UHY

DOING BUSINESS

IN MEXICO

The network for doing business

CONTENTS

1 – INTRODUCTION

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in around 90 countries throughout the world.

Business partners work together through the network to conduct transnational operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Mexico has been provided by the office of UHY representatives:

UHY GLASSMAN ESQUIVEL Y CÍA S.C.
Av. Paseo de la Reforma No.
195 Piso 17
Col. Cuauhtemoc Delegacion.
Cuauhtemoc Mexico D.F.
C.P. 06500

Phone	+52 55 55661888
Website	www.uhy-mx.com
Email	contacto@uhy-mx.com

You are welcome to contact Oscar Gutierrez Esquivel (oge@uhy-mx.com) for any inquiries you may have.

A detailed firm profile for UHY's representation in Mexico can be found in section 8.

Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current at April 2016.

We look forward to helping you do business in Mexico.

2 – BUSINESS ENVIRONMENT

The official name of the country is the United Mexican States. It is the 14th largest country in the world with an area of 1,964,375 square kilometres (755,106 square miles), an area about the same as the whole of Western Europe. It borders to the north with the US (3,141 kms.) and to the south with Guatemala (962 kms.) and Belize (250 kms.). Its exclusive economic zone of territorial sea covers 3,149,920 square kilometres

As of 2014, Mexico's population was 120.3 million inhabitants, with a 1.4% annual growth rate. It is the 11th most populated country in the world, with 77% of its population living in urban areas. According to projections, by 2030 Mexico's population will peak at approximately 135 million.

The country's currency is the Mexican Peso (MXN) and the national language is Spanish.

POLITICAL AND LEGAL SYSTEM

Mexico is a Federal Republic and its political system stems from the 1917 Political Constitution. It is divided into 31 States and Mexico City, the country's political capital. Constitutional changes require approval by a qualified majority (two-thirds plus one) in both Houses of Congress and by a simple majority of State legislatures (at least 17).

The political structure is divided into an executive branch, a bicameral legislative branch and a judicial branch.

EXECUTIVE

The Executive is headed by the president, who is solely responsible for the appointment of its secretaries (equivalent to ministers), with the exception of the Secretary of Finance and the Attorney General whom must also be confirmed by the Senate.

The central public administration is formed by the Office of the President, 22 Secretaries and the Attorney General's office, which directly depend on the President. Public enterprises, such as PEMEX (oil company) and CFE (electricity company) are formally under the supervision of a corresponding Secretary (for example, the Secretary of Energy), although the President appoints their CEOs.

Presidential elections are held every six years and there is no possibility for re-election. President Enrique Peña Nieto from the Institutional Revolutionary Party (Partido Revolucionario Institucional–PRI) will be in office until November 2018.

LEGISLATURE

The Legislative branch or National Congress is divided into the Senate (upper house) and the Chamber of Deputies (lower house). The Senate has 128 seats with terms lasting for six years, while the lower house is made up of 500 representatives with a three-year term. As of 2018, Deputies will be able to run for re-election and Senators as of 2024.

The National Congress' current composition is as follows:

- Senate (2012–2018)
  - Partido Acción Nacional (PAN): 38 seats
  - Partido Revolucionario Institucional (PRI): 52 seats
  - Partido de la Revolución Democrática (PRD): 22 seats
  - Partido Verde Ecologista de México (PVEM): 9seats
  - Other smaller parties: seven seats

- Lower House (2015–2018)
  - Partido Revolucionario Institucional (PRI): 208 seats
  - Partido Acción Nacional (PAN): 109 seats
  - Partido de la Revolución Democrática (PRD): 60 seats
  - Partido Verde Ecologista de México (PVEM): 42 seats
  - Movimiento de Regeneración Nacional (Morena): 35 seats
  - Other smaller parties & independent representatives: 46 seats

Since 1997, no single party has had an absolute majority in either House, thus creating the need for lengthy and, at times, difficult negotiations between the main parties and between the National Congress and the Executive.

The annual approval of the federal budget is governed by the Federal Budget and Fiscal Responsibility Law which mandates for a balanced budget (with some exceptions). The budget process states that the revenue side (Revenues Law) has first to be approved by both Houses, followed by the expenditure side which is the sole responsibility of the Lower House.

JUDICIARY

Mexico's legal system has its roots in the Napoleonic Code and it is divided into federal and state systems, each with its own Codes and procedures. Therefore, some legislation applies to all States (federal laws), while some matters are exclusive to the States (local laws).

The Supreme Court of Justice is the highest authority and concentrates mostly (though not exclusively) in constitutional matters. It is formed by 11 ministers with spaced-out terms. They are nominated by the Executive and need to be ratified by the Senate.

POLITICAL PARTIES AND NATIONAL ELECTIONS

There currently are eight registered national political parties, even though the four largest hold most of the elected posts both at the federal and state levels.

The four main parties are:

- Partido Revolucionario Institutional (PRI)
  - Left-of-centre party which held the presidency for 72 years until 2000, and returned to the presidency in December 2012. At present, it holds 19 state governorships (out of 32).
- Partido Accion Nacional (PAN)
  - Right-of-centre party which held the presidency from December 2000 until November 2012 and has six state governorships.
- Partido de la Revolución Democratica (PRD)
  - A leftist party holding three state governorships and the capital, Mexico City.
- Movimiento de Regeneración Nacional (Morena)
  - A populist-left party breakaway from the PRD which took part in its first election in 2015, with no state governorships.

In addition, coalitions (PAN-PRD) head four state governorships.

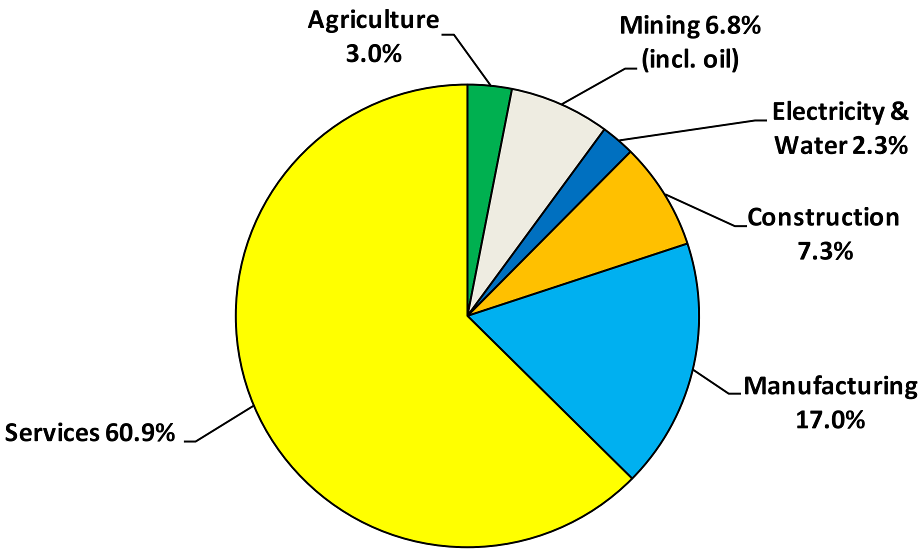
The other smaller parties are:
- Partido Verde Ecologista de México (PVEM) – 'Green Party'
- Partido del Trabajo (PT)
- Partido Nueva Alianza (PANAL)
- Partido Movimiento Ciudadano (MC)
- Movimiento de Regeneración Nacional (Morena)
- Partido Encuentro Social (PES)

In the June 2015 federal elections, there were several alliances between different parties and, for the first time, Mexican electoral law allowed the running of independent candidates. One governorship (Nuevo León), one Lower House seat and several municipalities were won by independent candidates.

ECONOMIC STRUCTURE

According to the World Bank, in 2014 Mexico's economy was the 15^{th} largest in the world measured in current dollars and the 11^{th} in PPP dollars. Gross domestic product (GDP) amounted to USD 1,294.7 billion (current dollars) and USD 2,145.1 billion in terms of purchasing power parity (PPP). Per capita income was USD 18,500 per annum in PPP dollars.

In 2015, the country's GDP structure was:



Broadly speaking, in regional terms northern states concentrate on manufacturing, the central region on manufacturing and services, and the southern region on agricultural activities.

The oil industry is mainly concentrated in the southern region and along the Gulf of Mexico coast. It should be noted that, contrary to widespread belief, the oil industry only accounts for around 6% of Mexico's GDP. Its main importance is for the government's finances, representing, on average, 33.8% of total government revenues in 2000-2010; however, due to the oil price collapse and the 2014 fiscal reform, in 2015 they fell to 18.6% of total government revenues.

