the Mexican corporate tax rate or if the entity or vehicle is deemed to be fiscally transparent.

As a general rule, a Mexican taxpayer is not subject to income tax on earnings of a foreign subsidiary until the income is distributed. However, when the subsidiary or other investment vehicle is located in a preferential tax jurisdiction, such income must be reported as earned on a current basis, subject to certain exceptions.

Taxpayers are subject to tax on earnings from foreign investments that are generated, directly or indirectly, by foreign entities or legal organizations from foreign sources subject to preferential tax regimes in proportion to their participation in the capital of the entities or legal organizations.

For this purpose, income subject to a preferential tax regime is considered to be income not subject to tax outside Mexico or subject to income tax of less than 75 percent of the applicable income tax that would have been calculated and paid in Mexico. The income subject to this anti-deferral regime includes income in the form of cash, goods and services or credit, as well as any presumed income determined by the tax authorities, even in those instances where the income has not been distributed to the Mexican taxpayer.

In addition, these anti-deferral rules are applicable to income generated directly or indirectly through fiscally transparent entities. For this purpose, foreign entities or organizations are deemed to be fiscally transparent when they are not considered income taxpayers in their country of incorporation or they are treated as residents for tax purposes but the income they generate is taxed not in their hands, but at the level of their members.

There are exceptions to these anti-deferral rules when income from business activities is generated and no more than 20 percent of the income is passive income. The following are deemed to constitute passive income for these purposes: interest income, dividends, royalties and gains from the sale of shares, securities or immovable property; income from the leasing of assets; and gratuitous income when such income is not generated through the carrying on of business activities.

FOREIGN TAX CREDITS

A tax credit is allowed for foreign income tax paid or deemed paid by Mexican corporations, but the credit is generally limited to the amount of Mexican tax incurred on the foreign-source portion of the company's worldwide taxable income.

SPECIAL RULES APPLICABLE TO REAL PROPERTY

There is a state-level property transfer tax (*ie*, *Impuesto sobre Adquiscion de Inmuebles*) that could range from 2 percent to 4.5 percent depending where the property is located, and is generally based on the market value of the property. This tax should be paid by the purchaser and cannot be creditable or offset against other taxes.

TRANSFER PRICING

Mexico has transfer pricing rules. Acceptable transfer pricing methods include the comparable uncontrolled price method, the resale price method, the cost-plus method, the profit-split method, the residual profit-split method and the transactional net-margin method. In certain cases, specific appraisals are used. Transactions between related parties are subject to greater scrutiny, and there are several informative tax returns on related parties transaction that must be filed. It may be possible to reach transfer pricing agreements in advance with Hacienda. These agreements may apply for a period of up to 5 years, such agreements are not available for Maquila regime companies since 2022.

Beginning in 2016, certain Mexican taxpayers must file additional transfer pricing documentation, including a Master File and Country-by-Country reports, as recommended by Action 13 of the Base Erosion and Profit Shifting report.

The 2022 reform included changes in definitions to increase the scope of transfer pricing adjustments; to compare the financial information of similar companies (single year/same year); to include detailed information for capital adjustments; to expand function, risk and asset analysis of the foreign entity; and to clarify the use of the interquartile range.

Interest deductibility rules

Interest deductions may be disallowed under 2 scenarios: in case of the thin cap rule and in case of a net interest in excess of 30 percent of the EBITDA tax.

If the debt-to-equity ratio exceeds 3 to 1 on loans with foreign related parties, the interest triggered by the exceeding proportion of the loan are non-deductible under the thin cap rule. There are some exceptions to these rules, based on the type of activities that would be funded in Mexico.

Net interest against a Mexican taxpayer that exceeds 30 percent of a taxable EBITDA will not be deductible. The first MXP20 million (USD1 million) of annual interest per group is fully deductible. A carry-forward of the non-deductible interest is provided for up to 10 years.

WITHHOLDING TAX

Dividends, royalties, interest, rents, etc.

	Rates (percent) under Domestic Provisions
Paid on Negotiable Instruments	10 (a)(b)
Paid to Banks	10 (a)(c)
Paid to Reinsurance Companies	15 (a)
Paid to Machinery Suppliers	21 (b)
Paid to Others	35 (a)
Royalties	
From Patents and Trademarks	35 (a)
From Know-how and Technical Assistance	25 (a)
From Railroad Cars	5 (a)
Dividends after 2013	10 (d)
Branch Remittance Tax after 2013	10 (d)

(a) This is a final tax applicable to non-residents. Payments to tax havens are generally subject to a 40-percent withholding tax. (b) This rate can be reduced to 4.9 percent if certain requirements are met. (c) A reduced rate of 4.9 percent is granted each year to banks resident in treaty countries. (d) This tax applies to dividends paid out of profits generated after 2013.

