cutting through complexity™

Investment in Mexico

2012

Investment in

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1. Business environment

1.1. Facts and Figures

Mexico belongs geographically to North-America; ethnologically it belongs to Latin America. Mexico is the most populous Spanish-speaking country in the world. About 70% of the people live in urban areas. According to the last census results, the Mexico metropolitan area had a population of 21.4 million; making it the largest populous in the western hemisphere.

Highly developed cultures, including those of the Olmecs, Mayas, Toltecs, and Aztecs existed in this area long before the Spanish invasion. Mexico remained under Spanish occupation for three centuries before achieving independence early in the 19th century.

During the last two decades, Mexico has been undertaking a process of change. In particular, Mexico is transitioning from being a small economy to an open and diverse economy.

After braving economic turmoil in the early eighties, the result of low oil prices, and again in the mid-nineties, due to a significant undervaluation of its currency, Mexico experienced an impressive turnaround after the turn of the century. This growth phase lasted several years (Mexico was relatively unaffected by the 2002 South American crisis) until 2008, when the global recession took a heavy toll on the Mexican economy. During 2009, Mexico had $11 billion in foreign direct investment and received $23 billion in remittances.

The Mexican economy has a mixture of modern and outdated practices in both its industries and in agriculture. Furthermore, the Mexican economy is increasingly being dominated by the private sector. Recently the government has made improvements in infrastructure and has opened competition in seaports, electricity generation, telecommunications, airports, distribution of natural gas and railroads.

Population

Mexico is a multifaceted country. According to the latest official estimate, the country has a population of 112,336,538 million[1], of which 57,481,307 are women and 54,855,538 are men. Mexico is the most populous Spanish-speaking country, but most of the different cultures have their own language or dialect. Between 2005 and 2010 the population grew 1.7% annually, a significantly higher rate than the rate between 2000 and 2005, 1.2%.

[1] According to the most recent census by the National Institute of Statistics, Geography and Information (2010).

Geography

Mexico is located at about 23° N and 102° W in the southern part of North America. Mexico covers an area of 1,964,375 sq. km., 1,959,248 of which are on the mainland and 5,127 of which are islands. There is also an exclusive economic zone of territorial sea comprising of 3,149,920 sq. km., meaning that the total area of the country is 5,114,295 sq. km.

Mexico is comprised of 32 states, the capital of which is the Federal District, where the branches of government are located. Mexico is entirely part of North America, along with Canada and the United States. It is considered the world's 14th largest country by total area.

Mexico has borders with the United States of America, Guatemala and Belize, totalling 4,301 kilometres.

Political Situation

President Felipe Calderon has made public security a priority for his administration, launching aggressive operations against organized crime and drug traffickers and deploying the army in several states. Because of these operations, many important drug kingpins have been brought down within the last year.[2]

The government has had to address the issues associated with the global economic crisis and the Mexican people have confronted severe tests of endurance. The government has had to respond with drastic economic adjustment measures to resume a sustained recovery. The president and his team have instituted reforms to strengthen the honesty and efficiency of governmental institutions.

Additionally, and arguably most importantly, the government has drawn strength from the exemplary solidarity of our different social groups to create better relationships and benefits for the country and its citizens.

In any case, Mexico is considered to be fairly stable from a political standpoint and is considered more and more in international forums as a country with significant potential and increasing global influence.

Mexico in the World Economic Context

Mexico is a country of huge economic potential that has demonstrated predictable and stable economic growth. It is a dynamic market and analysts predict that Mexico will be the fifth largest economy in the world. Mexico is considered attractive for foreign investors seeking to make new investments.

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[2] World Bank

Mexico is the largest trading nation in Latin America; its Gross Domestic Product (GDP) has been growing strongly the last decades and the country has high levels of foreign direct investment. This has changed the competitive production costs and development environment.

Mexico is also a party to a number of free trade agreements; please refer to the Logistical Services and Customs section for a list of these agreements.

Economy

Mexico has a free market economy in the trillion dollar class. Trade with the US and Canada has nearly tripled since the implementation of NAFTA in 1994. Per capita income is roughly one-third of that of the US; income distribution remains highly unequal.

The Felipe Calderon administration was able to garner support from the opposition to successfully pass pension and fiscal reforms. The administration passed an energy reform measure in 2008 and another fiscal reform in 2009. Mexico's GDP plunged 6.5% in 2009 as world demand for exports dropped and asset prices tumbled, but GDP had a positive growth rate of 5.5% in 2010.

The administration continues to face many economic challenges, including improving the public education system, upgrading infrastructure, modernizing labour laws, and fostering private investment in the energy sector. President Calderon has stated that his top economic priorities remain reducing poverty and creating jobs.

Mexico GDP Growth Rate

The GDP in Mexico expanded 1.34 percent in the third quarter of 2011 over the previous quarter. Historically, from 1993 until 2011, Mexico´s average quarterly GDP growth was 0.64 percent reaching an historical high of 2.90 percent in March of 1996 and a record low of -7.00 percent in March of 2009.

In 2011, Mexico had an extraordinary progress in the market, having the following results:

Country	Interest Rate	Growth Rate	Inflation Rate	Unemployment Rate	Exchange Rate
Mexico	4.50%	4.5%	3.5%	4.8%	13.8952

Mexico's Figures for 2011

Exports: US$316 billion (world rank: **14th**)

- **Major exports**: Manufactured goods, electronics, oil and oil products, aircraft, silver, computers and servers, fruits, meats, consumer electronics, processed foods, vegetables, ships, coffee, LCD screens, electricity, biotechnology, cotton, rolling stock, automotive and aircraft engines, cellular phones, metals, industrial equipment, granite and marble, lithium batteries.

- **Major export partners:** United States 82%

Imports: US$317 billion (world rank: **13th**)

- **Major imports**: Metalworking machines, steel mill products, agricultural machinery, electrical equipment, car parts for assembly, repair parts for motor vehicles and aircrafts.

- **Major import partners:** United States 55.5%, Brazil 31.4%, Chile 9.3%, China 5.4%, South Korea 5.4%, Japan 4.1%.

Unemployment, prices and inflation

Description	2010	2011
Unemployment rate (% of the labour force)	5.4	4.8
Prices and Inflation:		
Prices	97.7121	100.8134

Inflation (annual percentage)	3.89	3.5

Minimum Wages

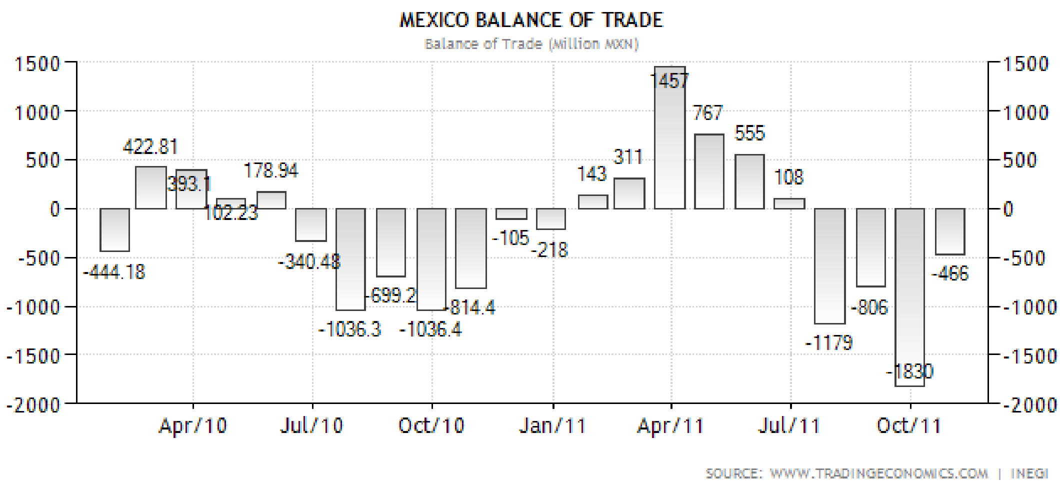
The minimum wage in Mexico is divided by areas (A, B and C) and grows at approximately 3-5 percent annually.

Area/Year	2009	2010	2011	2012
A	52.59	57.46	59.82	62.33
B	50.96	55.84	58.13	60.57
C	49.50	54.47	56.70	59.08

Source: SAT 2012

Mexico Exports and Imports

Mexico is the biggest exporter and importer in Latin America. Mexican trade is fully integrated with that of its North American partners; close to 86% of Mexican exports and 50% of its imports are traded with the US and Canada. Mexico's major exports are: manufactured goods, oil and oil products, silver, fruits, vegetables, coffee and cotton.



Mexico imports were worth USD 30,554 Million in October of 2011. Mexico is the biggest importer in Latin America. Mexico imports mainly metalworking machines, steel mill products, agricultural machinery, electrical equipment, car parts for assembly, repair parts for motor vehicles and aircrafts. Its main import partner is the US. Mexico also imports from the European Union, China and Japan.

1.2. Business Climate

Legal Framework for Foreign Investment

The foreign investment legal framework is governed mainly by the Foreign Investment Law effective as of December 1993, which opens the possibility of foreign investors investing in various economic activities that were restricted by the former law. This law provides only 11 areas limited exclusively to the Mexican State and 5 others to Mexican nationals or corporations with a foreign exclusion clause.

Among its purposes, this law promotes the benefits of “neutral investment” and intends to simplify the administrative procedures on this subject.

Participation of Foreign Investment

As a general rule, the law allows foreign investors and Mexican companies controlled by foreign investors, without the prior approval from the Mexican Government, to own up to 100 percent of the equity in Mexican companies, acquire fixed assets, engage in new economic fields, manufacture new lines of products, open and operate establishments and expand or relocate existing ones, as otherwise provided for in such law.

Activities Reserved to the Mexican State

Following Constitutional provisions, this law reserves the following areas, because of their strategic nature, only for the State:

- Oil and other hydrocarbons;
- Basic petrochemical;
- Electricity;
- Generation of nuclear energy;
- Radioactive minerals;
- Telegraph industry;

- Radiotelegraph industry;
- Postal service;
- Issuing of currency;
- Minting coins;
- Control of marine ports, airports and heliports; and
- All other services expressly considered as such by the applicable legal provisions (public services).

Activities Reserved for Mexican Individuals or corporations with a Foreign Exclusion Clause

The areas reserved exclusively for Mexican individuals or corporations with a foreign exclusion clause are as follows:

- National land transport of passengers, tourism and cargo, excluding services of messaging and courier;
- Retail gasoline sales and distribution of liquid petroleum gas;
- Broadcasting and repetition of television programs and other radio services, excluding broadcast by TV cable stations;
- Development bank institutions pursuant to the related law; and
- The rendering of professional and technical services expressly provided in the applicable legal provisions.

Specifically Regulated Activities and Acquisitions

The law also provides activities where foreign capital may only share in certain proportions that range from 10 percent (only Cooperative Companies of Production), 25 percent (National Air Transport, Air Cab Transport and Specialized Air Transport) and 49 percent,(basic telephone services, insurance institutions, bonds institutions, exchange houses, bonded warehouses, among others). It also provides areas where foreign investment can participate in excess of 49 percent, as is the case of legal services or cellular telephone services, subject to prior authorization of the National Foreign Investment Commission.

Acquisition of Property and Use of Trusts

Under the Mexican Constitution, foreign individuals and entities may not hold legal title to real estate in Mexico located within 100 kilometres of the borders or 50 kilometres of the coastlines (Restricted Zone).

However, foreign investors may hold the beneficial interest in such real estate under a trust arrangement. Real Estate Trusts must have a Mexican bank as the trustee and have a maximum term of 50 years; however, the term may be extended.

The law however, allows Mexican companies with foreign equity participation to hold direct title in real estate located in the Restricted Zone, if they engage in non-residential activities and if their by-laws include the agreement executed with the Foreign Affairs Department provided in Article 27 of the Mexican Constitution.