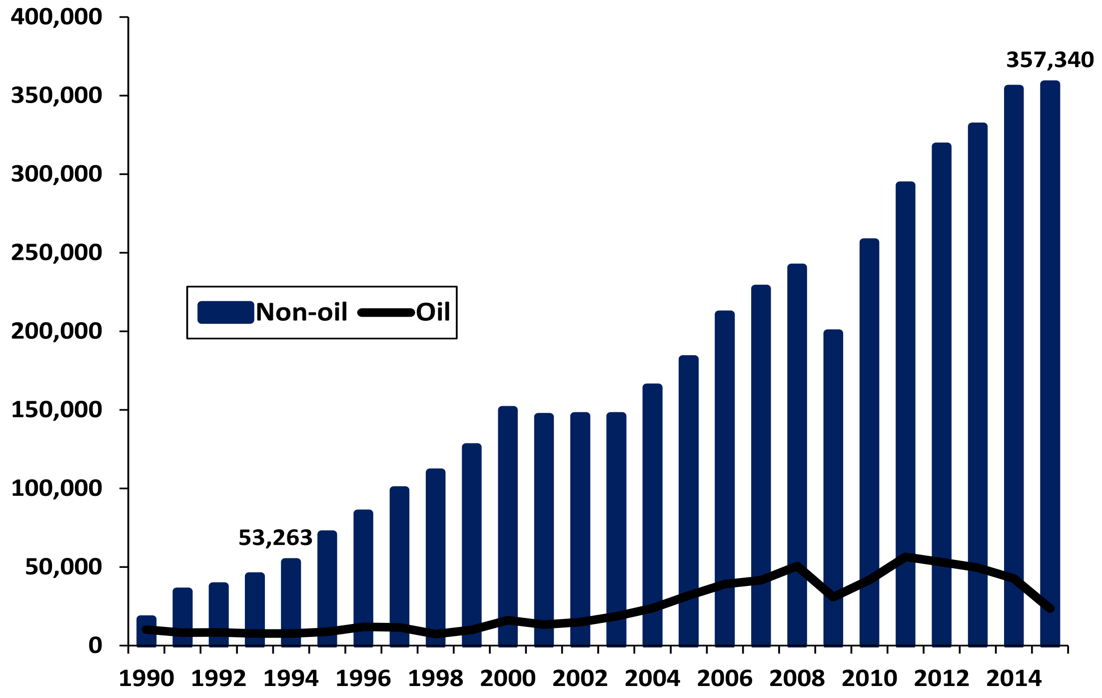
Since the mid-1980s, Mexico began an aggressive foreign trade liberalisation policy, both removing non-tariff barriers and substantially reducing import duties. This policy has been complemented with a large raft of Free Trade/Preferential Trade Agreements. At present, Mexico has 15 such Agreements covering 46 countries, including NAFTA, the European Union, EFTA, Japan and with most of the Latin American countries representing approximately 60% of the world's GDP. In addition, Mexico is one of the 12 members of the recently signed Trans-pacific Partnership (TPP) that will create the world's largest trading bloc.

The trade liberalisation policy has led Mexico to being the 12th largest exporter in the world and the biggest in Latin America. Moreover, 89.3% of Mexican exports are manufactured goods and only 10.7% are commodity-related (mining, oil and agricultural products), while Latin America's average for commodity-related exports stands at 53.9%.

Although 62% of Mexico's exports go to its NAFTA partners, in the past 10 years its fastest growing markets have been Latin America, the European Union and Japan with an annual average growth rate of 11.0%, 8.8% and 8.6% respectively (vs. 6.4% for NAFTA countries). Currently, Mexico is the second largest trade partner of the US (behind China) and the third largest trade partner of Canada (after the US and China).

TABLE 1

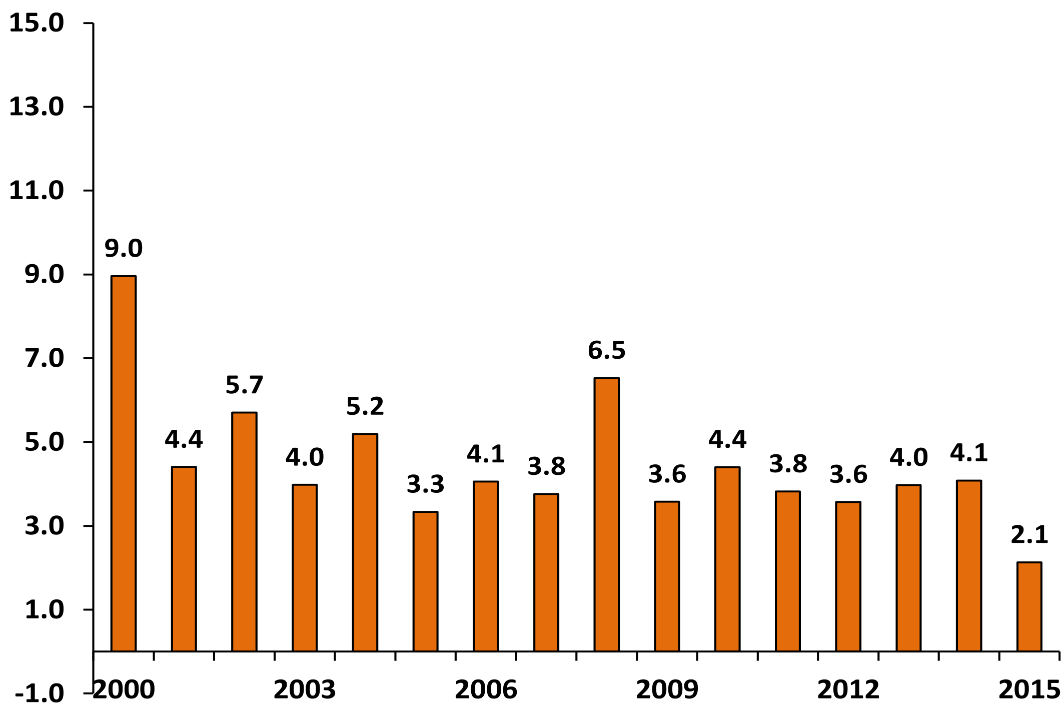
Mexico: Oil and non-oil exports, 1990-2015 (USD million)



Another important development has been the consolidation of macroeconomic stability over the past 15 years with single-digit inflation figures. In fact, in 2015 Mexico registered its lowest inflation on record at 2.1%. This stability has been achieved through a combination of fiscal (low government deficit) and monetary discipline (an independent Central Bank).

TABLE 2

Mexico: Annual inflation rate (%)



This macroeconomic stability has led to a gradual, but consistent, recovery of the domestic market supported by an improvement in real wages and steady credit growth. In 2015, new bank lending increased 8.3% in real terms, after a rise of 4.2% in the previous year.

ENERGY SECTOR

In 2014 the Mexican Congress approved a Constitutional reform which ended 76 years of a government's monopoly in the oil and gas sector and 52 years in the electricity industry. This so-called Energy Reform allows for private investment participation in these sectors to both, complement and compete, with the state owned companies (PEMEX and C.F.E.) that have run these sectors.

The Reform's main points are:

1. The Oil & Gas industry is no longer considered a "strategic activity of the State" in the Constitution, therefore, private investment is allowed in both upstream and downstream activities.

2. Although hydrocarbon resources in the subsoil continue to be property of the State, once they are extracted private ownership is allowed.
3. Contracts for upstream activities can be of the following types:
   - Pure service
   - Profit-sharing
   - Production-sharing
   - Licences (which will operate like concessions)
   - Any combination of the above
4. Private investment is allowed in midstream and downstream operations (natural gas processing, oil refining and transportation, storage and distribution)
5. In the electricity sector, power generation and retail distribution is no longer deemed a public service, therefore private investment is allowed.

BUSINESS ENVIRONMENT

Trade liberalisation, an extensive Free Trade Agreements network and the increasing exposure to the world economy have led Mexico to increasingly embrace international standards and regulations in most areas of economic activity. In addition, Mexican authorities have pursued an active de-regulation policy and require that any new government legislation complies with a 'regulatory and competition impact' assessment.

These measures have led to a substantial improvement in general business conditions and ease of doing business in Mexico. According to the latest Doing Business 2015 publication by the World Bank, Mexico ranked 53 (out of 183 countries) in the overall 'Ease of Doing Business Index', a considerably higher position than other BRIC countries (Brazil, Russia, India and China).

See Table 2.

TABLE 2

Ease of Doing Business rankings (183 countries), Source: Doing Business 2015, World Bank

	BRAZIL	RUSIA	INDIA	CHINA	MEXICO
Ease of doing business [1]	**116**	**92**	**134**	**96**	**53**
Starting a business [2]	123	88	179	158	48
Getting credit [3]	109	109	28	73	42
Trading across borders [4]	124	157	132	74	59
Paying taxes [5]	159	56	158	120	118
Protecting investors [6]	80	115	34	98	68

1 –Average of the economies' rankings in the ten topics covered by the study.
2 – Procedures (number), time (days), cost (% of income per capita), minimum capital
3 – Strength of legal rights, depth of credit information.
4 – Documents to export/import (number), time to export/import (days), cost to export/import.
5 – Taxes and contributions for a middle-sized company, administrative burden.
6 – Extent of disclosure and director liability, ease of shareholder suits.