Income Tax Treaties

These withholding rates may be reduced to under available Income Tax Treaties entered into by Mexico, and to the extent that the requirements provided in the relevant Income Tax Treaty and the MITL are met.

Service fees

Income received by a foreign resident from rendering services in Mexico may be subject to a 25-percent withholding tax rate under domestic rules. However, income tax treaties may reduce or eliminate this rate under specific circumstances. It is important to consider potential VAT implications.

CAPITAL DUTY, STAMP DUTY AND TRANSFER TAX

There is no capital duty and stamp duty in Mexico. As noted above, there are real estate transfer taxes.

EMPLOYMENT TAXES

Employees must be registered with the Mexican Institute of Social Security (ie, *Instituto Mexicano de Seguro Social*, IMSS), as well as the National Housing Fund (ie, *Fondo Nacional para la Vivienda de los Trabajadores*, INFONAVIT).

This is relevant because Mexican employers are required to make contributions to the IMSS and INFONAVIT based on the salaries of their employees. These contributions are subject to daily salary caps that are determined based on a multiple of the minimum daily salary in the area in which the work is performed.

In this regard, an employee must pay approximately 2.755 percent of their salary to the IMSS (payment to the IMSS includes all social security dues), while an employer must pay a total of 36.69 percent of the employee's salary. Contributions to INFONAVIT are approximately 5 percent, and contributions to a Mandatory Pension Plan are progressive up to 4.241 percent of employee compensation for 2023, and increase at such rate until 2030, amounting to a maximum rate of 11.875 percent.

These contributions are subject to daily salary caps that are determined based on a multiple of the minimum daily salary in the area in which the work is performed.

The contribution percentages are generally applied to an employee's total integrated salary. However, in some cases, the percentage is broken down and applied to only a portion of the salary. There are maximum contributions that are capped for high salaries.

In addition, most states impose a payroll tax of approximately 2 percent of a company's total payroll. There are no caps for the state payroll tax.

Profit sharing

Mexican companies are required, under the Federal Constitution and labor laws, to make mandatory profit-sharing payments to employees equal to 10 percent of the adjusted taxable income of the company. In general terms, the same overall rules are applied in determining the adjusted taxable income for profit sharing as for income tax purposes. Most significantly, profit-sharing rules do not provide for inflationary adjustments or net operating loss carryforwards. Furthermore, exchange gains and losses are recognized as realized rather than an accrual basis. Mexican companies are not required to make profit-sharing payments for the 1st year of existence.

The profit sharing is allowed as a reduction for income tax purposes. The reduction of taxable income, once certain calculations are made, does not fall under deductible expenses. However, since profit sharing is not a tax *per se*, it is not creditable for foreign tax credit purposes, representing a cost to most foreign investors.

- On April 23, 2021, amendments to the Federal Labor Law (*Ley federal del Trabajo*), the Social Security Law (*Ley del Seguro Social*), the Employee Housing Fund Law (*Ley del Instituto del Fondo Nacional de la Vivienda para los Trabajadores*), the Mexican Tax Code (*Código Fiscal de la Federación*), the MITL and the VAT Law in order to regulate outsourcing was published in the Federal Official Gazette, which came into effect of April 24, 2021.

- It prohibits the subcontracting of personnel (ie, outsourcing), which is defined as an arrangement in which an individual or entity provides or makes its own employees available for the benefit of another.

- Subcontracting of personnel for rendering specialized services or to execute specialized works that are not part of the main corporate purpose (ie, core business) or main economic activity of the beneficiary of the services or works (ie, the customer) is permitted, provided that the provider entity is duly registered as provider of specialized services or works with the STPS.

Although the Federal Labor Law establishes penalties in case of breach of the abovementioned provisions, in accordance with the amendments to the Mexican Tax Code, the invoices derived from the outsourcing of services in order to carry out activities forming part of the main corporate purpose or economic activities of the beneficiary will not be deductible for income tax purposes and not creditable for VAT purposes by the customers of such services.

OTHER TAX CONSIDERATIONS

Not applicable for this jurisdiction.

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