This Article provides, amongst others requirements, that a foreign investor must agree to be deemed a Mexican national with regard to the investment in question, and should not seek the protection of its Government in the event of a dispute, under penalty of forfeiting its interests in favor of the Mexican nation, if it seeks such protection. If the foreign investors engage in residential activities they may hold real estate through a trust.

Organization and Modification of Corporations

As to the incorporation of a business entity, the law first requires obtaining an authorization from the Ministry of Foreign Affairs. In addition, such entity's by-laws must include the foreign exclusion clause or the agreement provided in Article 27 of the Mexican Constitution.

Branches

The law provides that in order for foreign business entities to operate in Mexico through a branch. They must first obtain a permit from the National Foreign Investment Commission of the Ministry of Economy. To obtain a permit from such Ministry, foreign business entities must agree with the provisions of Article 27 of the Mexican Constitution.

The law simplifies the approval process by considering an application as authorized within 5 days after such application is filed. Subsequently, the branch must be registered with the National Registry of Foreign Investments and will obtain the answer to the application within approximately 15 days after it was presented. After the application for opening a branch has been accepted, the address of the branch must be specified within 30 days to the National Registry of Foreign Investments .The branch has to be registered by the Public Registry of Commerce within the first year after the authorization was obtained.

All incorporations and opening processes require formalization before a Mexican Notary Public.

Neutral Investment

This investment is available for Mexican Corporations or authorized Trusts to obtain external funds and financing from the public. The corresponding shares will not have voting rights but will have preferential treatment with respect to dividend payments.

Through this investment, corporations may conduct expansion or financial restructuring projects without Mexican investors losing control of corporations while allowing participation of foreign capital.

It is worth noting that this investment is not only available for large companies, but for small and medium size companies too, and this investment is not considered when determining the amount of foreign investment in the capital stock of Mexican corporations.

National Foreign Investment Commission

The law provides the powers of such Commission and determines that it must dictate the policies on foreign investment and establish the terms and conditions applicable to participation of foreign investment. The law provides that the Commission must resolve applications within 45 business days; otherwise, applications will be deemed approved. Accordingly, the law sets forth the criteria under which such Commission must perform its evaluations.

National Foreign Investment Registry

The law establishes this Registry for Mexican entities, foreign entities and trusts. A significant matter is that a Notary Public may request foreign investors or their representatives to prove their registration at such Registry and if such registration is in process, they must prove the existence of such filing. Otherwise, the Notary Public may authorize the transaction under disclaimer, but will inform the Registry of such omission.

Penalties

On failing to comply with the provisions of this law, the Ministry of Economy may impose fines that range from one hundred to five thousand times the minimum daily wage in force in Mexico City ($62.33 daily basis), and if the actions relate to the use of properties within the Restricted Zone, the penalty will be equivalent to the amount of the transaction.

Another significant aspect of the law is that foreign investors may submit to the consideration of the Office of the General Director of Foreign Investments, the release from compliance with programs, requirements and commitments previously agreed with such Director. The Director should resolve the request within 45 business days from the date the application is filed. There are also provisions that allow foreign participation in certain economic areas up to 100 percent of the capital stock of Mexican corporations as from a certain date, there being no need to obtain a favourable resolution from the National Foreign Investment Commission.

Indirect Foreign Investment

Foreign investors may combine direct and indirect investments. Income from indirect investments may be subject to lower tax rates since a parent company's charges to its Mexican affiliate represent tax-deductible expenses (such as, namely, technical service fees, royalties, interests and rental payments).

However, foreigners may have to choose indirect investment because of the aforementioned restrictions, existing competition, or other market conditions. The National Foreign Investment Commission is interested in activities that will result in training Mexican technical personnel, create jobs and in general benefit the Mexican economy.

2. Starting or acquiring a business in Mexico

2.1. Starting a business

2.1.1. Legal forms and registration/application requirements

There are several ways in which a foreign corporation or individual can do business in Mexico. In this regard, the foreign corporation may undertake its activities through an agent or representative, through a branch of the foreign company or through a subsidiary organized in Mexico.

Mexican Partnerships and corporations

The most common types of mercantile entities used by foreign and national investors in Mexico are the following:

- Sociedad de Responsabilidad Limitada or “S. de R.L.”- A partnership with limited liability for all its members, in which the capital is represented by social interests.
- Sociedad Anónima or “S.A.” - Entity similar to the US Corporation, in which all its members have limited liability and its capital is represented by common shares.

There are other types or forms of entities regulated by Mexican law, which may be useful in certain situations:

- Sociedad Anónima Promotora de Inversión or “SAPI” - as of June 2006, this new type of entity is eligible to investors. This entity is organized in general terms as an S.A. but it is exempt from certain obligations resulting on the ability to give to its shareholders further corporate and economical rights. The SAPI is recommendable for Joint Venture projects or for entities which may become Publicly Held Companies.
- Sociedad Anónima Búrsatil or “SAB” entities that issue shares listed in the Mexican stock Exchange (BMV)
- Sociedad Anónima Promotora de Inversion Búrsatil or “SAPIB” This entity is organized in general terms as an S.A. but it is exempt from certain obligations resulting on the ability to give to its shareholders further corporate and economical rights and has the ability to issue shares listed on the Mexican stock Exchange (BMV)

It is important to point out that currently the Mexican Senate approved an important amendment to the General Mercantile Companies Law concerning the creation of the Companies with a sole shareholder. The following type of Companies will have the same regulation as described above (the only significant change is that a sole Shareholder Company has less restrictive requirements for the notice of meetings).

Sole Shareholder Company: Sociedad Anónima or “S.A.” - Entity similar to the US Corporation Sociedad de Responsabilidad Limitada or “S. de R.L.”- A partnership with limited liability for all its members. The above mentioned approved Senate bill was referred to the Chamber of Deputies to continue with the legal process. This is not yet in force.

General partnerships are not typically used by foreign investors due to their lack of limitation on the liability of the partners.

Although for tax purposes the Mexico an S de R.L. is treated exactly as any other mercantile entity, for tax purposes in the US, it may be considered as an eligible entity for partnership status. In this regard, if the partners of an S. de R.L. are from the US, either a corporation or an individual, they may benefit from flow-through taxation rules.

Both an S.A. and an S. de R.L. may be incorporated under the mode of variable capital (“de capital variable”), in which case the capital of the company may be increased or decreased by simple shareholders’ or partners’ resolution, as the case may be, without the need for further formalities. The shareholders may reimburse their contributions to the variable capital without any special formalities; however, they cannot reimburse the portion of the fixed capital, which has to remain at the minimum mandatory amount.

Organizing a Mexican corporation

An S.A. must have fully subscribed capital of at least MXP$50,000 pesos. One fifth (20%) of the share capital is payable at the time of subscription, when the subscription is for cash. However, if the capital contribution is in kind, the capital must be fully paid. The company may be formed by incorporation or by public subscription (normally not used), but in either case it must be registered at the Public Registry of Commerce.

Shareholders’ liability is limited to the amount of their contributions. When shares are issued for property (“Treasury Shares”), they must remain in escrow for two years as protection against property of little value being exchanged for shares.

Any outstanding balance on shares must be paid within five years. Other factors that apply to stock ownership include the following:

- Different classes of shares may be issued and shares may or may not carry par value; all shares within a certain class have equal rights and value; shares cannot be issued at a discount; a company cannot own its shares; all shares must be issued and subscribed, except those of an S.A. de C.V.
- The capital may be increased or decreased by the shareholders of a fixed stock capital corporation. A fixed stock capital corporation or a variable stock capital corporation may have only registered shares.

Number of Shareholders

There must be at least two shareholders to organize an S.A. The General Corporations Law does not require a specific number of the shareholders to be Mexican individuals or entities other than as required under the Foreign Investment Law described earlier since the restrictions of the law focus on the type of activity developed by the corporation. Consequently, all of the shareholders of corporations that qualify to be totally foreign owned may be formed by foreign investors that could be individuals or corporations.

Joining the above, it's important to mention that there is a maximum of shareholders for the S. de R.L. established by Law, which rises to 50 partners.

Taxpayers' Registry and Advanced Electronic Signature Certificate

The federal tax authorities maintain a registry where all taxpayers must apply for a registration number and an Advanced Electronic Signature Certificate.
Failure to have a taxpayer registration number generates penalties. Most of the states also have their own registries for local tax purposes.

Non-resident partners, shareholders or associates participating in companies or joint ventures are not required to register in the Taxpayers' Registry provided that the Mexican company or joint venture files a listing of these partners, shareholders and associates, indicating their domicile, tax residence and foreign tax identification number during the three months following the closing of each period.

2.2. Acquiring a business

2.2.1. Mergers, acquisitions and restructurings

An acquisition in Mexico can take the form of either an asset deal or a share deal. According to the Mexican tax rules, the vendor and purchaser are jointly liable in the acquisition of a business during the five years prior to the acquisition.

In this regard, the Mexican tax law does not define the term "business", but the criteria used by the tax authorities is that a sale of a business occurs when a company sells or otherwise disposes of the assets and liabilities that were used to develop the core business of a company.

Another indication that a transfer of a business has occurred is the simultaneous transfer of employees to a company acquiring the assets and liabilities. This joint liability is limited to the purchase price paid for the assets.

If the acquisition of assets is properly planned and reviewed by tax and legal advisors, the transfer of a potential tax risk can be mitigated. However, in a purchase of shares, the historical liabilities remain with the company acquired.

Asset acquisition

The significant advantages and disadvantages of an asset acquisition are outlined below:

<table>
<tr><th>Advantages</th><th>Disadvantages</th></tr>
<tr><td>

Any VAT paid may be refunded if the purchaser is a Mexican tax resident
A step-up in the tax basis of fixed assets and intangible property is allowed for income tax and flat tax purposes
There is no transfer of seller´s liabilities, except in the case of an acquisition of the overall trade or business. However, strategies are available that avoid this contingency
Vehicle can be properly structured from the beginning, including exit strategy

</td><td>

Time required to establish the vehicle to complete the asset purchase
Employees transferred typically demand seniority recognition from the new employer, unless they receive a severance payment from the old employer
Property transfer tax may apply
Goodwill is not tax deductible
VAT may increase the cost of the transaction in certain circumstances

</td></tr>
</table>

Share acquisition

The significant advantages and disadvantages of a share acquisition are outlined below:

<table>
<tr><th>Advantages</th><th>Disadvantages</th></tr>
<tr><td>

Less time consuming process
It is likely to be more attractive to the seller, both commercially and from a tax perspective (because the disposal may be exempt and because cash is directly in its hands), so the price may be lower
Transfer of tax loss carry-forwards and other tax credits generally allowed
The right to distribute dividends to shareholders from the net after tax earnings account (CUFIN) tax-free is transferred with the shares

</td><td>

The buyer effectively becomes liable for any claims or previous liabilities of the entity, including tax (that is, there is a joint liability for unpaid taxes over the previous five years)
No deduction is available for the purchase price for either income tax or flat tax purposes
Deferred tax liabilities are acquired
It may be more difficult to finance tax-efficiently

</td></tr>
</table>

• There is no real estate transfer tax • The acquisition of shares is not subject to VAT	

Corporate Reorganizations

Several provisions regarding corporate reorganizations such as mergers, spin-offs and transfers of shares were incorporated in the law. The provisions primarily establish requirements to carry out tax-free reorganizations and specific rules, such as those relating to the transfer of assets and their carry forward tax basis, the basis of shares issued as a result of the reorganization, the transfer of net operating loss carry forwards, the CUFIN and the holding period of the same shareholders.

The Federal Tax Code establishes the requirements for tax-free spin-offs, providing the “continuity of interest rule” which requires 51% of voting shares of the original entities to be held by the same shareholders for at least three years, one year prior to the spin-off and two years after it.