SOCIETY/CULTURE

LANGUAGE

Spanish is the official language of Mexico and business meetings are usually held in this language. However, English is quite well-accepted and spoken in business circles. Therefore it is likely that business hosts will have no problem communicating in English. Nevertheless, it is recommended that before any meeting takes place, participants make it clear in which language the meeting will be conducted.

While Mexican hosts are likely to adapt to the language needs of visitors, it is advisable for visitors to learn some Spanish if making several business trips to Mexico. Any attempt to communicate in Spanish will be greatly appreciated and considered as a sign of interest and respect.

All marketing literature, production manuals, warranty information and other relevant material used in official documents must be in Spanish. It is also advisable to have information available in Spanish for business partners to show a serious intention of doing business in Mexico.

DRESS CODE

Mexicans tend to dress formally during business meetings. In large cities (Mexico City, Monterrey, Guadalajara, etc) they usually wear a suit and tie, and expect business partners to do the same.

However, in regions with hot weather, such as coastal cities, or in the southern part of the country (eg. Puerto Vallarta, Cancun, Villahermosa, Merida), business meetings can be attended wearing casual clothing and a jacket and tie are often not required.

NAMES AND TITLES

In Mexico, people use their given name and the surnames of both father and mother. It is also common for people to have two given names and in written form, all names are commonly used. When speaking, only the first and last names tend to be used, so for example, Ana Maria Vazquez Laredo may be addressed as Maria Vazquez or Ms. Vazquez.

Titles are important in Mexico, since they symbolise status. Professionals with a degree-level education are known by their relevant title as lawyers, engineers, doctors, etc. Business cards usually show if someone has such a title.

SCHEDULING MEETINGS

When scheduling a business meeting, visitors should be aware of the very different concepts of time across Mexico. In the main cities, people tend to be on time for meetings, particularly in the northern region (Monterrey). In other important cities (Mexico City, Guadalajara, Chihuahua), a 10–15 minute delay is acceptable (due to traffic, parking etc), though generally timeliness shows respect to the hosts. An exception is when meeting with government officials, where a considerable waiting time can be expected.

In medium-sized cities and particularly in coastal areas, the time of any meeting should be double-checked, as people tend to have a more ‘easy-going’ attitude. For example, a meeting scheduled at 5pm might easily start at 6pm.

It is also common to hold business meetings during lunch or dinner, so a long lunch/dinner appointment is not unusual. It is advisable to accept such invitations which provide the opportunity for a more personal relationship to develop in a more relaxed environment.

BUSINESS WOMEN

A formal handshake is appropriate, although women also kiss on the cheek when greeting and taking leave of someone. In general, in Mexico physical contact is important, and not just to say 'hello, nice to meet you'.

The attitude towards women executives is first-rate. Businesswomen are cosmopolitan, professional and respected. A woman looking to establish a business in Mexico, whether on their own or as part of an organisation, will be easily accepted and treated with courtesy and professionalism by most business people.

NEGOTIATIONS

When doing business in Mexico, it is important to remember that it can be critical to make friends with Mexicans. In general, Mexicans make friends first and then do business, rather than the opposite way round. Not taking the time to develop a relationship of trust will hinder the possibility for a long-term business relationship, so business people should initially focus on building relationships.

A meeting should begin with a brief casual talk. Family is very important in Mexico, so a brief enquiry about the wellbeing of a host's family is common practice. Other conversation topics to break the ice may be previous visits to the country (if any), the country's natural beauty (whether known about or not experienced) or the weather. Business deals are rarely concluded over the telephone, since eye-contact and personal acquaintance are essential for doing business in Mexico.

3 – FOREIGN INVESTMENT

In line with trade liberalisation, foreign direct investment (FDI) has been substantially liberalised over the past 20 years.

Foreign Investment is restricted in only a handful of areas, most notably, media, nuclear energy, radioactive minerals and air transportation. Furthermore, there are no controls whatsoever (neither administrative nor special taxes) on capital flows, including profits' repatriation and royalties' payments.

Foreign companies investing in Mexico are only required to notify the National Foreign Investment Registry (RGNI) of their operations for statistical purposes.

With the Sector Promotion Programmes and the In-bond for Export Programme (commonly known as the 'Maquiladora Programme'), registered companies benefit from special benefits on customs, local taxes and import duties.

As mentioned, 2014 Energy Reform Law has opened up upstream and downstream operations to private investment (both local and foreign) either in association with the State oil company, PEMEX, or on their own. This opening is being carried out on a gradual basis through the auctioning of different oil producing sites and exploration areas.

In 2015 there were three rounds of such auctions for 44 fields and exploration areas in shallow waters and on-shore with the result being 30 fields allocated to private companies, both Mexican and foreign. It is estimated that FDI from these already assigned fields will reach US$10 billion over the next five years and that will significantly increase over the medium term as international oil prices start rising.

In addition to provisions for investors' protection included in the different Free Trade Agreements, Mexico has also signed Reciprocal Investment Promotion and Protection Agreements with more than 30 countries.

EVOLUTION OF FDI

Traditionally, FDI has come mainly from the United States and has been concentrated in the manufacturing sector. However, over the past fifteen years there have been important changes both in terms of the countries of origin and in the sectors of destination for investment.

The importance of the US has gradually diminished, while that of countries such as Spain and the Netherlands has risen, and the removal of restrictions has led to important FDI flows to sectors such as the financial industry (banks, insurance companies and brokerage houses) and retail trade (large international chains).

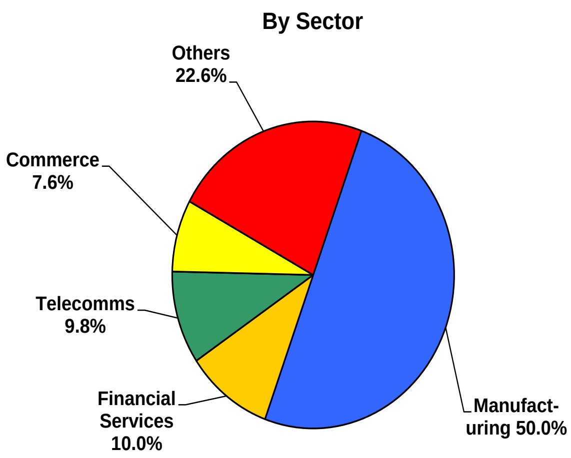
More recently, new sectors have benefited from substantial FDI inflows, like the aeronautical industry and information technology, where important 'clusters' have been developed in different parts of the country.

During the period 2010–2015, Mexico received an accumulated amount of USD 169,453 million dollars in FDI, averaging USD 28,242 million per year.

In 2015, total FDI in Mexico reached 28,382 million dollars, with the manufacturing industry accounting for 50.0% of total FDI, financial services 10.0%, telecoms 9.8%, and commerce and retail 7.6%. By country of origin, the U.S. had the biggest share (53.1%), Spain (9.6%), Japan (4.7%), and Germany (4.3%).

TABLE 3

Foreign Direct Investment by Country and Sector, 2015



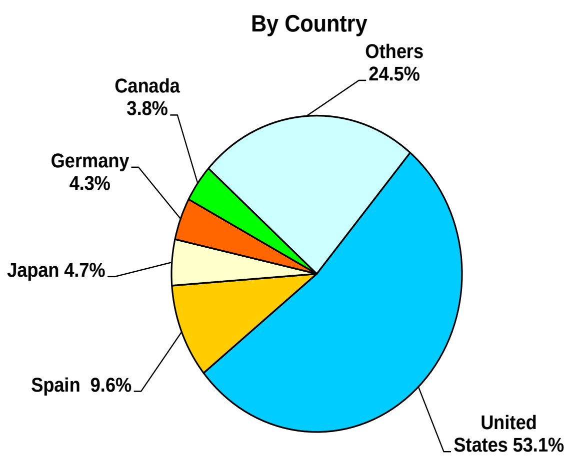
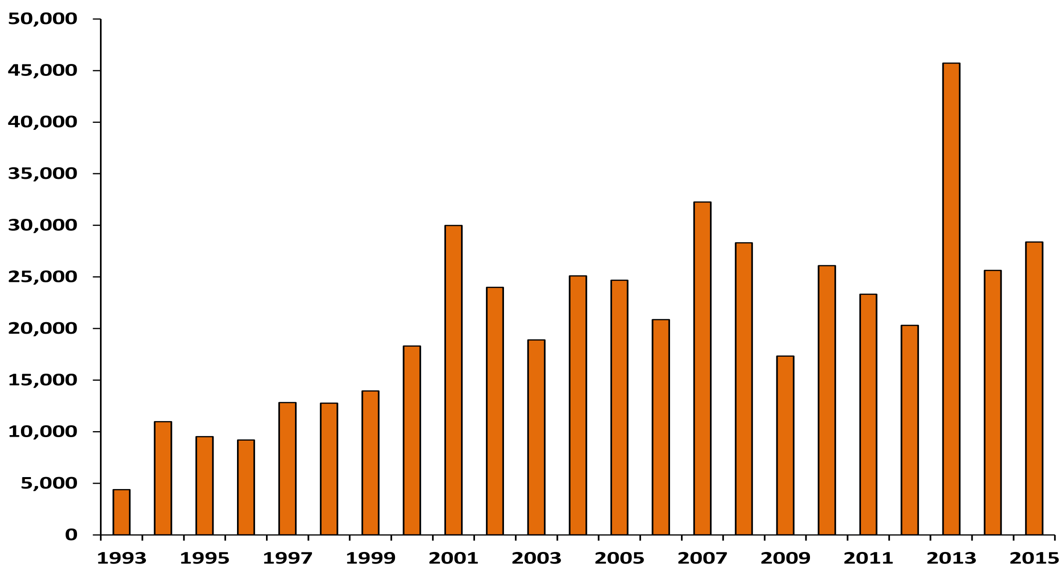


