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MEXICO

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Chapter 7

Tax Law

Introduction

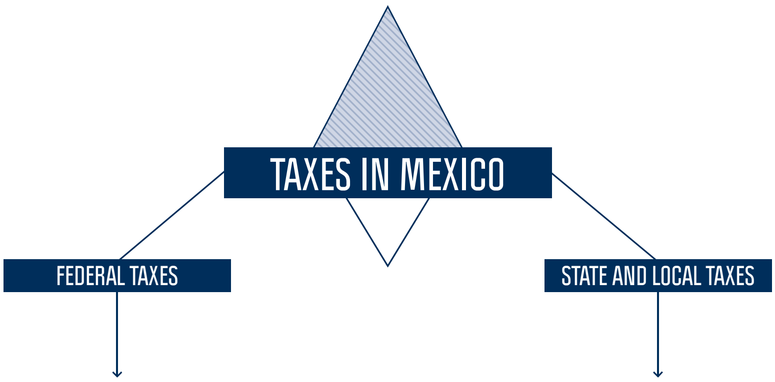
The Mexican State is a federation made up of 31 states and a Federal District. The municipality is the territorial, administrative, and political division of each state. The Mexican tax code provides for three levels of government taxation: federal, state, and local.

As a result of the divisions between different levels of government, federal taxation is the primary level of taxation and consists of the Federal Income Tax (ISR), a Revenue Flat Tax (IETU), and a Value Added Tax (IVA). State taxes basically consist of a Payroll Tax, Property Tax, and a Real Estate Acquisition Tax, amongst others. The collection of tax revenue for drinking water, drainage, sewage, street lighting, etc. is reserved to local governments by the Mexican Constitution.

The body in charge of calculating and collecting federal income tax is the Tax Administration Service (SAT), while state and local taxes are calculated and collected by their respective treasuries. It is important to keep in mind, however, that there are tax coordination agreements between the federal and state governments, and therefore the states are entitled to audit and collect federal taxes.

KEY POINTS

- Federal Income Tax is levied on the income of individuals and corporations. Payment is made annually, and interim monthly statements are sent to the taxpayer.
- The Revenue Flat Tax is levied on revenue, and calculated in conjunction with the Federal Income Tax. The taxpayer pays the higher of the two taxes.
- The Value Added Tax is levied whenever a person or entity performs any of the following activities within Mexican territory: (a) sells goods or real estate; (b) renders independent services; (c) grants temporary use or benefits over goods or real estate; or (d) imports goods or services.
- Main state taxes include: property taxes, which are levied upon land and attached buildings, and payroll taxes, which are levied upon salaries or wages.



- **Income Tax:** Corporations - 30%, Individuals – between 1.92% and 30%.
- **Revenue Flat Tax:** 17.5%.
- **VAT:** exempt, 0%, 11% and 16%.
- **Tax on Cash Deposits:** 3%.
- **Special Tax on Production and Services:** variable rate between 3% and 160%.

- **Payroll Taxes:** between 2% and 2.5%.
- **Property Tax:** rates vary depending on the value of the property.
- **Real Estate Acquisition Tax:** progressive rates up to 4.5%.

QUESTIONS AND ANSWERS

1. Does the Mexican government provide tax benefits?
   Yes. The tax code provides benefits such as immediate deductions for investment, the hiring of people with disabilities, and investment in real estate developments, amongst others.

2. Do taxpayers have to pay both Federal Income Tax and the Revenue Flat Tax?
   Yes. However, the payable flat tax is the difference between the amount of this tax and the amount of income tax that has already been withheld. The flat tax is only paid when the amount of the income tax is less than the flat tax amount. For example if the flat tax is calculated at $500 and the withheld income tax is $500, then the taxpayer pays $0. If the flat tax is calculated at $500 and the withheld income tax is $400, then taxpayer must pay $100. Likewise, if the withheld income tax is greater than the flat tax, then the flat tax is not paid.

3. Are transactions carried out by related parties subject to certain requirements?
   In some cases, it is mandatory to carry out a transfer pricing analysis. In all cases, parties should determine the value of their deductions and revenue as if the transactions were being carried out by independent parties.

4. Are there mechanisms in Mexico to avoid double taxation?
   Yes. Mexico provides a credit for income taxes paid abroad, and has also concluded a number of international treaties to avoid double taxation. The majority of these treaties have adopted the OECD Model Tax Convention.

5. Can you recover VAT paid in Mexico?
   Yes. Taxpayers who generate a VAT can receive refunds on the VAT they have paid in Mexico, in accordance with certain rules.

CASE STUDY

"Company A" which is located in Mexico will distribute dividends to "Shareholder B," who is a resident of "Country X." Thereafter, "Shareholder B" intends to sell his shares in "Company A" to "C." Finally, "C" who is also a resident of "Country X," wants to market machinery in Mexico which originates from "Country X," and employs one worker for such ends.

a) Are dividends distributed to "Shareholder B" by "Company A" taxable?
The dividends are not subject to withholding and will not be subject to a corporate capital gains tax if income tax (ISR) has already been paid on the dividends in Mexico.

b) Does "Shareholder B" have to pay income tax, flat tax, or value added tax on the sale of shares of "Company A"?
The income tax code requires that taxes be paid upon the sale of shares, however, there are some treaties that have been entered into which offer relief from double taxation, and establish benefits such as the reduction or exemption from payment of income taxes for non-residents. The sale of shares is exempt from VAT and IETU taxation.

c) Do the activities performed by the employee of "C" create a permanent establishment in Mexico?
No, so long as the employee does not have the authority to enter into contracts in the name of or on behalf of "C" with the intention of conducting business for "C" in Mexico.