Mergers of Mexican residents may be completed tax-free if the surviving or new company files the annual tax returns and information returns on behalf of the liquidated entities.

In exchange of shares among companies of a group, tax deferrals may be authorized by the tax authority.

2.2.2. Exit issues

Mexico has 42 Double Tax Treaties (DTTs) in force, and so it is a good option for foreign investors to invest their capital into Mexico and apply the tax benefits given by the DTTs in order to maximize their profits as well as the tax burden.

Investment structures should be reviewed prior investing into Mexico to ensure tax optimization at exit, since the transfer of shares of Mexican entities are subject to capital gains tax in Mexico.

Capital Redemptions

Capital redemptions may be made without any legal restriction. Capital redemptions are not treated as capital gains but as dividend distributions. The dividend so distributed is determined when the shareholder’s equity, as shown on the financial statements approved at a shareholder’s meeting, including inflation adjustment recognition (Mexican GAAP), exceeds the capital contributions account

(CUCA for its Spanish acronym), and/or the capital reduction per share exceeds the CUCA per share.

The CUCA is the commonly used term for the tax account that accrues the shareholders capital contributions effectively made, including share premiums. The account takes into consideration the contributions made by shareholders adjusted for inflation. It is not considered as capital contributions profits or any other equity concept capitalized nor dividends reinvested in the company within a period of 30 calendar days following its distribution.

The balance of the company's CUCA is annually restated for inflation at the end of each fiscal year or at the date any new capital contributions or capital reductions are effectively made.

The balance of the company's CUCA may be transferred through mergers, consolidations or spin-offs.

In the case of spin-offs, the balance of the company's CUCA must be divided in the proportion of the company's equity, pursuant to the financial statements as approved by the shareholders for this purpose.

Mexican legislation allows shareholders of a Mexican company to receive a redemption payment from the company in exchange for shares on a tax-free basis to the extent that the redemption payment does not exceed the shareholders pro-rata share of the CUCA and the CUFIN accounts.

The mechanism to determine whether a capital redemption is treated as a taxable dividend distribution is as follows:

Reimbursement per share
(-)
Capital contributions account per share (CUCA)
=
Difference (when reimbursement is greater than the CUCA balance)
(x)
Number of shares redeemed
=
Dividend

The dividend so determined may be tax exempt if the balance of the CUFIN attributable to the shares redeemed is at least equal to the dividend amount. The CUFIN applied to cover this dividend amount must be reduced by the same amount at the time the reimbursement was paid.

The dividend amount that exceeds the CUFIN balance is taxed as a dividend in the manner indicated in section 5.2.1.

The CUCA per share must be multiplied by the number of shares redeemed and the resulting amount must be reduced from the overall company's CUCA balance but up to the amount of the redemption.

The balance of the CUCA per share must be determined by dividing the overall balance between the overall shares including those issued as a result of capitalizing any book retained earnings or other items included in the company's net equity.

The net equity in all cases must be restated pursuant to Mexican GAAP.

In the case of spin-offs, the transfer of the monetary assets to the new companies originated by the division, when such assets represent more than 51% of the total assets, is considered to be a capital reduction. Additionally, when the spun-off corporation keeps more than 51% of its monetary assets, this is also considered to be a capital reduction.

A capital redemption is also considered to occur when a company purchases its own shares (i.e., not treated as a capital gain but a dividend or profit distribution) and debits the amount in question to capital stock or to the reserve for the acquisition of its own shares, except when the shares acquired do not exceed 5% of the total capital stock and are resold within one year.

Any capital reduction made within two years following a capital increase may be treated as a sale of shares when the gain resulting from the rules applicable to a sale of shares exceeds the gain resulting from a capital redemption. For this purpose, the amount of the reimbursement per share is considered to qualify as gross income.

2.3. Financing

Mexican taxpayers can receive loans either from national banks, foreign banks, national related company or foreign related companies in order to be able to carry out their activities. It is important to take into account that some requirements must be met by taxpayers in order to deduct the expenses derived from those loans (interest) such as, mainly: i) the loan must be used to carry out the business activities in Mexico; ii) comply with thin capitalization rules, iii) the interest rate is agreed at market value, etc. Interest is not deductible for Business Flat Tax purposes as further described in 5. Corporate Taxation.

Also, it is worth mentioning if a company receives a loan or equity contribution for more than $600,000 Mxp **in cash**, the company that receives such amount must inform the tax authorities about this funding 15 days after the reception of the money. If there is a failure to do so, such amount will be considered as taxable income.

2.4. IP

In Mexico, there are two different laws regarding intellectual property:

- Industrial Property Law, enforced by the Mexican Trademark Office (IMPI), mainly for inventions, trademarks, industrial designs, and appellations of origin; and
- Copyright Law enforced by the Mexican Copyright Office (INDAUTOR), primarily for literary, musical, artistic, photographic and audiovisual works.

Both laws were developed from international standards as set by the World Intellectual Property Organization (WIPO) and are similar to the ones applied by most developed countries.

The most relevant provisions are as follows:

- Patents are protected for a 20-year term as of the filing date. Patented foreign inventions that have not yet been produced in or imported to Mexico qualify for a national patent. The patent will be granted to the original applicant abroad provided that he or she files an application in Mexico within a year of the date of enactment of this law. Such patent protection is available for chemical, pharmaceutical and biotechnological products and processes.
- Industrial and trade secrets are protected. Unauthorized disclosure by any person previously warned as to the confidentiality of the information constitutes a criminal offence.
- Minor inventions qualify for legal protection as utility models for a period of 10 years from the filing date. Also, industrial designs are protected against unauthorized imitation for 15 years.
- Brands have a valid duration after obtaining registration for 10 years, renewable for the same period of time.
- Registration of three-dimensional and collective trademarks is permitted.
- The term of protection for a trademark is 10 years from the filing date. An affidavit stating that use had been interrupted for periods greater than three years must be filed when applying for renewal of registration.
- Commercial notices can be protected on nationwide basis for a renewable period of 10 years.
- Appellations of origin are protected in the terms of the Treaty of Lisbon.
- Administrative procedures have been simplified to expedite the granting of patents and the registration of trademarks.

The Mexican Patent and Trademark Office will cooperate with its counterparts in other countries to reduce the local examination process for patents that have already been registered in other countries. Penalties, sanctions and damages can also be claimed.

This law replaces the Law on Inventions and Trademarks, as well as the Law for the Control and Registration of Transfer of Technology and the Use and Exploitation of Patents and Trademarks and its derivative statutes. Consequently, any agreements relating to technical assistance, transfer of technology (know-how), royalties or others to which the replaced law makes reference shall no longer be required to be recorded before the extinct National Registry for the Transfer of Technology.

The subject matter of copyright is usually described as "literary and artistic works," that is, original creations in the fields of literature and arts. The form in which such works are expressed may be words, symbols, music, pictures, three-dimensional objects, or combinations thereof (as in the case of an opera or a motion picture). The law provides for the protection of computer programs as literary works.

The most important provisions of the Copyright Law are the following:

- Copyright protection generally means that certain uses of the work are lawful only if they are done with the authorization of the owner of the copyright.
- In Mexican Copyright Law, these rights which together are referred to as "economic rights," are not exclusive rights of authorization but, in certain specific cases, merely rights to remuneration. In addition to economic rights, authors (whether they own the economic rights or not) enjoy "moral rights" on the basis of which authors are entitled to claim their authorship and require that their names be indicated on the copies of the work.
- An exception for this right is in those works of publicity, where the name of the author is not included; the author has the right to oppose the mutilation or deformation of his/her works.
- The owner of a copyright may generally transfer his/her right or may license certain use of his/her work. This transfer is always for an economic fee and in every case is temporary. Moral rights are, however, generally inalienable although their exercise may be waived by the author.
- Copyright generally vests in the author of the work. The law provides for exceptions and, for example, regards the employer as the original owner of copyright if the author was, when the work was created, an employee and was employed for the very purpose of creating the work.
- The law provides that protection is independent of any formalities, that is, copyright protection starts as soon as the work is created.
- The law provides a series of different contracts with specific regulations attending to the type of commercial use (advertising contracts, editing a musical piece contract, editing a literary piece contract etc.).
- Copyright protection is limited in time. As a general rule, the term of protection starts at the time of the creation of the work and ends 75 years after the death of the author.

- This law concerns only acts performed in Mexico. Consequently, the law cannot provide for the protection of the citizens of Mexico in another Country.

3. Incentives

3.1. Subsidies

Generally the application of specific allowances, subsidies or non-tax incentives has its origin in the intention of States or municipalities to attain social goals by attracting investments, or to encourage (for different reasons) growth of activities or areas in different industries.

These subsidies or incentives are generally negotiated directly with the State or municipality where the investment will be made and their importance depends on the size of the investment, whether there is land purchase, number of jobs to be created over a certain timeframe and other similar factors.

These may include, among others:

- Discount on the land purchase price
- Reduction of State taxes (real estate acquisition tax, property tax, payroll tax, etc.) for a determined period
- Reimbursement of training fees

3.2. Tax

Entities dealing exclusively in agricultural, livestock breading, forestry or fishing activities are exempt from income tax when their gross revenues do not exceed 20 times the annual minimum wage for each partner and the aggregate does not exceed 200 times the annual minimum wage for the geographic area in which the taxpayer is located.

When the taxpayer's income exceeds the above-mentioned limit, the tax payable is reduced by 30% from 2011 and 2012, 27.59% for 2013, and 25% for 2014 and income years going forward.

Additionally, there are others incentives:

1. Retirement insurance premiums and personal savings accounts.
2. Accelerated depreciation of new fixed assets.
3. Employers who hire persons with motor disabilities or impaired vision.
4. Incentive for the promotion of first employment.
5. Incentive for Mexican REITS.
6. Tax benefits for business corporations and trust engaged in the construction or acquisition of real properties.
7. Deduction of land by real-estate developers incentive.

8. Tax incentive for investment projects in domestic cinematographic and theatre productions.
9. Incentive for venture-capital investments in Mexico.
10. Deduction of special taxes paid in the acquisition of diesel, for use in machinery different to motor vehicles.
11. Deduction of special taxes paid in the acquisition of diesel for motor vehicles that were intended only for public and private transport of people or goods.
12. Deduction of toll roads for those which render public and private transport of people or goods.
13. Maquila tax incentives.

The tax incentives have been granted, in general terms, in the form of tax credits or deductions applicable to federal taxes; however some of the above require special authorization from the tax authorities.

4. Reporting, Audit and regulatory environment

4.1. Financial Reporting

Statutory Requirements for Books and Records

The Mexican Commercial Code and Income Tax Law requires that certain summary accounting records be maintained in the form of bound books; however, mechanized and electronic data processing systems are acceptable.
The principal books of account are the General Journal and the General Ledger. Loose-leaf or any other type of subsidiary records may be maintained. The principal and subsidiary records of a company must be written in Mexican pesos and in the Spanish language. They should be kept at the official domicile of the company.

Accounting Principles and Practices

Through mid 2004, the Accounting Principles Commission, a branch of the Mexican Institute of Public Accountants (MIPA), was responsible for issuing formal statements on generally accepted accounting principles, which differ in certain significant respects from those applied in the United States (U.S. GAAP). On June 1, 2004, this responsibility was transferred to a new entity Consejo Mexicano de Normas de Información Financiera) - (CINIF), independent from the MIPA. The standards issued by this entity are known as financial reporting standards (FRS) and are intended to achieve convergence with International Financial Reporting Standards (IFRS) in 2012.

Since June 1, 2004, CINIF has issued 33 FRS, some of them, effective for years after December 31, 2011. The FRS are mainly replacing statements previously issued by the Accounting Principles Commission. Those statements not specifically superseded by FRS continue to be mandatory and, thus, considered FRS. One of the FRS in force establishes the supplementary application of IFRS and, in limited circumstances, other country standards, in the absence of IFRS in the case of events or transactions not dealt with by existing FRS.