TABLE 4

Mexico: Foreign Direct Investment, 2000–2015 (US$ millions)



4 – SETTING UP A BUSINESS

As a very open economy to trade and investment, Mexico has a vast experience with foreign companies operating in its territory and offers a reliable institutional and legal framework for their operations.

The following section aims to provide basic guidelines for companies starting business in Mexico. These are general guidelines and their particular application depends on several factors, special laws and business activities.

Mexican laws are mostly federal in nature; therefore this guide is applicable to virtually any state of Mexico and represents what can be done without any special permission or authorisation in the different states.

FOREIGN INVESTMENT RESTRICTIONS

The current law on foreign investment dates from 1993 and mainly specifies the sectors and activities where any types of restriction exist. All sectors and activities not specifically singled out by law are fully open to foreign investors.

The Foreign Investment Law states that the following areas are reserved exclusively for the state:

- Generation of nuclear energy
- Radioactive minerals
- Wireless transmissions
- Postal service
- Note issuing and coining
- Airports, heliports, ports, and railroads control and supervision.

Some economic activities are reserved exclusively for Mexican individuals or companies and others allow for limited foreign investment. The Certificate of Incorporation of a company includes an article referring to the exclusion of foreigners as shareholders if the company is engaged in the following activities:

- Domestic land passenger transportation, tourism and freight, except parcel and courier services
- Sale and distribution of retail petrol
- Liquefied gas distribution
- TV and radio broadcasting, except cable television
- Credit unions
- Development banking.

However, the Foreign Investment Law allows foreigners to have 'neutral investment' in these companies and activities. This investment gives equal rights to profits and dividends, but prohibits foreign investors the right to vote on the board of directors and to have control of the companies. The Law also restricts foreign investment in some activities and companies to the following maximum percentages:

- Production co-operatives – 10%
- Domestic air transportation, taxi and specialised transport – 25%

- Insurance and bonds companies, exchange offices, business retirement funds, investments trusts and other companies – variable %
- 'T' series shares in companies which have arable and forest lands – 49%
- Freshwater, coastal, deep-sea fishing, except fish farms – 49%
- Printing and issuing of national newspapers – 49%
- Port management – 49%
- Manufacture of and trading in firearms and explosives – 49%.

Foreigners may have more than a 49% stake in the following activities, but must have the approval of the National Foreign Investment Commission:

- Legal services
- Credit offices
- Brokerage houses
- Pipeline manufacturing for gas, oil and products, and transportation (except duct construction, operation and ownership); natural gas transportation, facilities and equipment for its distribution
- Oil and gas-well drilling
- Railway construction and management
- Port services, such as tugging and docking
- Shipping companies
- Airports management
- Mobile phone services
- Private schools and universities.

Except for the limitations stated above, foreigners can own up to 100% of Mexican companies without any licence from the Mexican government. Moreover, investment in manufacturing, assembling or merchandise processing companies for exporting purposes, does not need any licence. All Mexican companies which have foreign-owned capital must be in the National Register of Foreign Investments. No conditions apply to this register, except the aforementioned ownership restrictions. Each year the register is renewed by an annual financial report.

PROPERTY

In general, there are no restrictions on foreign ownership of Mexican property. However, in coastal or border areas, foreigners can own property for non-residential purposes only if such property is acquired through the ownership of the equity interests in Mexican companies. The National Commission of Foreign Investment must be notified of such acquisitions.

ESTABLISHING A BUSINESS IN MEXICO

ADVANTAGES

As mentioned, Mexico has more than 16 free trade agreements with 48 countries including NAFTA (North American Free Trade North America) and the European Union, and consequently companies incorporated in Mexico enjoy the benefits of such treaties, which provide foreign companies the same treatment as a domestic investor.

BUSINESS CONSTITUTION

The establishment of a business as a legal entity is not a legal requirement. What makes this an important step, is the protection this provides for the personal assets of shareholders, because there are always risks in starting a business.

AN OUTLINE FOR FOREIGN COMPANIES IN MEXICO

The type of activity, form of administration and policies dictate the makeup of any company. Each company is therefore unique and market entry strategies must be tailored to suit each business.

Establishing a business focuses more on these three aspects than on legal requirements, but the most common ways of incorporating a company in Mexico are the following:

- Investing foreign capital in Mexican companies via:
  - Creation of a legal Mexican entity.
  - Acquisition of a Mexican company.
  - Merging with a Mexican company.

Under any one of the above, the most common legal form used in Mexico for establishing a company is a corporation, more particularly the stock company and the limited liability company.

TYPES OF ORGANISATION

STOCK COMPANY

This form of company is the most popular. The minimum share capital required is the one the shareholders considered. The amount cannot be decreased (in order to provide a guarantee to the various creditors of the company) and can be administered through a sole administrator or under a board of directors.

This type of company is required to keep four types of record:

- Minutes of the board of directors
- Meeting minutes
- Register of shareholders
- Capital changes.

Books are commonly managed and safeguarded by the lawyer for the company.

This is the only form of incorporation in which social capital is represented by common stock, depending on the social contract, and it provides various rights to its shareholders.
It can be used by any commercial company and capital increases or decreases do not require a formal motion, only a resolution to be passed at a shareholders meeting.

Usually foreign companies prefer to invest in Mexico as corporations and not as individuals. This generates tax benefits in their respective countries of origin. However, the Mexican Commercial Law makes it mandatory to have at least two individual shareholders. (This means there could be just two shareholders, one with 99% of the company and the other with 1%.)

The entities which make up any company are the shareholders (or investors) and the board of administration (often known as the management board). The first group resolves the way in which the company shall be managed. But it is advisable for those who will run the company to be on the board of directors. This is more than an honorary designation, imposing obligations and accountability for the running of the company.

The governing council is formed by at least two members –the president and secretary. The first proposes and establishes the key policy directives and the second executes directives and gives legal form to the resolutions. However, the board of directors may consist of an unlimited number of staff and may have as many nominations as the society requires, for example the positions of vice president, deputy secretary, members, legal representative, treasurer, director, etc.

LIMITED LIABILITY COMPANY (LLC)

This is a form of company often preferred by foreign companies in Mexico because of its similarity to institutions in their countries of origin. The minimum risk to guarantee the payment to various creditors is the amount the parties consider. The LLC can be administered by a sole administrator or a board of directors. With this type of company, the social capital is not represented by shares with free movement, but by parts which are not entitlements.

PARTNERSHIP

This type of company is becoming less popular, mainly because taxes are applied to the individuals and because the individual assets of partners are at risk. It does not require a minimum social capital and can be administered by a sole administrator or a board of directors.

BRANCHES

The opening of a foreign branch is advisable when a company wishes to do business with no income or income from Mexico. However, it is applicable only where the structure of ‘corporate governance’ and shareholders retain the same designation and distribution as abroad. In this case, registration with the National Commission on Foreign Investment is needed to obtain the necessary permission.

REPRESENTATION OFFICES

Representative offices are largely similar to branches, but have a different tax treatment, especially in the case of foreign banks where this is a legal imperative. With this type of organisation, companies must apply for a Tax Identification registration.

JOINT VENTURES

When investors have no prior knowledge of the country and its market, the risks of investing are often a major concern for foreign companies. In some cases, foreign investors therefore choose to use alternatives which reduce the risk, such as buying a Mexican society which has been duly constituted and has some experience and a track record in the local market. Or investors can enter into a joint venture with a local company.

There are two ways of establishing a joint enterprise –strategic alliances and joint ventures.

The strategic alliance does not require that the parties invest liquid resources in the business. However, companies are able to take advantage of benefits such as the use of infrastructure, establishment of branches without investment, the reduction of costs, and agreements to provide contracts and/or exclusive distribution etc. In the case of a joint venture, both companies invest a sum of money which is agreed upon to start the new business. A contract then sets out the way this business will be administered, the profit and dividend distribution, rights and obligations.

DOING BUSINESS IN MEXICO

DISTRIBUTION CONTRACTS

This form of entering the Mexican market does not involve direct investment of foreign companies and in some cases simplifies the sale of products. However, it involves a broker who keeps a significant portion of the profits. An advantage of distribution contracts is that, in many cases, dealers already have a network of customers. This allows distributors to facilitate contact with customers/consumers, which for a foreign company with no previous experience in the country would be difficult and may take some considerable time to achieve.

DISPUTE PREVENTION

Disputes which may arise can be diverse. The laws in Mexico are mostly federal, which fosters a favourable environment to prevent possible litigation. Attorneys should be contacted for information on corporate legal issues in various areas such as labour, trade, relations between partners and government procurement etc.

MANAGING COMPANIES WITH FOREIGN CAPITAL

The Foreign Investment Law allows foreign investors to establish their businesses in Mexico with up to 100% of the capital as foreign capital. However, there are specific regulatory requirements, particularly in relation to providing information to the Ministry of Economy. Some of the most common requirements are:

- Annual registration with the National Registry of Foreign Investment
- Notification of any change in the shareholders structure
- A quarterly income report
- Notification of any merger or division of the company
- Notification of changes to name or address
- Notification of any change in legal obligations, representatives etc. (in the case of branches and representative offices)
- Presentation of financial statements (in the case of branches and representative offices).

FOREIGN FRANCHISES

Currently, many foreign companies have found franchises to be the best way to become involved in business in Mexico and to distribute their products or offer services. This is because franchisees can have a better knowledge of the local market.

Corporate lawyers at UHY in Mexico are duly authorised to support foreign companies wishing to establish franchises, including management and financial consulting. For more information contact our specialists.

5 – LABOUR

Mexico's Federal Labour Law addresses employment relationships, their duration, and suspension of the effects of labour relations, lay-offs and termination of employment.

The law also establishes the length of working hours, rest days, holidays, remuneration rules and the right of workers to share in company profits.

The following section is a summary of the main items of general interest.

Labour inspectors regularly enforce numerous detailed requirements covering such matters as record-keeping and payment of overtime and benefits. Therefore, it is essential that the personnel department of any company is sufficiently knowledgeable about labour laws to deal with these matters.

WORK RELATIONSHIP

A work relationship is deemed to exist, regardless of whether there is a formal contract, whenever an individual receives a regular payment for their services.

INDIVIDUAL EMPLOYMENT CONTRACT

An individual employment contract is required whenever there are no an applicable collective agreements. At least one copy should be held by each party.

TERMINATION OF LABOUR RELATIONS

The worker or the employer may terminate the relationship at any time because of a justified cause, without incurring liability. Justified causes include a lack of integrity and honesty, aggression towards co-workers, the committing of serious acts against supervisors, their families or representatives, intentional damage to machinery or work equipment, immoral acts, revealing secrets, absence for more than three days without justification, disobedience, or working in an unhealthy environment, among others.

SEVERANCE PAYMENTS

When an employer decides to terminate a work relationship, if it was for a fixed period of less than one year, the employer shall pay an amount equal to the wages of half the length of service. If the employment exceeded one year, the employer must pay an amount equal to six months' wages for the first year and twenty days for each subsequent year the worker served.

If the employment relationship was for an indefinite period, compensation shall consist of three month’s salary or wage plus twenty days' pay for each of the years of service.

OVERTIME

Overtime hours will be paid at a rate of 100% over the salary of the job.

REST DAYS

For every six days of work, the employee is entitled to one day of rest with full pay. Workers are not required to serve on their days off. If this provision is ignored, the employer must pay the worker, regardless of salary due to him, a double salary for the service.

HOLIDAYS

Workers who have more than one year of service enjoy an annual period of paid leave, which will not be less than six working days. This increases by two working days (up to twelve) for each subsequent year of service for the first four years. After the fourth year, the holiday period is extended by two days for every five years in service.

Employees are entitled to a bonus of not less than 25% of wages on top of their normal pay during their vacation.

SALARY

The salary is composed of payments made in cash and fringe benefits such as housing aid, bonuses, commissions, benefits in kind and any other amount or benefit the employee is entitled to for their work.

Workers are entitled to an annual bonus paid in December, equivalent to a minimum of 15 days' wages. To determine the amount of compensation payable to employees, the compensation shall be based on salary per day.

EMPLOYEE PROFIT-SHARING

Workers are entitled to a 10% profit sharing scheme on companies' annual profits to be paid, at the latest, on the fifth month after the closing of the fiscal year.

SOCIAL SECURITY

Social security contributions cover a number of areas.

Contributions cover:

- Work risks
- Sickness and maternity leave
- Disability and death
- Retirement, severance and old age
- Medical treatment and welfare

The employee's social security contribution is 3.9% of their salary and it is withheld by the employer. The employer's contribution is 39.3% of the salary, but with an annual maximum contribution for employees of MXN 19,502 (approximately EUR 1,220) and for employers of MXN 196,520 (EUR 12,280) per employee.

HOUSING FUND CONTRIBUTIONS

Employers must also contribute with an equivalent of 5% of salaries (limited to 25 times the minimum salary) to the government's housing fund. This provides financing for employees' house acquisition, remodelling and/ or construction. The maximum annual contribution is MXN 24,988.80 (EUR 1,560) per employee.

RETIREMENT FUND

Employers must contribute 2% of salaries (up to a maximum of 25 times the minimum salary) to a private pension fund managed by a financial institution on behalf of each employee. The maximum annual contribution is MXN 9,995.52 (EUR 625) per employee.

EXPATRIATE WORK VISA REQUIREMENTS

Depending on the place of residence, it is important for business visitors to Mexico to request a 'business visa'. This document gives the holder a legal capacity to do business in the country. A business visa can be requested at any Mexican consulate. The list of requirements and documentation needed to receive a visa can also be obtained at Mexican consulates.

Once a business visa has been obtained, it is important to know the specific procedures and requirements of the state where the business is to be based, such as:

- Registration of the company's name
- Registration at the Ministry of Finance for tax purposes
- Work, property and patent and royalties registry proceedings.

WORK PERMITS

Work permits are commonly granted for a period of one year. However, this may be extended. Usually a foreign employee must show documentation that proves he/she has gained employment in Mexico and has sufficient income to sustain him/her whilst working in the country. This documentation could be a contract of employment or an employer's letter. The employee must provide a passport and official identification. This information is referred to the immigration department in the state where the employee will be living. Foreign nationals can be also work independently in Mexico.

PERMANENT IMMIGRANTS

Immigrants who have been legal residents in Mexico for a minimum period of five years can request to the Foreign Affairs Ministry a change of their migratory status to a permanent resident or request Mexican nationality.

FAMILY CONSIDERATIONS

Each family member must apply for their own separate visa. However, registration forms for family members are often processed alongside those of the employee. If a family member wants to work, he/she must apply for their own separate work permit.

6 – TAXATION

There are three levels of taxation in Mexico – federal, state and municipal (or local), with Federal taxes comprising both direct and indirect taxes.

DIRECT TAXES

- Income tax –on individuals and companies

INDIRECT TAXES

- Value added tax
- Real estate transfer tax
- Import tax or duty
- Excise taxes – ad valorem taxes on specific products and services
- Withholding Income

STATE AND LOCAL TAXES

Payroll tax, real estate transfer tax and land tax are the main state taxes.

INCOME TAX

Income tax is dependent on the type of taxpayer, according to the following classification:

- Mexican resident individuals and legal entities
- Non-residents having a permanent establishment in Mexico
- Non-residents who have income from a source located in Mexican territory, but who do not have a permanent establishment in Mexico
- Non-residents who have a permanent establishment but no income which is attributable to any sources in Mexico.

TAXABLE INCOME AND CORPORATE RATE

The taxable base is defined as the difference between taxable revenue and expenses. Since 2010, the top corporate rate has been 30%.

PAYMENT PERIOD

Although income tax must be paid annually, there is obligation to make monthly advance payments on account for the annual tax. The annual tax return has to be filed and tax paid within three months after the end of the fiscal year.

VALUE ADDED TAX

Mexico has a federal Value Added Tax (VAT or 'IVA'). The general rate is 16%, with certain goods and services with zero rate, while others are fully exempted.

VAT is territorial in nature, since taxed acts/activities are those performed within Mexico. VAT is not transferred to outbound operations, so exports of goods and services are taxed with a 0% rate.

Individuals and legal entities must pay VAT whenever they are engaged in the following activities within the Mexican territory:

- Transfer of goods
- Rendering of independent services

- Temporary use or enjoyment of goods
- Import of goods or services.

VAT must be paid on a monthly basis.

OTHER TAXES

EXCISE TAXES

Excise taxes are levied on a number of specific products or activities such as the new vehicle sales, alcohol, alcoholic beverages, beer, tobacco and some fuels such as gasoline and diesel. Rates vary according to each of these products.