The principal changes introduced by FRS are:

- Recognition of the effects of inflation on the financial information is allowed only when the entity operates in an inflationary economic environment.
- Employee’s benefits, the recognition of an additional liability and the related intangible asset or any comprehensive item is no longer allowed.
- The use of nominal rates and the incorporation of the term salary increases due to promotions.
- Instead of the Changes in Financial Position Statement, the financial statements shall include the Cash Flow Statement.

- Income Statement items are split into ordinary and non-ordinary, thus eliminating special and extraordinary items.
- Employee statutory profit sharing is reported under ordinary expenses, as a component of other income and expenses, instead of as a separate line item after income (loss) from continuing operations.
- Disclosure of the officer or body authorizing issuance of the financial statements, as well as the date on which such authorization was granted.
- Retroactive recognition of the effects of changes in standards used.
- Beginning January 1, 2007, long-term liabilities at the call of the creditor because of a breach of covenants at the balance sheet date should be classified as short-term even if a waiver is obtained from the creditor prior to issuance of the financial statements. This requirement is the same as that established by IFRS, but departs from U. S. GAAP.
- Disclosure of the possibility that owners or others modify the financial statements after issuance.
- Disclosure of the name of the direct parent company, as well as the ultimate parent, when different.
- Disclosure of total benefits for key management personnel or relevant officers, in the aggregate, broken down in four categories. This only applies for public companies.
- Mandatory capitalization of comprehensive financial results (CFR) directly attributable to the acquisition of qualifying assets which acquisition period begins after December 31, 2006. The obligations or cost associate with removal of components of Fixed Assets (FA) originated during the constructions, development or used should be recognized as a provision. This standard should not be applied for companies who want only to sell their FA or obligations related with leasing.

The FRS in force cover:

- Structure of financial reporting standards
- Basic postulates
- Users' needs and objectives of financial statements
- Qualitative characteristics of financial statements
- Basic elements of financial statements
- Recognition and valuation
- Presentation and disclosure
- Supplementary application of international financial reporting standards
- Basis of conclusions of the conceptual framework
- Accounting changes and correction of errors
- Cash Flow Statement
- Comprehensive Income Statement
- Statement of change in equity
- Comprehensive income
- Segment information
- Business acquisitions

- Consolidated and combined financial statements
- Interim financial information
- Effects of inflation
- Subsequent events
- Earnings per share
- Translation of foreign currencies
- Financial statements of not-for-profit entities
- Cash and cash equivalents
- Financial instruments
- Accounts receivable
- Inventories
- Prepaid expenses
- Property, plant and equipment
- Investments in associates and other permanent investments
- Intangibles
- Liabilities, accruals, contingent assets and contingent liabilities and commitments
- Financial derivative instruments and hedge transactions
- Shareholders' equity
- Financial instruments with liability or equity characteristics, or both
- Related parties
- Impairment of long-lived assets
- Employee's benefits
- Taxes on income
- Leases
- Capitalization of comprehensive financial results
- Construction-type contracts
- Earnings per share
- Agriculture
- Revenue and contributions received by not-for-profit entities, as well as contributions made by them.

In addition to the statements, the CINIF used to issue interpretive circulars (INIF) on the application of the statements to special events and/or transactions. CINIF has continued with this practice when necessary.

Inflation Accounting

FRS B-10 is effective for years beginning after December 31, 2007 and supersedes Bulletin B-10. The FRS states that the Recognition of the effects of inflation is required only when an entity operates in an inflationary economic environment when cumulative inflation over the immediately preceding 3-year period is equal to or greater than 26%.

When an entity ceases to operate in an inflationary economic environment, the restatement effects determined through the last period in which the entity operated in an inflationary economic environment (in this case 2008), must be kept and shall be reclassified on the same date and using the same procedure as that of the corresponding assets, liabilities and stockholders' equity. Should the entity once more operate in an inflationary economic environment, the cumulative effects of inflation not recognized in the periods where the environment was deemed as non-inflationary should be recognized retrospectively.

Valuation of Assets and Liabilities

Assets and liabilities on the most recent Balance Sheet presented and income, costs and expenses on the Income Statement are stated as follows:

- All rights and obligations arising from financial instruments, including derivatives, are recognized on the balance sheets and classified into one of three categories, depending on the purpose for which acquired: (i) held-to-maturity, (ii) trading, or (iii) available-for-sale. Trading and available-for-sale instruments are reported at fair value and held-to-maturity instruments are reported at amortized cost. Changes in the carrying amounts of trading instruments, including the related costs and yields, as well as other-than-temporary declines in value of held-to-maturity instruments, are reported in operations.

- Gains or losses arising from changes in the fair value of financial instruments classified as available-for-sale, as well as the related gain or loss from monetary positions, are reported under comprehensive income within shareholders' equity, excluding the impairment of these assets (which is carried to the results of operations) provided the instruments are not sold or transferred to a different category. Upon sale of the instruments, the effects recognized in comprehensive income are carried to the results of operations for the year.

- Inventories are stated at the lower of historical cost and net realizable value.

- Cost of goods sold represents the replacement cost of inventories at the time of sale, increased, as applicable, for reductions in the replacement cost or net realizable value of inventories during the year.

- Investment in subsidiary and/or affiliated companies is primarily accounted for under the equity method; however, lack of control (as defined in FRS B-8) prevents the company from applying this method and/or consolidating.

- Intangible assets acquired in a business combination should be accounted for at fair value as at the date of acquisition and reported separately, unless their cost cannot be reasonably determined, in which case these assets should be reported as goodwill. Should there be no active market for these intangible assets, the entity must determine the assets fair value based on recent transactions of similar assets. These assets and other non-monetary assets are subject to impairment evaluations, both at the date of acquisition and at least annually thereafter. However, the stated value of non-monetary assets does not have to be reduced to zero before recognizing a negative goodwill (as required by U.S. GAAP)

- Goodwill resulting from business acquisitions is carried in the balance sheet as a non-current asset which is considered to have an indefinite useful life and, therefore, is not amortized but is subject to periodic impairment evaluations. Amortization of goodwill is not tax deductible. Under U.S. GAAP, goodwill is not amortized and is also subject to periodic impairment evaluations. Negative goodwill upon acquisition of businesses is reported under non-ordinary income. At present, this is non-taxable income.

- Property, plant and equipment including those under capital lease, are initially recorded at acquisition cost and through December 31, 2007, adjusted by applying the National Consumer Price Index (NCPI) or, when imported, the consumer price index of the country of origin, not in excess of recoverable cost, may be used. Depreciation charged to operations is based on the useful life of the assets and usually differs from the depreciation rates allowed as a tax deduction. The write-down to recoverable cost (impairment), when necessary, is charged to operations for the year as an operating item and, if recoverable cost increases in subsequent years, a write-up may be credited to operations for the year, not to exceed the previously recognized write-down. The capitalization of net comprehensive costs to finance assets under construction (interest and foreign exchange gains or losses) is mandatory beginning in 2007. Capitalized costs should be depreciated over the lives of the related assets. Changes arising from segregation into components of property, plant and equipment items having a clearly different useful life, will be effective for fiscal years beginning on or after January 1, 2012.

- U.S. GAAP do not accept adjustments for inflation (but translates these assets at historical rates of exchange in highly inflationary economies) and requires capitalization of interest costs associated with their construction, to be depreciated over the lives of the related assets. Also, a write-down to fair value (instead of recoverable cost) may be required and charged to operations for the year; however, no subsequent write-ups are allowed.

- Intangibles relate mainly to identifiable costs where future benefits are reasonably certain and are under the control of the company. Their recognition is restricted and should be amortized to income over their useful life, unless indefinite. These assets are subject to periodic impairment evaluations. The tax deductibility of these items is also restricted.

- Financial statements of foreign subsidiaries for consolidation into the financial statements of a Mexican company, or for applying the equity method of accounting, if the subsidiaries operate in an inflationary economic environment, the financial statements are first adjusted for inflation in the country where the investees operate and then translated into the reporting currency. Differences in translation are carried to shareholders' equity. Through December 31, 1990, most U.S. companies considered Mexico to be in a hyperinflationary economy (more than 100 percent cumulative inflation over a three-year period, under the provisions of SFAS-52) and translated the financial statements of their subsidiaries at historical exchange rates. Then, beginning in 1991, some companies changed the reporting currency of their Mexican subsidiaries to the functional currency of such subsidiaries, because of, among other factors, the drop in the official inflation rates of the Country; thus, the financial statements of the subsidiaries were translated based on "re-measured" pesos, i.e., a combination of historical and current exchange rates. Again in 1996, the reporting currency had to be changed to the U.S. dollar, because of high inflation. Since cumulative inflation for the three-year period ended December 31, 1998 was below 100 percent, most companies changed again the reporting currency of their Mexican subsidiaries to the Mexican peso in 1999 and have continued to translate the subsidiaries' financial statements based on "re-measured" pesos.

- Non-controlling interest consolidated subsidiaries is presented as a separate component within shareholders' equity on the consolidated balance sheets. Under U.S. GAAP non-controlling interest is presented between liabilities and shareholders' equity.

- Employee benefits liabilities (pensions, severance and seniority premiums) are to be recorded in the balance sheet. The related expense is based on a specific methodology under FRS D-3 that reflects the concepts of accrual accounting, carrying cost for the year to the income statements systematically over the service lives of the employees covered by the plan (similar to U.S. GAAP).

- For tax purposes, only actual payments or contributions to a trust fund approved by the Treasury Department are tax deductible. Compensated absences are also accrued during the period this benefit is earned by the employee. As a result, differences with U. S. GAAP have been practically reduced to the methods of computation.

- Deferred taxes are accounted for under the asset and liability method, in a way similar to U.S. GAAP. Also, under FRS, deferred employee statutory profit sharing is accounted for under the asset and liability method.

- There are other discrepancies between U.S. GAAP and FRS, and assistance should be obtained when trying to evaluate Mexican FRS financial statements.

Disclosure

The classification of certain items varies to a certain extent from U.S. GAAP and IFRS. Footnote disclosures are less stringent under Mexican FRS than under U.S. GAAP and IFRS.

Corporate taxation

In Mexico, there are two principal taxes: Corporate Income Tax (CIT) and Business Flat Tax (IETU as per its acronym in Spanish) which, in general, apply for residents in the country, permanent establishments of non-residents and non-residents with Mexican-source income for CIT purposes only in this last case. Please refer to section 5 for further detail.

Taxable income – CIT is imposed on a company's profits on an accrual basis, which consist of business/trading and passive income, and capital gains. Expenses may be deducted in computing taxable income. Inflationary accounting for tax purposes is applicable to certain concepts of revenue and expenses.

IETU – The IETU operates under a cash flow method and applies since January 1, 2008. It taxes profits which are determined by reducing the major part of revenue with most expenses and costs, excluding some specific items. The tax rate is 17.5% for 2012.

The main differences between book and income tax treatment of income and expense items are the following:

Income or expense	Income or Expense Income Tax Treatment	Business Flat Tax (IETU for the Spanish abbreviation)
Interest income and foreign exchange gains	Taxable and included in inflationary effect determined under the income tax rules	Non taxable (except for entities applying financial margin)
Bad debts and other allowances for receivables	Deductible when the requirements of the Income Tax Law are fulfilled [(1)]	Deductible when exportation income was deemed to be received and the requirements in the Income Tax Law are fulfilled. However this law started in 2008, as a result these allowances could be deductibles for receivables from 2008 thereafter.