IMPORT DUTIES

Import duties have considerably diminished their importance in Mexico's tax structure as a consequence of the deep trade liberalisation and free trade agreements. However, there still are some specific products where a duty applies.

The taxable base for importation duties is the customs value of goods, except for cases where the law on the subjects sets forth a different taxable base.

CUSTOM REGIMES

Goods imported to or exported from Mexico may fall into any of the following customs regimes:

- Final
- Temporary
- Fiscal deposit
- Transit of goods
- Manufacture & conversion
- Strategic.

SPECIFIC FEATURES OF INCOME TAX LAW

Some specific features of Mexican corporate taxation are important to mention.

INTEREST TAX REGIME

Interest taxation considers the following elements:

- Inflationary annual adjustment
- Interest income and interest expense
- Exchange gains and losses.

A comparison of the annual average balance of debts and credits has to be made and if the former is higher, then the difference is multiplied by the inflation factor of the corresponding year and the result is the accruable inflationary annual adjustment.

Losses from inflation are deductible (as a deductible inflationary annual adjustment). In accordance with this procedure, if the annual average balance of credits is higher than the annual average balance of debts, the difference is multiplied by the inflation factor of the relevant year and the result is the deducible inflationary annual adjustment.

Interest income is included in the taxpayer's taxable income on an accrual basis. Accrued interest is deductible (at its nominal value, without any adjustment, since it will be subject to the inflationary annual adjustment) providing the funds obtained from the loan are invested in the business.

Exchange gains and losses resulting from financial assets and liabilities are deemed as interest for income tax purposes. If a Mexican company has foreign currency liabilities, a devaluation of the currency will result in an exchange loss. This loss is recognised on an accrual basis and is added to the interest expense for the month.

If a company has an exchange gain resulting from a financial asset denominated in a foreign currency, then the gain is added to interest income.

CAPITAL GAINS

An inflation adjustment is made to the acquisition cost of i) shares of stock or ii) fixed assets, to compute the gain on their sale. Capital gains and losses are treated as ordinary income.

DEPRECIATION

The basis for deductible depreciation is the acquisition value as defined in the Law, adjusted for inflation. Depreciation should be computed using the straight-line method at the maximum rates. Examples of such rates are shown in Table 5 below.

TABLE 5

Maximum rates for straight-line method of depreciation

	RATE
Buildings and other related structures	5%
Office furniture and fixtures	10%
Computer equipment	30%
Peripheral computer equipment	30%
Patents, trademarks, copyrights, etc.	15%
Automobiles, heavy trucks, tractor trucks, tow trucks, buses	25%
Anti-pollution equipment and equipment for conversion to natural gas consumption	100%
Equipment used in research of new products and development of technology	35%

In the case of railroads, telephone and satellite communications, depreciation rates are subdivided, according to the different kinds of assets they involve.

COST OF SALES

Since 2005, Mexican corporate income tax follows the cost of sales system which treats inventory purchases as deductible when sold. As such, it is necessary to compute the cost of goods sold for tax purposes.

EMPLOYEE PROFIT SHARING

Profit sharing contributions to employees are deductible.

DEDUCTIBLE AND NON-DEDUCTIBLE EXPENSES

PROVISIONS

Provisions to create or increase asset or liability reserves are not deductible.

CONTRIBUTIONS TO RETIREMENT PLANS

Contributions to retirement plans are only deductible when companies comply with the following requirements:

- Contributions should be funded through a trust
- They must be computed according to an actuarial study
- 30% of the reserves should be invested in government securities or in a bank trust.

NON-DEDUCTIBLE ITEMS

Other non-deductible items are:

- Goodwill
- Expenses incurred abroad and allocated on a pro-rata basis
- Payments to members of the board of directors, bondholders or other parties where the payments represent shares of profits or are contingent upon the taxpayer's profits
- Sanctions, indemnities for damages and contract penalties unless imposed by the Law
- Foreign tax credits.
- The amount paid for salaries in 53%, with in turn is exempt income for workers.

DIVIDENDS

When corporations distribute dividends, they must calculate the related tax by applying the 30% tax rate to the amount which results from multiplying those dividends by a factor of 1.4286, and a there is a withholding tax of 10% for the shareholders.

This tax can be taken as a tax credit against the income tax of the year of dividend distribution and carried forward for the next two subsequent tax periods.

Dividends paid from the net profit account (CUFIN), which is defined as the income for which corporate tax has already been paid in past years, are not subject to the tax on dividends already mentioned.

TAX CONSOLIDATION

As of 2015, the tax consolidation regime has been replaced by a limited consolidation scheme optional to conglomerates subject the following requisites:

1. The holding Company must have at least 80% of voting shares of the controlled company;
2. Each controlled Company must directly pay its taxes;
3. There no longer exists a consolidated fiscal profit account;
4. Distributed dividends among the companies of the group are subject to income tax in the year they are paid; and,
5. There no longer exists an annual consolidated tax filing

LOSSES CARRY FORWARD

Tax losses can be carried forward for ten years. The amount of the tax loss which can be carried forward to any given year is adjusted for inflation. Loss carry backs are not allowed.

PERMANENT ESTABLISHMENTS

A permanent establishment of non-residents can be created under the following circumstances:

- By conducting business activities in whole or in part within Mexico
- By performing construction or installation projects, maintenance or assembly activities on real estate property or supervisory activities in connection therewith, should such activities last more than six months (including working days of subcontractors)
- When performing business activities in Mexico through a trust fund ('fideicomiso')
- When conducting business activities through a dependent agent
- When acting through an independent agent which does not act pursuant to the ordinary course of its own activities, occurring when the agent:
  - Exercises the authority to enter into contracts on behalf of the foreign entity
  - Assumes risks in the name of the resident abroad
  - Acts under instructions or general control of the resident abroad
  - Performs activities which economically correspond to the foreign resident and not to its own activity
  - Obtains guaranteed remuneration, regardless of the results of its activities
  - Has inventories with which deliveries are made on behalf of a foreign entity
  - Carries out operations with the resident abroad, establishing prices or compensation which are different from those which would be used between independent parties in comparable operations
- Insurance companies which obtain insurance payments from within Mexico.

Essentially, permanent establishments are subject to the same tax rules as Mexican resident companies. The income tax treaties which Mexico has in force establish narrower definitions under which a permanent establishment is deemed to exist.

NON-RESIDENTS

NON-RESIDENTS HAVING TAXABLE SOURCE OF WEALTH

Non-residents, either legal entities or individuals which do not have a permanent establishment in Mexico, may be liable for tax on certain specific sorts of revenues which are derived from wealth sources located in Mexico.

In general, the Mexican payer must withhold on the gross payment made to a foreign corporation. Mexico's income tax treaties with other countries reduce the withholding tax rates on certain Mexican source payments made to non-residents. A Mexican taxpayer who is subject to withholding must deliver the income tax when i) the payment becomes due or ii) when the payment is actually made, whichever occurs first. In addition, gross payment is subject to withholding tax without deductions.

Under specific cases, the non-resident may be subject to taxation on a 'net' basis, instead of on a 'gross' basis, which is the general rule. This occurs when the non-resident has a tax representative in Mexico who remains jointly liable for the tax incurred.

Some of the relevant tax rates levied on gross income are:

- Services on real estate projects –25%
- Rental of property and assets –25%
- Sale of real estate and shares of stock –25%
- Technical assistance –25%

- Royalties on the use of patents, trademarks, and commercial names –25%
- Interest paid to foreign banks registered with the tax authorities –10%.
- Interest from certain securities –4.9% or 10%
- Interest paid to suppliers of machinery and equipment –21%.
- Interest paid to other creditors – the maximum tax rate for resident individuals applies (ie 30%)
- Any payment to residents of territories with preferential tax regimes (tax havens) –40%
  - Except for income from dividends and profit sharing from companies or interest paid to foreign banks and interest paid to foreign residents derived from securities.

It is important to stress that dividends paid by Mexican resident companies are not subject to taxation for non-residents. The reasons for this are that the Mexican company either i) distributes profits previously taxed at the corporate level, or ii) triggers income tax itself upon such dividend distribution.

TRANSFER PRICING

As a consequence of Mexico's incorporation into the OECD in 1994 its transfer pricing rules have been adopted since 1997.

In interpreting/applying this regime, authorities and taxpayers use the OECD Commentaries, and over time Mexican tax authorities have taken a more 'international approach', rather than a local one when auditing related parties' transactions.

This transfer pricing regime is widely accepted by a large number of countries and in Mexico, both authorities and taxpayers are used to its application, even though it is still awaiting a Supreme Court revision as to its constitutionality. Mexican authorities have been very active over the past four years conducting transfer pricing audits and, as of today, there has not been any tax controversy raised for constitutional analysis.

PERSONS AND/OR ENTITIES SUBJECT TO TRANSFER PRICING

Transfer pricing rules apply to related resident and non-resident juridical entities and individuals, permanent establishments or fixed base activities established in Mexico by non-residents and to activities carried out through trust funds.