Inventory purchases	Non deductible when made, up to December 31, 2004 [1]	Deductible when acquired and the requirements of the Income Tax Law are fulfilled. (cash flow basis)
Cost of goods sold	Deductible, since December 31, 2005 [1]. Transition provisions are established at January 1, 2005	Non deductible
Depreciation and amortization expenses, except goodwill	Deductible at the maximum rates specified by law, under the straight-line method and adjusted for inflation under rules differing from Mexican FRS [1]	Not applicable. Fixed assets and expenses are totally deductible if they have been paid (cash flow basis).
Goodwill	Non deductible	Not applicable
Accruals	Amount due to specific creditors payable on defined dates may be deducted; all others are non-deductible [1]	Amount due to specific creditors' payable on defined dates may be deducted when subject to the financial margin; all others are non-deductible. However the law started in 2008, as a result accruals will be deductible by obligations known from 2008 thereafter
Employee profit sharing (EPS)	The EPS is not a deductible item from the taxable profit in the year it is paid.	Not applicable
Negative goodwill, reported as gain on business acquisitions beginning in 2005	Non taxable	Non applicable

Tax losses carried forward	Tax losses may be carried forward for ten years, adjusted by inflation (1)	Non applicable. Credit corresponding to deduction higher than income could be carried forward for a ten-year period.
Tax on assets (minimum tax payable)	Tax on assets was abrogated in 2008. Some specific rules could be applied in order to be able to recover a portion of the tax on assets effectively paid within the ten previous years	May be credited in future years if some rules are complied with
Interest charged or paid on loans to individuals and legal entities	Taxable / deductible complying with requirements	Not taxable / non-deductible
Royalties received or paid by related parties	Taxable / deductible complying with requirements	Not taxable / non-deductible except if deriving from the leasing of industrial, commercial, or scientific equipment
Contributions for future capital stock increases	Not taxable except when the increase is made in cash and is in excess of 600,000 Mxp and it is not reflected in the tax report to the tax authorities.	Not taxable
Dividends	Taxable when received from abroad	Not taxable
Salaries and wages	Deductible	Not deductible. There is a salaries and wages credit

(1) These items usually result in temporary differences.

Under the self-assessment regime, advance corporate tax is payable in 12 instalments. The annual tax return must be filed within the first 3 months of the following year. From January 2011, individuals and legal entities are obligated to issue digital invoices/bills.

4.2. Audit

Auditing Standards

The International Auditing Standards (ISAs) issued by the International Federation of Accountants (IFAC) through International Auditing and Assurance Standards Board (IAASB), will be applicable in Mexico for accounting periods beginning January 1, 2012.

Reports on the financial statements (opinions) must be signed with the name of the CPA (an individual), although it is permitted to mention the name of the accounting firm of which he or she is a member.

Audited Financial Statements

All companies listed on the Mexican Stock Exchange, as well as banking institutions, insurance companies and other companies in the financial sector, and majority government-owned corporations, are required to file annual audited financial statements with the opinion of a CPA.

Many business taxpayers and not-for-profit organizations are obligated to file audited financial statements accompanied by a statutory tax report for review by the Federal Tax Administration, a branch of the Treasury Ministry. Most companies use their auditor's reports for this purpose.

In general, local as well as foreign banks request audited financial statements as a standard requirement for granting loans and/or lines of credit.

The following basic financial statements are included with the public accountants' reports:

- Balance sheet
- Income statement
- Statement of changes in shareholders' equity
- Cash Flows Statement
- Accompanying notes to financial statements

Statutory Examiner's Report

All companies must appoint one or more statutory examiners at the annual general shareholders' meeting. Shareholders owning 25 percent of the capital stock can appoint a statutory examiner.

Statutory examiners must not be employees of the company or blood relatives of any board member. However, they may own shares in the company and are required to guarantee the performance of their duties by a bond or a nominal cash deposit.

In addition to reporting on the company's year-end financial information, statutory examiners should examine the books and records, as well as the monthly balance sheet and income statement at least once a month. They have the right to modify the agenda for shareholders' and directors' meetings and can call shareholders' meetings whenever considered necessary. Although they must attend all shareholders´ meetings and board of directors´ meetings, they have no voting rights at such meetings.

Statutory examiners must be informed in advance of all meetings. In addition, if a shareholder advises a statutory examiner of any irregularity, the statutory examiner must report on this, with recommendations at the shareholders' meeting. Statutory examiners are held jointly responsible with the company for any legal violation.

Although the duties and obligations of statutory examiners are fully detailed in corporate law, no mention is made of the qualifications they must have.

4.3. Tax reporting

To be allowed to sign tax reports, the CPA must be certified and registered with the Federal Tax Administration and comply with annual requirements as to continuing education.

In addition to the independent auditor's report, basic financial statements and footnote disclosures mentioned above, the tax report must be submitted through the internet, complying with very strict regulations and must contain the following information which is presented in approximately 50 exhibits:

- A special report signed by the auditor (an individual), stating that all federal tax obligations have been complied with. Materiality considerations are practically not allowed for purposes of this report.
- A questionnaire comprised questions regarding the entity´s tax status
- A questionnaire comprised questions regarding transfer pricing
- Detailed analyses of income and expense accounts included in the statement of income.
- Details of amounts subject to federal taxes and dues, either withheld or payable by the company and including social security dues and other payroll taxes, retirement fund and housing fund, sworn by the chief financial officer.
- Reconciliation of taxable income to book income (or loss) and cash flows.
- Reconciliation of income included in the income statement to that included in the income tax return.
- Details of federal taxes payable at year end, stating the date and place of payment.

This report requires both additional work and responsibility from the CPA to ascertain that all federal taxes have been withheld and paid properly (largely regardless of materiality). The report also requires additional work from the companies' personnel to prepare the related supplementary information mentioned above and special training on the use of the software required by the Federal Tax Administration, in addition to an electronic "key", "certificate" and a password for delivery.

It is a common practice for the tax authorities to review reports filed by CPAs, including the supporting audit working papers. No bases are established for the selection and, thus, the likelihood for a company being selected, even for several consecutive years, is unpredictable. Generally, these reviews include the CPA visiting the tax authorities, so that they may inquire of the work performed and request additional detailed information, which usually has to be prepared by the company's personnel.

On June 30, 2010, the Tax Authorities announced through Federal Decree in the official gazette (Diario Oficial de la Federación) the possibility for the taxpayers to not submit the Tax report for the fiscal year 2010 and thereafter subject to compliance with certain information required by the tax authorities. Taxpayers required auditing of their financial statements by a CPA and those who choose not to submit the tax report must comply with the following:

A) Should state in their normal income tax return that it corresponds to the period for which the option is exercised. This option must be exercised within the laws established for the submission of the CIT tax return.
B) Provide during August 2011, via Internet, certain information required by tax authorities, amongst other:

- Balance sheet
- Income statement
- Statement of changes in shareholders' equity
- Cash Flow Statement
- Expenses analysis
- Detailed analyses of income and expense accounts included in the Income Statement.
- Details of amounts subject to federal taxes and dues, either withheld or payable by the company.
- Reconciliation of income included in the Income Statement to that included in the CIT return.
- Details of federal taxes payable at year end, stating the date and place of payment.
- Related parties transactions

Statutory Tax Reports

Taxpayers with annual income obtained in the previous year exceeding MXP $34,803,950 or with total assets exceeding MXP $69,607,920 or with at least 300 employees working in each month of the previous year may elect to engage an independent public accountant to perform an annual tax audit and issue a statutory tax report to be filed no later than June 30 of the following year of the corresponding tax year. Taxpayers not included in these situations may also elect to file this report. One of the advantages of filing such report is that any review by the authority is conducted through the public accountant who issues the report instead of making a direct review at the taxpayer's premises.

The filing of an audit report is mandatory for legal entities participating in a merger or spin-off, as well as those entitled to received donations or entered into a liquidation process. Penalties for not complying with these provision, range from MXP $9,790 to MXP $97,930.

4.4. Regulatory aspects

4.4.1. Competition

Antitrust Law (Federal Law of Economic Competition)

This law became effective in June 1993. The ultimate meaning and significance of the Federal Law of Economic Competition will depend on the regulations, decisions and opinions issued by the Federal Commission of Competition, which is a decentralized administrative entity of the Ministry of Economy.

The law forbids monopolies, cartels and activities that, under certain terms, diminish or obstruct the competition and free markets in the production, processing, distribution and commercialization of goods and services. Also, the absolute monopolistic activities are provided in this law and are declared void and are subject to penalties in addition to criminal liability under other laws. Regarding these activities, the law forbids agreements, arrangements or combinations of economic agents that are competing amongst them, whose purpose or effect is to fix, raise, coordinate or manipulate prices.

Acts, agreements or combinations whose purpose or effect is to displace other market agents, substantially obstruct their access to the markets or establish exclusive advantages in favor of one or various persons, under certain circumstances, shall be considered monopolistic activities by this law.

The law provides that the above mentioned Commission should be notified of certain concentrations before they are created, for example, if the transaction's value exceeds an amount equal to 18 million times the minimum daily wage; when the transaction implies the accumulation of 35 percent or more of the assets or stock of an economic agent whose assets or annual sales exceed an amount equal to 18 million times the minimum daily wage or when the agents participating in the transaction, individually or jointly, have assets or annual sales for an amount exceeding 48 million times the minimum daily wage.

4.4.2. Financial

Year-End

The fiscal year of corporations organized within the calendar year will run from the day in which they were incorporated through December 31. Any subsequent fiscal year shall run from the first to the last day of every calendar year, except in the case of the corporation’s liquidation or winding-up. For financial purposes, a different year may be elected.

Accounts

Corporations must prepare the following financial information within three months of the close of the year-end: a balance sheet, an income statement, a statement of shareholders’ equity, a statement of changes in financial position, and the necessary footnote disclosures. A management report containing all the foregoing information should be delivered to the statutory examiner at least one month before the shareholders’ meeting. Within 15 days of receiving this information, the statutory examiner should prepare an opinion and any proposals for change. Although this is a tight schedule, in practice the financial statements are usually ready for the audit in plenty of time to issue an opinion, as required by law.

The financial information and the statutory examiner’s report must be in the hands of the Sole Administrator or the Board of Directors and available for inspection by the shareholders at least 15 days prior to the shareholders’ meeting. Fifteen days after approval by the shareholders, the financial statements, footnote disclosures and statutory examiner’s report should be published in the Official Gazette of the jurisdiction where the company has its address, and a copy must be delivered at the Public Registry of Commerce. If there are any votes against approval, these must also be published and registered. If the financial information and statutory examiner’s report are not ready in time, the shareholders may dismiss and take action against both the directors and the statutory examiner.

4.4.3. Corporate Governance

Shareholders’ meeting

The main business management decision level of the company is the shareholders’ meeting, which must be held at least once a year within four months of the close of the company’s fiscal calendar year. This meeting approves, rejects or modifies financial statements, elects the sole administrator or board of directors and also elects the statutory examiner (comisario). Extraordinary shareholders’ meetings must be held to rule on increases or decreases in fixed capital, liquidations, mergers and other items of a special nature which implies a modification of the by-laws of the corporation.

Ordinary shareholders' meetings require a quorum representing 50 percent of the company's capital stock, and resolutions are passed by a majority vote of the shares represented. On the other hand, special shareholders' meetings require a quorum of 75 percent of the capital stock unless the by-laws require a higher percentage. Resolutions must have a favourable vote of at least 50 percent of the share capital. All shareholders' meetings must be held at the company's legal address. The sole administrator, directors and statutory examiner cannot hold proxies for voting.

The Shareholders' Meeting minutes must be summarized within at least fifteen days prior to the execution of the Meeting, but if all shareholders are represented at the Meeting, this summary is not necessary.

The minutes of extraordinary shareholders' meetings must be notarized and registered with the Public Registry of Commerce. Directors may not vote in connection with the approval of financial statements.