The term juridical entity includes commercial and civil entities, governmental agencies developing commercial activities, credit institutions and associations. Neither not-for-profit organisations nor mutual funds are included in this definition.

Mexican joint ventures ('asociacion en participacion' agreements) are treated as taxpayers and, therefore, subject to transfer pricing regulations. The pricing of transactions is regulated only in the case of transactions between related entities.

It should be stressed that Mexican resident companies are obliged to apply this system not only with respect to their transactions with related parties residing abroad, but also with other resident parties in Mexico.

Two or more parties are related when one party participates directly or indirectly in the management, control or capital of the other, or when one party or group of parties participates directly or indirectly in the management, control or capital of others.

The Mexican definition is broader than the one included in US regulations and, in principle, could extend the transfer pricing regulations to companies or individuals which own a small participation in other companies, thus exceeding the scope of the US definition of controlled taxpayer.

It is worth mentioning that when related parties enter into transactions, they are compelled to determine their taxable revenues and/or deductible items considering the prices and/or considerations which would have been agreed upon by unrelated parties in comparable transactions.

TRANSACTIONS SUBJECT TO TRANSFER PRICING

Transfer pricing rules are applied to any import or export or goods, services and rights entered into between related parties.

METHODS

The arm's length nature of a transaction between related parties (ie a controlled transaction) is tested by comparing the pricing, terms and other characteristics of the transaction in question with the pricing, terms and other characteristics of comparable transactions entered into between unrelated parties (i.e. uncontrolled transactions).

The comparable uncontrolled price method pre-empts the applicability of other methods and only where it is not suitable for the taxpayer's circumstances, should the taxpayer elect to follow any other of the five additional methods established by the law.

The methods that are acceptable/needed for transfer pricing purposes are the following:

- Comparable uncontrolled price method (CUP) –the CUP method requires comparison of pricing in the controlled transaction to pricing in uncontrolled transactions
- Resale price method – under this method, the resale price charged by the controlled party to unrelated purchasers is reduced by an appropriate gross profit amount to determine the deemed sales price on the sale between the controlled parties
- Cost plus method – in this method, the cost from the company selling to the related party is first determined and then an appropriate gross profit margin is added to this amount, so as to obtain the appropriate deemed sales price between the controlled parties
- Profit split method – under this method, the profitability of a related company group is allocated among members of the group proportionally to their economic contribution to the company
- Residual profit split method – this consists in assigning the operation profit obtained by the related parties in the same proportion as it would have been assigned among unrelated parties
- Operation marginal transactional method – in this method, the operational profit for transactions among related parties is determined according to the operational profit which would have obtained from comparable unrelated companies in similar transactions.

STANDARDS OF COMPARABILITY

The lack of comparables in Mexico is one of the problems that Mexican taxpayers face.

Current sources of comparables used by taxpayers are the following:

- Internal comparables

- Data from the Mexican stock exchange (approximately 150 companies are traded on the stock exchange)
- Public sector Mexican company's database (which contains information from approximately 90% of companies belonging to the public sector).

If no comparables are found in these sources, Mexican taxpayers may use foreign databases (from the US and Europe) and make price adjustments taking into account the specific characteristics of the Mexican market.

Although Mexican law allows for the use of secret comparables, they have not yet been used by authorities and according to tax administration officials, should only be used as a last resort resource.

ARM'S LENGTH RANGE
In some cases, application of a pricing method will produce a single result which is the most reliable measure of an arm's length result. However, in other cases, application of a method may produce several results from which a range of reliable results may be derived. A taxpayer will not be subject to adjustment if results fall within that range (the arm's length range).

Mexican Income Tax Law does not establish a specific method with respect to financing transactions as loans between/among related parties.

ADVANCED PRICING AGREEMENTS (APA)
In 1998, the Mexican Government created a committee to approve APA resolutions. Current APA regulations allow this committee to approve APAs for the effective year requested, as well as for one prior and three subsequent years. However, although forward-looking APAs are allowed for, most APAs issued to date are for prior years.

INFORMATION AND DOCUMENTATION REQUIREMENTS
With respect to transactions with non-residents only, Mexican law provides for information and documentation requirements in order to be able to demonstrate, when required, that the arm's length principle has been accomplished.

There is no specific legal provision establishing that this information/analysis needs to be obtained when performing transactions with Mexican residents parties; however, it is a fact that such information is needed in order to prove before the Mexican tax authorities that there has been due compliance with the transfer pricing rules.

SECONDARY ADJUSTMENTS
According to transfer pricing principles, when a principal adjustment is made by the tax authorities, it is reasonable to expect that a secondary adjustment will be needed.

However, under the Income Tax Law, the possibility for secondary adjustments is only explicit with respect to international transactions in which a contracting party is a resident of a country with which Mexico has in effect an income tax treaty.

Under Mexican Income Tax Law and transfer pricing rules, taxpayers are obliged to: i) accrue as taxable income principal adjustments derived from those rules, as well as to ii) deduct the taxable items considering the same transfer pricing amounts.

TAX HAVEN RULES

As of 1 January 2005, provisions regarding tax havens moved from a territorial-based criterion based on those territories contained in the Black List to a conceptual criterion.

Since 1 January 2008, Mexican tax residents are subject to this special tax treatment when:

- Income is generated indirectly through foreign legal entities or legal representatives in which they participate directly or indirectly, in proportion to their participation in such legal entities or representatives, as long as said income is subject to preferential tax regimes (PTR), or
- Income is obtained through fiscally transparent foreign entities or legal figures.

INCOME SUBJECT TO PTR

It is deemed that income is subject to PTR if it is generated indirectly through foreign entities or representatives in which Mexican tax residents participate directly or indirectly, in the proportion of their participation in such entities or legal figures, as long as such income:

- Is not taxed abroad, or
- The income tax triggered and paid abroad results in less than 75% of the income tax which would have been paid in Mexico in accordance with the provisions of the Income Tax Law.

Although the sole fact of indirectly generating income subject to PTR triggers the application of the special tax regime, the Income Tax Law establishes some exceptions to this general rule (eg. lack of control exception, active income exception, royalties' exception, etc).

As of 2008, a lack of control statutory exception entered into force (applicable even in cases of direct participation). Such an exception provides that income generated through foreign legal entities or representatives will not be considered subject to PTR whenever the Mexican taxpayer does not have effective control of the vehicle or control of the vehicle's administration, in such a degree as to decide upon distribution of income, profits or dividends, whether directly or through third parties.

INCOME OBTAINED THROUGH TAX TRANSPARENT ENTITIES OR LEGAL REPRESENTATIVES

Income obtained through foreign entities or legal representatives which are fiscally transparent is subject to this special tax treatment, even if such income is not subject to PTR (ie even where it is taxed abroad with less than 75% of the income tax which would have been paid in Mexico).

Tax transparent legal representatives or entities are those which:

- Are not considered as income taxpayers in the country in which they are incorporated or where their main administration or seat of effective direction is located
- The revenues generated through such an entity or legal representative are attributed to its members, partners, shareholders or beneficiaries.

TAX CONSEQUENCES

In general, income under this special tax treatment is subject to tax in the fiscal year in which such income is generated abroad, even though the income has not yet been distributed. The payment of the corresponding income tax has to be made together with the annual tax return of the fiscal year in which the income is generated.

INFORMATIVE TAX RETURN

Taxpayers must file in the month of February of each year an informative return before Mexican tax authorities regarding:

- Income generated in the previous tax year subject to PTR
- Income generated in jurisdictions of the 'Black List'
- Transactions carried out through tax transparent foreign legal entities or representatives (Art. 214 ITL).

THIN CAPITALISATION RULES

Thin capitalisation rules were established in 2005, providing for a five year period to attain a 3:1 debt/net worth ratio; thus, as of 2010, these rules were in full force.

The most important features of this regime are:

- Interest derived from debts with foreign related parties which exceeds three times the net worth of the company, is not deductible
- The procedure established to determine the non-deductible interest may produce awkward effects contrary to the spirit of the provision. In certain events, the higher the proportion of debt contracted by a company with its foreign-related parties, the higher the proportion of non-deductible interest will be and the lower the proportion of debt and deductible interest
- Debt contracted in the following circumstances:
  - By the members of a financial system in the performance of their activities
  - For the construction, operation and maintenance of productive infrastructure linked with strategic areas
  - By taxpayers who obtain an advance price agreement, who will not be considered for thin capitalization purposes.

TAX TREATIES

Mexico has a vast array of tax treaties on income tax matters.

Tax treaties only provide benefits with respect to what is set forth in Mexican law. Therefore, such treaties may not impose burdens which are not established in Mexican law.

Income tax is covered by the treaties; however, due to the recent effectiveness of the business flat tax, an effort to include this within the purview of the treaties has been actively made by the Mexican tax authorities.