The by-laws may provide that resolutions taken outside the shareholders' meeting and approved unanimously by the shareholders representing the total of the voting shares or of the special category they belong to, as the case may be, will have, for all legal purposes, the same force as if taken within the shareholder's meeting, as long as resolutions adopted are confirmed in writing. A corporation is required to keep Corporate Books in order to keep record of the Shareholders' meeting minutes.

Voting truce between shareholders is not permitted and shareholders must have full freedom to vote. Thirty-three percent of shares is enough to call a shareholders' meeting for a particular reason or to postpone voting for three days on any matter discussed at a shareholders' meeting.

Thus, a minority shareholder holding 33 percent of the shares can cause procedural problems. Any shareholders who oppose proposed changes in the corporate purpose, corporate nationality or reorganization of the company can request reimbursement of their shares at the book value listed on the last balance sheet approved by the shareholders' meeting. This reimbursement must be requested within 15 days after the corporate change was agreed.

Management Structure

In a general meeting, the shareholders may appoint a sole administrator or a board of directors (depending on what the deed of incorporation provides). These administrators or directors may or may not be shareholders. The quorum for a board meeting is at least 50 percent of the directors and resolutions are passed by a majority vote of those present. However, the chairman of the board has the deciding vote.

The by-laws or the general shareholders' meeting, as the case may be, may establish the obligation for administrators and managers to grant a guarantee to cover any liability that may arise while performing their duties.

Shareholders representing 25 percent of the share capital have the right to elect one director. Directors may be foreigners who live abroad and directors' meetings may be held anywhere. Nonetheless, the tax residency derives from the mind and management location and hence, care should be taken to ensure Mexican directors are elected and some meetings held in Mexico. Where a quorum is not present the statutory examiner has the right to appoint provisional directors. The resolutions of the Board of Directors must be recorded in a Corporate Book that must be kept by the corporation.

Legal Representatives

Legal representatives of corporations can be Mexican nationals or foreigners. In both cases they should have a Mexican taxpayer registration number (tax I.D. number).

If the Legal Representative of the Company is a foreign person considered by the Mexican Immigration Laws, in order to be able to perform his duty, he must obtain the correspondent immigration permit that is issued by the National Institute of Immigration.

However, the legal representation of the corporation corresponds to the Sole Administrator or the Board of Directors and their faculties commonly are granted in the by-laws of the corporation

Environment

The General Law of Ecological Equilibrium and Environmental Protection (the "Environment Law"), enacted in 1988, is the primary Mexican environmental statute. It contains specific chapters concerning air, water, soil, hazardous waste, noise, vibration, thermal energy, lighting, odour and visual pollution. It also sets out enforcement procedures and other provisions concerning the respective responsibilities of the Federal and State Governments.

SEMARNAT

The Ministry of Environment and Natural Resources (SEMARNAT) is the federal body which oversees the enforcement of the Environment Law and sets national policy procedures through the frequent issuance of technical standards to control the allowable level of emission of pollutants. Although several of Mexico's States and the Federal District have also enacted environmental laws, SEMARNAT is the only governmental entity actively engaged, at present, in enforcement and the only entity empowered to enact and enforce laws regarding hazardous wastes.

Nevertheless, all activities conducted in Mexico must comply with the Federal and State laws.

The Environment Law provides a licensing system based upon media-specific discharge limitations for air emissions and wastewater discharges and for the generation, transportation, handling and disposal of hazardous waste. All companies operating in Mexico must limit the amount of pollutants that they release or discharge within the specific ranges issued by SEMARNAT. In addition to establishing technical standards applicable to all wastewater discharges, the wastewater regulations specify the allowable discharge level for specific contaminants. For example, the specific industry discharge limitations apply to glass, textile, petroleum, construction, synthetic rubber, tire, upholstery, sealant, sugar cane, carbonated beverage, lumber, meat packing, leather, fertilizer, plastic, synthetic polymer, beer, milk, metal, paper, food packing, iron and steel industries.

All companies must comply with the licensing system provided by the Environment Law. Depending on the nature of its activities, a company may be required to file for an operating license; file an environmental impact statement; file for a residual water discharge license; file for an air discharge license; and register, file and maintain documents concerning hazardous wastes.

Environmental Impact Statement

Environmental impact statements must be filed for a wide range of proposed activities, generally whenever the activity may cause ecological imbalance or exceeds the limits and conditions provided for in the ecological technical standards and regulations issued by the Federal Government.

The Environment Law defines the term “ecological imbalance” as “alteration of the independent relationships between natural elements which form the environment and which negatively affects the existence, transformation and development of man and other beings.”

SEMARNAT has taken the informal position that the best way for a company currently operating or contemplating future operations to ensure compliance with the Environment Law is to file an environmental impact statement. Upon receipt of the statement, the Government may fully authorize the activity, authorize the activity on the condition that changes must be made, or deny a license for the activity.

Operating License

All “fixed sources” which emit odours, gases, solid particles or liquid particles into the air, i.e. all manufacturing plants, including those plants which were operating prior to the enactment of the Environment Law, must obtain an operating license from SEMARNAT. SEMARNAT may grant or deny the license or require changes to be made.

5. Business Taxation

5.1. Corporate tax

5.1.1. General system and rates

Tax Legislation

Mexico's tax legislation is based on civil law principles and it is comprised of several laws containing provisions regarding each specific tax. Taxes are usually levied on income, capital and certain transactions and activities. The fundamental legal structure of taxation is defined by the Mexican Constitution, which establishes procedures whereby Congress enacts tax laws.

In addition to special tax laws there are some basic laws that relate to general tax administration, such as the Annual Revenue Law and the Federal Tax Code. Most of the laws have a series of regulations issued by the tax authorities, which provide some procedures and interpretations.

Annual Revenue Law

Effective January 1 of each year, the Annual Revenue Law establishes the federal taxes, duties, fees and all other types of internal revenues payable to the federal government during that calendar year. However, tax administration is in accordance with the applicable tax laws for each specific tax.

Federal Tax Code

The Federal Tax Code (FTC) provides the basic tax administration procedures applicable to federal tax laws, unless specific provisions are contained in these laws.

Generally speaking, it provides definitions for taxes, taxpayers, domicile, resident status, and exemptions, as well as rules relating to administrative procedures, litigation before tax courts, penalties, statutes of limitation, reimbursements and others. The major provisions of the FTC are summarized in the following paragraphs.

Domicile

The tax domicile of an individual engaged in business activities is considered to be his or her main place of business. The tax domicile of a corporation is considered to be the place of the business's main administration.

Residence

Individuals are considered Mexican residents (solely for tax purposes) when they establish their place of abode in the country. If such persons have their place of abode in another country as well, they would be considered Mexican tax residents if they have their centre of vital interest in Mexico.

For these purposes, the centre of vital interest is in Mexico when:

a) 50% of the revenue is derived from Mexican sources.

b) The main place of activity is situated in Mexico.

Mexican individuals who change their residence to a country considered having a preferential tax regime would still be considered residents in Mexico for tax purposes for the year the notice is made and the three following years, unless that country has entered into a broad exchange of information agreement with Mexico.

Legal entities are deemed Mexican residents when the principal business administration or place of effective management is established in Mexico.

In this respect, the Regulations to the Federal Fiscal Code considers that such situations arise when the persons making or executing the decisions dealing with the control, direction, operation or management of the legal entity and its activities are in Mexico.

Main applicable taxes:

1. Federal taxes:
    a. Income Tax
    b. Business Flat Tax
    c. Value Added Tax
    d. Tax on Cash Deposits
    e. Special Tax on Production and Services
2. State or local taxes:
    a. Real Estate Acquisition Tax
    b. Property Tax
    c. Payroll Tax

Fiscal Period

The fiscal period must be twelve months for legal entities and individuals, coinciding with the calendar year, except for the initial and liquidation periods (irregular period). Therefore, the start and closing dates must always be January 1 and December 31, respectively. In case of liquidation of an entity, a fiscal period will be considered for the entire liquidation period. In the cases of liquidations, mergers or spin-offs, where the original entity ceases to exist, the fiscal period will end early.

Updating (Restating for Inflation)

Late tax payments will be restated using inflation indexes from their due date to the actual date of payment. Interest for late payment and penalties are computed on the updated taxes.

Tax and related items authorized for extension will also be updated with inflation indexes.

All balances in favor of taxpayers that should be refunded by the tax authorities will also be updated with inflation indexes from the date of filing the return that shows the balance in favor or from the date the payment was made to the date of actual refund. The term for making the refund is 40 business days from filing the refund request along with all the relevant information, provided no additional information is requested. If the taxpayer files tax reports by CPA, the refund period should not exceed 25 business days.

Interest for late payment will be applied on updated tax payments at a rate determined annually by Congress (currently an annual rate of 13.56% or 1.13% per month). Generally speaking, surcharges are limited up to five years and in certain cases of major irregularities may be extended to ten years.

The same rules for late interest payments are applicable to interest payable by the authority for delayed/slow refunds of taxpayers' favourable balances.

Offsetting

Balances in favor may be offset by taxpayers and will also be updated with inflation indexes from the month in which the amount in favor results, to that in which the offsetting is applied.

Favourable balances derived from federal taxes may be offset according to the requirements established by the tax authorities through general rules that must be fulfilled by the taxpayers, and among others, a notice of offsetting must be filed with the tax authorities.

Amended Returns

Taxpayers may only file three amended returns to modify the original one provided that the tax authorities have not initiated an audit. This limitation will not apply when there is an increase in taxable income or in the value of taxed activities; there are less deductions or net operating losses or creditable taxes and/or offset amounts; and when the taxpayer has its financial statements audited for tax purposes, he may correct his original tax return as a result of the audit tax report.

Verification powers

In order to verify that taxpayers, parties jointly and severally liable with them, or third parties related to them have complied with the tax provisions and, as applicable, to assess tax deficiencies or unpaid contributions, as well as to determine if any tax offenses have been committed and to provide information to other tax authorities, the authorities are authorized to require from the taxpayers the documentation or vouchers that prove the legal presence in Mexico, the ownership and importation of goods. In exercising their verification powers and ascertaining compliance with tax obligations with respect to taxes and periods already reviewed, the tax authorities may only do so when dealing with different events and many base their review on the documentation supplied by the taxpayers with the defence means filed by the latter.

Audited Years

Where the authorities determine omitted taxes corresponding to a year that has already been reviewed but that arises from different events, such a determination should be supported by information supplied by third parties.

Likewise, the determination should rely on specific concepts not previously reviewed and also on information that taxpayers have already contributed through the defence means filed and not produced to the tax authorities during the exercise of their verification powers.

Presumptive determination

As of 2008, it shall be deemed that deposits in excess of $1,000,000 in bank accounts during a given fiscal year, of persons who are not registered in the Federal Taxpayer's Registry (RFC) or not required to keep books, is income on which taxes should be paid.

Examination of Returns and Statute of Limitations

The tax authorities are entitled to examine and assess additional taxes for any year at any time within a five-year period commencing on the day following the day taxes were due or tax returns were filed, including amended returns: if the taxpayer has deducted tax losses from the tax profits, the tax authorities are entitled to examine and assess the information relating to such tax loss, regardless of the fiscal year in which it was generated up to 5 years after the amortization of the loss. For this purpose, the tax authorities may audit the taxpayer's operations or third parties' operations relating to those of the taxpayer. The same five-year period applies to taxpayers' claims for refund of tax overpayments.

A special ten-year statute of limitations applies to cases in which the taxpayer has incurred major irregularities such as not having a tax ID number, failing to file a tax return, or not properly maintaining accounting records.

Appeal Procedures against Tax Assessments

In general terms, taxpayers are granted a period of 45 business days in which to file with the Ministry of Treasury an appeal for reversal at the administrative level resolution or to elect to initiate legal proceedings at the federal tax court level as a result of an assessment derived from a review of a taxpayer´s returns.

Accountants and attorneys often take part in preparing such an appeal and may be in charge of handling the appeal. The appeal must be filed in writing and must state the grievances caused by the decision, with evidence offered. A copy of the Ministry of Treasury's decision must be attached to the appeal.

The authority in charge of deciding for or against the appeal must issue a decision within three months of the filing date.

Collection of tax assessments is suspended at the taxpayer's request during the handling of appeals or legal proceedings provided that the amount of taxes involved and surcharges thereon is guaranteed. Generally, this guarantee is given by means of a bond.

Court and Legal Recourses Available to Taxpayers After Administrative Relief is Exhausted

If an unfavourable decision is issued and administrative relief has been exhausted, the decision may be appealed at the federal tax court within 45 business days. Legal proceedings are handled by attorneys, usually with assistance from accountants as expert witnesses in accounting matters. The federal tax court's decisions may be appealed at the circuit court and this decision is definitive.

Loans and Equity contributions

If a company receives a loan or equity contributions for more than MXP $600,000, in cash, the company that receives such an amount must inform the tax authorities about this funding within 15 days after the receipt of the money; in the event of a failure to inform, such an amount will be considered as taxable income.

5.1.2. General Computation

Income tax

For 2011, the following groups of taxpayers are subject to income tax:

1. Residents of Mexico on their worldwide income.
2. Permanent establishments of residents abroad on income attributable to those permanent establishments.

3. Foreign residents without having a permanent establishment in Mexico on income arising from Mexican sources.

Mexican residents and permanent establishments pay tax on a calendar year basis. Foreign residents not having a permanent establishment in Mexico are, in general terms, subject to withholding tax by the payer of the item of income. Each withholding tax remittance is deemed to be a final and definitive payment.

For 2011 and 2012, the corporate income tax rate is 30%. However, under transitory provisions, the rate will be gradually reduced to 29% in 2013, and 28% for the 2014 fiscal year and onwards.

Taxable Income

The MITL establishes that taxable income includes any income received in cash, goods, services, credit or any other form during the year, including income from establishments located abroad and the annual inflation adjustment to be discussed later.

Nevertheless, the concepts listed below are not included in taxable income:

- Capital contributions;
- Payment of losses by shareholders;
- Premiums obtained by the issuance of shares;
- Revaluation of assets and capital for inflation;
- The equity method;
- Dividends received from Mexican corporations.

Authorized Deductions

On the other hand, taxpayers may claim, among others, the following deductions:

- Returns of merchandise, discounts or refunds;
- Cost of goods sold;
- Expenses;
- Investments in fixed assets;
- Bad debts, if certain requirements established in the MITL are met;
- Annual inflationary adjustment.

It is important to note that some requirements must be met for a taxpayer to deduct the above items:

- The deductions must be strictly indispensable for carrying out the taxpayer's trade or business;
- The invoices must comply with tax requirements[3];

[3] Starting January 2011, all taxpayers should issue electronic invoices complying with law requirements and monthly filings.

- The payments must be made with a nominative cheque, except as stated in the corresponding regulations;
- The deductions must be recorded in the accounting records.
- Any IT withholdings applicable must have been made and remitted to the tax authorities.

Furthermore, some deductions have additional requirements, including:

- Disbursements for professional services rendered by individuals or professional service firms, and rents to individuals must actually be made;
- Duties must be paid on goods imported from abroad;
- Travel expenses must be made outside of a 50 km radius from the taxpayer's tax domicile.

Among others, the following items are not deductible:

- IT, Cash Deposits Tax or Business Flat Tax paid;
- Certain gifts;
- Disbursements made in bars;
- Premiums on capital reimbursements;
- Goodwill;
- Provisions for the creation or the increase of complementary reserves of assets or liabilities.

Inflationary Accounting for Tax Purposes

The MITL recognizes the effects of inflation in determining taxable income. Taxpayers must determine an inflationary adjustment on liabilities (not including certain reserves) and monetary assets and may restate the tax depreciation deduction and net operating losses by applying the National Consumers' Price Index published in the Official Gazette of the Federation by the Bank of Mexico (central bank).

The main items that require inflationary adjustments, according with the MITL are as follows:

- Tax depreciation
- Sale/disposal of fixed assets
- Inflationary adjustment (which is an average on the inflationary effects of the receivables/debts of the entity)

Exchange rate fluctuations (FX gains/FX losses) are also cumulative / deductible in the calculation of the taxable income.

Employee Profit-Sharing

Mexican entities are required to pay a mandatory employee profit-sharing of 10% of its profits from the second year of operation. The profit for this purpose is the taxable income for IT purposes adjusted to eliminate any inflationary items included in such income.

The profit-sharing should be paid to the employees during the month of May of the following year.

Profit-sharing paid may be deductible for IT purposes for the fiscal year in which it is paid. Any profit-sharing paid may also be added to any tax loss incurred.

A Mexican branch of a foreign resident must pay the employee profit sharing in the same manner as a company.

A separate employee service company may be set-up to control the employee profit sharing to be limited to the profit margin in this entity and additional compensation through productivity bonus or similar may be granted.

In summary, the corporate income tax will be calculated as follows:

Gross Taxable Income
- Authorized Deductions
Result
- Employee profit-sharing
Tax Profit
- Tax losses from previous years
Taxable Income
@ 30% (Income tax rate)
Income tax payable

Business Flat Tax (IETU for its Spanish acronym)

This complementary tax became effective on January 1, 2008.

This is a sort of minimum tax that must be computed and is payable in excess of the IT if it results higher. This is a final tax; it is not recoverable or creditable.

Individuals and legal entities residing in Mexico, as well as non-residents with a PE in Mexican territory for the revenues attributable to said establishment, are obligated to pay, regardless of where the income is generated, the IETU on revenues obtained from engaging in the following activities:

- Alienation of goods
- Rendering of independent services

- Granting of temporary use or enjoyment of goods

In order to establish the proper definition of the abovementioned concepts, the IETU Law references to the provisions of the Value Added Tax Law (VATL).

The tax will be computed by applying the rate of 17.5% to the amount resulting from deducting the authorized expenses from total income earned in the year from these activities. It is important to mention that this tax applies on a cash flow basis.

Income

In general terms the IETU Law establishes that in addition to price, any other amount that may be collected, including advances, received deposits, taxes and fees, interest and contractual penalties are regarded as taxable income.

Furthermore, the allowances or discounts received, as well as the advances or deposits refunded are also considered as income, when the original transactions were subject to the tax payment.

Non-taxable income

- Interests not considered as part of the sale price;
- Royalty payments received from related parties, except for granting temporary use or enjoyment of industrial, commercial or scientific equipment;
- Gains derived from the financial derivative transactions, if the underlying is not subject to IETU.

Exempt income

- Income not subject to IT for example:
  - Capital contributions;
  - Payment of losses by shareholders;
  - Premiums obtained for the issuance of shares;
  - Revaluation of assets and capital;
  - Dividends received from Mexican corporations by Mexican corporations.

- Income derived from the alienation of:
  - National or foreign currency;
  - Credit instruments, documents pending collection, partnership interests or shares.

Deductions

Certain deductions that the taxpayers could apply in order to reduce the taxable income are provided in the IETU Law, as long as certain requirements are fulfilled.

- The disbursements corresponding to the acquisition of goods, independent services or the temporary use or enjoyment of goods used to carry out the activities mentioned before;
- Value Added Tax (VAT) and Special Tax on Production and Services (IEPS) when these cannot be credited in terms of the respective Law;
- Disbursements for the administration of the activities subject to IETU;
- Disbursements regarding the production, commercialization and allocation of the goods and services that generate taxable income according to the IETU Law;
- Contributions to be paid by the taxpayer. An exception is made of the IETU, IT, Cash Deposits Tax (IDE) and social security contributions (IMSS);
- Damages and prejudice compensations;
- Conventional sentences, if the Mexican Tax Authorities (MTA) obligate to pay this compensation;
- Payments for granting temporary use or enjoyment of commercial, industrial or scientific equipment.

Deductibility requirements:

- Expenses or disbursements will have to correspond to the activities for which the taxpayers will have to pay IETU;
- Strictly necessary to obtain the income;
- Effectively paid at the time of deduction (cash flow basis);
- Registered in accounting;
- Invoice complies with tax requirements;
- Payment made by check (or other authorized form wire transfer, electronic transfer, etc.);
- Related party transactions must be at arm's length prices.

Non-deductible expenses

- Salaries and fringe benefits;
- Interest payments;
- Royalty payments to related parties;
- IETU, IT, IDE and IMSS;
- Irrecoverable accounts receivables.

Credits

The Law provides various types of tax credits against the IETU; among others:

- IT paid for the fiscal year can be credited against the IETU of the same year;
- IETU monthly payments can be credited against the annual IETU;

- Dividends IT paid for the year (when the dividend is paid in excess of the Previously Taxed Profits Account (CUFIN for its Spanish acronym) against IETU of the year;
- IT paid abroad, if income from abroad is subject to IETU;
- Tax credit for salaries and social security contributions (amount paid as salary to employees, as well as social security contributions multiplied by the IETU tax rate); this credit is applicable only when IT is caused for the employees from the income received; in general terms, the computation of this credit is determined by multiplying the amount of salaries and social security contributions paid in the fiscal year and taxable in the hands of the employees by a factor of 0.175.
- Tax credit when deductions are greater than income (multiplied by IETU tax rate corresponding to the fiscal year). Can be credited against IETU of the year or monthly and annual IETU returns for the following 10 years until depleted; restated by inflation.

Taxpayers who fail to use a tax credit for a year when entitled to it will forfeit the right to use it in subsequent years up to the amount that could have been credited.

5.1.3. Special regimes

Tax Consolidation

Please note that the Mexican consolidation regime is not a true consolidation and is a 5 year deferral scheme.

Mexican corporate groups may file consolidated income tax returns for up to 100% of profits and losses, if the following conditions are met:

Holding company - A Mexican holding company must exist and should own, directly or indirectly, more than 50% of the voting shares of other companies. In no case more than 50% of their voting shares may be held by another or other companies, unless said companies are residents of a country with which Mexico has in force a broad information exchange agreement. Please note that the application of the broad information exchange agreement has been modified and this should be reviewed on a case by case basis.

Controlled company - A company whose voting shares are owned at least 50 percent, directly or indirectly, by a holding company.

The following companies do not qualify for filing a consolidated tax return:

1. Income tax exempt entities.
2. Financial institutions.

3. Controlled companies residing abroad.
4. Companies under a liquidation process.

Authorization - The taxpayer must apply on or before August 15 with the Mexican Treasury for a ruling to consolidate for tax purposes. Once the election is authorized, consolidation becomes mandatory for a minimum period of five years.

Prior authorization is required to deconsolidate (i.e., recapture of any tax deferred). Consolidation rulings will only be valid when the request includes all companies in which the holding company has a majority interest (more than 50%).

Consolidated tax result

The holding company must determine the consolidated tax result by including the result of applying the factor of its participation as follows:

Holding company's profit or loss at 100%
Plus:
Subsidiaries' tax profits at 100% of the holding participation in their capital stock
Less:
Subsidiaries' tax losses at 100% of the holding participation in their capital stock
Consolidated tax losses carry forwards
Plus/Less
Any share participation's modification effect
Less
Capital losses obtained by the holding company
=
Consolidated tax result

Tax losses incurred prior to the consolidation regime are carried forward up to the amount equal to the tax profit of the company which incurred such losses but cannot be used as such in the consolidation.

Returns - Tax returns are filed individually by each company no later than March 31 of the following year. The consolidated tax return must be filed by the holding company on or before April 30 of the following year.

Controlled companies must remit to the holding company the amount of tax related to their consolidated participation and file and pay to the tax authority only the unconsolidated portion.