Examples of treaty benefits are:

- Lower rates than those provided in the local law
- Stringent cases (compared with those established under the local law) under which a permanent establishment is deemed to exist.
- Revenues not subject to taxation under provision of the local law, for example 'know-how' services payments.
- A non-discriminatory principle, which entails that the treaty partners resident may not be taxed higher than local tax residents.

RELEVANT PERSONAL TAXES FOR EMPLOYEES

INCOME TAX

Residents and non-residents in Mexican territory are subject to individual income tax if they obtain income in cash, in kind, in services or in any other way. Foreign resident individuals who carry out entrepreneurial activities or provide independent personal services in Mexico through a permanent establishment are also required to pay tax on the income attributable to this establishment.

Income for the provision of independent personal services includes salaries and other benefits derived from a labour relationship, including employee profit-sharing and benefits received as a result of the termination of the work relationship.

The maximum tax rate for individuals is 30%. For the purposes of this tax, this income includes the following types of income:

- Social security
  - The social security contribution in Mexico is paid for by the employee and the employer
- Remuneration of public employees
- Advance payments from production cooperatives, civil law partnerships and civil law associations
- Fees received by board members, statutory auditors etc.
- Fees for services rendered primarily for a client
- Earnings of independent service providers that elect this tax treatment
- Earnings of individuals with entrepreneurial activities that elect this tax treatment.

7 – ACCOUNTING & REPORTING

In June 2004, the Mexican Council for Research and Development of Financial Information Norms (CINIF) took over responsibility for issuing accounting regulations in Mexico.

The CINIF carries out its functions through study, research and consultation with professional organisations, financial and businesses communities and other interested sectors, leading to the issuing of so-called ‘Norms of Financial Information’ (NIF). The philosophy of the NIF is to ensure, on the one hand, the harmonisation of particular norms used by different sectors of the economy, and on the other, to converge to the greatest possible degree with the norms of the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

There are, however, many companies in Mexico which draw up their financial information based on the IFRS due to their comptrollers request and/or parent companies.

BASIC CONCEPTS

Some general principles are followed for financial statements.

Assets are presented at a fair value or net resale value, with the exception of non-financial assets which must be presented in a specific way. According to the accrual method, yields are recognised when they are made and costs are considered when they are incurred.

Accounting policies must be applied from one period to another. All reasons for non-compliance must be inormed.

Accounting concepts relevant to investors are described below.

LEASEHOLD

Leases which substantially transfer the advantages and risks of the property are considered as acquired assets and become liable. Other leases are considered as operating leases. Accounting rules for leases are similar to those of the generally accepted accounting principles (GAAP) in the US.

INTANGIBLE ASSETS

Acquired intangible asset costs are registered as assets and are amortised on the estimated period of the assets’ useful life – an important difference from US GAAP. The maximum period of amortisation under Mexican GAAP is 20 years.

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are imposed on income where liable, similar to the US GAAP practice. However (and this differs from the US GAAP), in some instances, start-up costs are not taken into account.

CONSOLIDATION

A company with more than a 50% interest in another company must provide consolidated financial statements, and include the investor’s financial statements. This principle is similar to provisions in the US GAAP.

EXCHANGE RATE PROVISIONS

Foreign currency transactions are filed using the exchange rate on the day the transaction took place. Assets and liabilities expressed in foreign currency are converted into Mexican pesos at the exchange rate prevailing at the time of reporting. Exchange differences are reflected in the net income.

AUDIT REQUIREMENTS

Mexican companies may prepare financial statements. Furthermore, Mexican GAAP requires a report on changes in the financial position, rather than one on the cash flow. Mexican publicly quoted corporations, governmental companies, financial sector companies, insurance sectors and most other companies which exceed a certain minimum in assets must present annual financial statements.

Annual audits must be carried out the year after the closing of the fiscal year and the audited financial statements are disclosed at the annual stockholders meeting, to the Treasury authorities and to the public through the CNBV.

DEFERRED INCOME TAXES

The NIF requires the recognition of deferred taxes to profits by the total of the differences between the financial and the fiscal value of assets and liabilities, thus eliminating the differences in the accounting treatment of income tax and employee's profit sharing.

It also establishes the re-classification of retained profits unless these are identified with accounts recognised in the shareholders equity and which comprise integral profit (loss) and have not been reclassified to income statement.

WORKERS' FRINGE BENEFITS

Under Mexican Labour Laws, companies must pay an indemnity to employees with 15 years' service who cease employment voluntarily, involuntarily or due to death.

This requirement –and any applicable pension requirement – increases with length of service. In most dismissal cases, indemnities and compensations must be paid to employees given that current accounting practices identify these payments as contingency remuneration.

ALLOCATION OF PROFITS

Costs associated with profit distribution are recognised (in a similar way to income taxes) after the pre-tax income. Companies must provide annual financial statements approved by stockholders.

REPORTING REQUIREMENTS

Financial statements must be presented at the annual stockholder meeting and approved. All companies must have a statutory inspector (corporation official) assigned to this position by the stockholders. This person is generally an independent public accountant and is usually from the accountancy firm which carries out inspections/audits.

Companies meeting certain criteria must file an annual tax return with the authorities for the last annual fiscal period. Companies filing a tax return may or may not be subject to an external audit by Mexican authorities. Consolidated and audited financial statements must be presented alongside this tax return.

MULTINATIONAL GROUPS' OBLIGATIONS

As of 2017, multinational companies groups will be required to provide information to tax authorities in the immediate following year to the current fiscal year (in 2017 they will have to present 2016's information) on:

I. Related parties:

- a) Organizational structure
- b) Description of activities, intangibles and related financial operations
- c) Financial and fiscal position

II**.** Local related parties:

- a) Organizational structure, strategic and business activities and related parties operations
- b) Information on operations or companies used as comparables

III. Group's individual country:

- a) Revenues and taxes paid
- b) Location of economic activities.
- c) List of the group's entities and their permanent establishments

8 – UHY REPRESENTATION IN MEXICO

UHY GLASSMAN ESQUIVEL Y CÍA S.C. MEXICO

UHY

CONTACT DETAILS

UHY Glassman Esquivel y Cía S.C.
Av. Paseo de la Reforma No.195 Pisos 16, 17 y P.H.
Del. Cuauhtémoc, Col. Cuauhtémoc
Mexico D.F.
Mexico
Tel: +52 55 5566 1888
Fax: +52 55 5566 1888 x11
www.uhy-mx.com

CONTACTS

Liaison contact:	Oscar Gutiérrez Esquivel
Position:	Managing Partner
Email:	oge@uhy-mx.com

SOCIAL MEDIA CONNECTIONS

- Facebook: www.facebook.com/pages/UHY-Glassman-Esquivel-y-C%C3%Ada-SC/193854340638116
- Google+: https://plus.google.com/113690444768289665210/posts
- LinkedIn: mx.linkedin.com/pub/uhy-glassman-esquivel/51/378/979
- Twitter: twitter.com/geuhy
- YouTube: www.youtube.com/user/uhyge

Year established:	1989
PCAOB registered?:	Yes
Number of partners:	7
Total staff:	117

BRIEF DESCRIPTION OF FIRM

UHY Glassman Esquivel y Cía, S.C. serves a variety of middle-market companies, including insurance companies, not-for-profit organisations, large retail companies, commercial operations, professional services, manufacturing and the health care sector.

SERVICE AREAS

Accounting services
Audits
Business consulting
Business valuations
Employment law advisory services
Financial planning
Internal audit services
IT services
Legal services
Management consulting
Mergers and acquisitions
Taxation services

SPECIALIST SERVICE AREAS

Sarbanes-Oxley services

The network for doing business

UHY GLASSMAN ESQUIVEL Y CÍA S.C. MEXICO

PRINCIPAL OPERATING SECTORS

Accounting
Energy: Services, extraction
Financial Services
Health Care
Information Technology (IT) & services
Legal
Machinery
Real Estate and Rental and Leasing

LANGUAGES

Spanish, English.

CURRENT PRINCIPAL CLIENTS

Royal & Coinco de Mexico, S.A. de C.V.
Opticas Devlyn, S.A. de C.V.
Markem de México, S.A. de C.V.
CONAPRO
Seguros Centauros Salud Especializada

OTHER COUNTRIES IN UHY CURRENTLY WORKING WITH, OR HAVE WORKED WITH IN THE PAST

Spain, US, UK.

BRIEF HISTORY OF FIRM

Founded in 1989 as an independent accounting and business consulting firm, Glassman Esquivel & Cia, began its operations by offering a wide range of professional services to companies that develop their activities in the various economic areas in Mexico in one of the most important periods in the development of our country.

The firm joined UHY in 2000.

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LET US HELP YOU ACHIEVE FURTHER BUSINESS SUCCESS

To find out how UHY can assist your business, contact any of our member firms. You can visit us online at www.uhy.com to find contact details for all of our offices, or email us at info@uhy.com for further information.