Tax obligations - Holding companies are required to keep special records to register the consolidation effects as follows:

- Special consolidating items for each period.
- CUFIN and if any, CUFINRE for each period.
- Total dividends or profits received or paid by the holding and the subsidiary companies.
- Tax profits and losses of the subsidiaries for each period, as well as the manner in which said losses are applied.
- The holding company's tax profits and losses for each period, as well as the manner in which said losses are applied, and the income tax that would have arisen had there been no tax consolidation. This registry applies also to capital gains and losses.
- The holding company's CUFIN and if any, CUFINRE that would have arisen had there been no tax consolidation.
- Control of the overall consolidated net reinvested previously taxed earnings and consolidated previously taxed earnings.
- Several concepts related to concepts that have been deferred due to the tax consolidation regime.

All the above mentioned records and supporting documentation must be kept for the duration of the consolidation, and a permit may be requested every ten years to destroy such records.

Holding companies must also provide in their consolidated tax return, information to allow the determination of their own taxable income or tax loss, as if they did not consolidate.

In addition, beginning in 2005, the tax report must state the tax deferred in each year regarding tax consolidation and only the year's deferred tax.

Deconsolidation - A group's authorization to consolidate will be cancelled in any of the following circumstances arise:

1. When the group does not include a subsidiary that holds at least 3 percent of the total assets of the group or two or more subsidiaries that hold at least 6 percent of the total assets of the group.
2. When the holding company's interest in the subsidiary falls below 50 percent; nevertheless, the group will continue to consolidate for a period of one-year following that event.
3. When the holding company fails to keep all records required by the authority.

When a group's authorization to consolidate is cancelled, all companies of the group will be required to pay tax retrospectively, for the periods during which they were in consolidation, as if they had not consolidated.

As of 2010, there is a particular procedure through which consolidating groups must determine and pay the tax deferred in the sixth previous years to which the payment must be made. Accordingly, every fiscal year, holding companies shall pay the income tax, updated for inflation, that they deferred by reason of the tax consolidation, which was generated in the sixth fiscal year preceding the year in which such payment must be made, and was not paid through December 31 of the year immediately preceding the year in which such payment must be made.

The deferred income tax shall be paid on the same date in which the consolidated tax return for the fiscal year immediately preceding the year in which the deferred tax must be paid, has to be filed.

The deferred tax, shall be paid in five fiscal years, pursuant to the following:

- **I.** 25% in the fiscal year in which the deferred tax must be paid
- **II.** 25% in the second following fiscal year
- **III.** 20% in the third following fiscal year
- **IV.** 15% in the fourth following fiscal year
- **V.** 15% in the fifth following fiscal year

The amount of the deferred tax to be paid should be restated for inflation and effectively paid each year as stated above. Otherwise, the total amount of the tax due should be paid in one instalment, including surcharges. There is an option to calculate the deferred tax above mentioned established on article 71-A of the Income Tax Law.

Manufacturing, Maquiladora and Export Service Decree (IMMEX)

Maquiladora Program (commonly known as maquila) is an industrial or service process aimed at transforming, manufacturing or repairing goods originating abroad and imported on a temporary basis, to be subsequently exported back and to provide services that could qualify as exportation of services such as: inventory management, calling centers, data processing, among others.

Up to the end of 2006, maquilas were operating under the Maquila Decree which was merged with the PITEX program (another export program similar to the maquila); generating a new Decree denominated "Decree for the Maquiladora Industry, Manufacturing and Services for the Exportation." This new Decree maintains all benefits previously granted to maquilas and was intended to simplify the operation of the two programs mentioned. This new Decree is commonly referred to as "DIMMEX".

One important change incorporated in this new Decree is that it recognizes the rendering of export services. It includes a complete list of services that could be considered as exported through this program.

Mexican corporations may apply to participate in this program, regardless of how their capital stock is structured. Such corporations may establish their facilities anywhere in Mexico (at the beginning more maquilas were located in border zones but through the years they have been locating their operations in different states to take advantage of available labor) and their purpose must be to export the majority of their production or services (although they can sell their products in the Mexican market).

Likewise, already established companies may become engaged in these kinds of operations, if they compete with their products in the domestic market and have the intention to use their available production capacity to export. This program also offers good opportunities to companies engaged in export projects through foreign companies that provide technology and raw materials but are not involved in managing such projects (commonly known as shelter maquiladora).

Entities operating in the maquila program are not restricted from carrying out other business activities such as lease or sale of goods.

In order to operate as a maquila, it is necessary to obtain a permit from the Ministry of Economy. The permit is granted once the entity has been duly incorporated in Mexico and a federal tax identification number has been obtained (Registro Federal de Contribuyentes).

Please refer to the Logistical Services and Customs section for the requirements and modalities of the IMMEX program.

The relationship between the Mexican maquila and its foreign related party or parties is managed through a Maquila Agreement, in which the terms and conditions of the services to be provided, including the use of the foreign entities' machinery and equipment, are established.

It is important to mention that through the years, different types of maquilas have been developed, such as service maquilas, manufacturing maquilas, maquilas operating under manufacturing agreements or shelter operations, involving the use of equipment provided by foreign residents or owned by the maquila and transforming raw materials owned by foreign residents or by the maquila. There are several options available for the use of this program and the program could be adjusted to almost all types of agreements to manufacture goods in Mexico, taking advantage of specialized labor, proximity to the United States and an extensive commercial treaties' network developed by Mexico, including, among others, the North American Free Trade Agreement (NAFTA), the European Community Treaty and the Economic Cooperation Trade Agreement with Japan.

One important issue to consider is that the Mexican Government has developed a complete legislation to allow maquilas to operate in Mexico in a very competitive way. For these purposes, Mexican legislation, in connection with transfer pricing compliance, trade and customs and VAT, has been adjusted through the years in order to eliminate or reduce negative consequences, taking into consideration the way in which global businesses are handled from different perspectives such as tax generation, delivery and destination of the goods.

Tax legislation - specific issues applicable to maquiladoras

Income tax

Maquiladoras are subject to Mexican taxes, as any other Mexican entity, notwithstanding the type of legal entity (i.e., corporation, partnership, etc.). There is no specific treatment for them. The income tax rate applicable to Mexican entities is currently 30%. A transitory scheme is already included in the Mexican Income Tax Law through which this rate would be reduced in the following years.

Estimated tax payments must be made every month, on behalf of the year's tax, taking into consideration the previous years' taxable income.

In addition to income tax, maquilas are subject to IETU (Business Tax and Flat Rate) like any other Mexican entity; however, they are entitled to a tax credit which is detailed below. As mentioned in another section the IETU's rate is 17.5%.

There are the following important issues that should be taken into consideration when dealing with maquilas:

- For the 2012 Fiscal year maquila operations cannot trigger a permanent establishment in Mexico for the foreign resident to whom maquilas services are provided in the case they are under the refuge modality provided by the Economy Department. In general terms, a maquila may not rise a PE for its foreign principal (company that provides goods to be manufactured by the maquila using assets provided by such company) when the requirements established in the law and the IMMEX Decree are complied with or to foreign residents that hire the Mexican entity to perform export services (Shelter Agreements), when such foreign residents are not related parties of the entity which applies the refuge modality and neither a related party of such entity.

- Income Tax Exemption. As of October 2003, the Mexican government issued a decree which allows the maquilas to reduce or eliminate their income tax, at both the annual and the estimated payments' level. This decree is currently in effect and there is no termination date. However, the Mexican government has the right to repeal it. The main reason for the issuance of the decree was to promote foreign investment in Mexico and avoid the exit of maquila activities to other countries such as China and to Central America.

- Tax Credit against Business Flat Tax (IETU as per its acronym in Spanish). On November 5, 2007 a Decree was issued to reduce the negative effect related with IETU in maquila operations. Through the same a tax credit is granted against IETU allowing maquilas to pay tax in Mexico at a very competitive level. This credit is applicable up to 2011. Through the mechanism established in this Decree maquilas end up paying the tax (either: income tax, income tax and IETU or just IETU) applying the IETU's tax rate over the income tax taxable base (assuming no other business activities are carried out by the maquila).

  The benefits granted in this Decree were extended to the tax periods of 2012 and 2013 through a new Decree published as of October 12, 2011. This Decree includes a set of obligations or requirements that the maquilas need to comply with in order to be able to access to this benefit.

As of the end of 2010, new changes were included in the DIMMEX mainly to restrict access to the above mentioned benefits granted to the maquilas. The main changes include:

- A new definition of maquila operation is included which considers that machinery and equipment, provided by the foreign principal, must represent at least 30% of the total machinery and equipment used in the maquila operation. When computing the 30%, the machinery and equipment cannot be previously owned by the maquila itself or by any other Mexican related party. With regards to the raw materials, they must be provided by the foreign principal and imported on a temporary basis. However, it is possible to utilize goods acquired in the domestic market or goods that were not temporarily imported as long as these goods are incorporated into the finished products and exported. This requirement is only applicable to IMMEX Programs obtained after January 1, 2010 and to Mexican entities that did not comply with transfer pricing rules applicable to maquilas before 2010.

- A new definition of "transformation of goods" which excludes several maquila business activities that qualify as service maquila. The exclusion of these business activities is to restrict the access to the benefits above mentioned.

Value-added tax (VAT)

Maquila services provided by maquiladoras are considered as exportation of services for VAT purposes, subject to the 0% tax rate. This rate is also applicable to the submaquila or submanufacture services provided by other maquilas if the goods are exported. We recommend review the scope of the new definition of maquila under the DIMMEX to identify possible divergences with this tax regime.

Generally, maquiladoras generate VAT balances in their favor that can be refunded or used as a credit against other federal taxes. The favorable VAT balance is generated from the tax paid to their local suppliers of goods and services. There is a specific treatment applicable to maquilas that allows them to consider all the VAT paid relating to the export operation, (providing that the supporting documentation complies with the tax requirements), creditable and subject to refund.

When maquilas acquire goods authorized in their maquila program from Mexican suppliers, they are required to withhold the VAT charged by the local supplier. Even when by Law this withholding is mandatory, currently through miscellaneous rules it is established that this it is not mandatory until a national supplier program has been developed.

The benefit of the withholding scheme allows the maquilas the immediate reimbursement of the VAT charged by the suppliers. One important issue to take into consideration is the acquisition or sale of products in Mexican territory carried out by non-residents when the goods are delivered to or by maquilas. In general terms, any sale of goods performed in Mexico (when the physical delivery is made in Mexico) is subject to VAT. For these purposes, the Mexican tax authorities have established mechanisms in the law and in the foreign trade rules, to avoid the payment of this tax when the goods are transferred between maquilas, sold between non-residents or sold by Mexican vendors to the foreign principal, but physically delivered to the maquila, if the goods continue to be imported on a temporary basis. Customs mechanisms have been established for these purposes.

Transfer pricing rules

Maquilas have been subject to specific transfer pricing rules since 1995 and such rules have changed throughout the years. New transfer pricing rules were introduced in 2002 and there are two options available in order to comply with the rules:

1) Safe Harbor

The new rules, as of 2002, provide that in order to meet the safe harbor and avoid the PE issue, the taxable income of the maquiladora should be the greater of:

- 6.9 percent of the value of the assets owned by the maquiladora and the foreign principal used in the maquila activity; or
- 6.5 percent of the operating costs and expenses incurred in Mexico in the maquiladora operation, including certain costs and expenses of the foreign principal.

Companies that elect this option must file with the Mexican tax authorities, within the first three months of the following year in which the option was applied, a statement that indicates the result of the above comparison.

2) Transfer Pricing Study

Alternatively, the maquiladora may prepare a transfer pricing analysis for Mexican purposes, under the guidelines of the Organization for Economic Cooperation and Development, which must consider either:

- The maquiladora operation in Mexico, plus 1% of the net book value of the foreign owned machinery and equipment located in Mexico and used in the activity, or
- The return of investment expected from the maquiladora operation in Mexico in comparable transactions, considering any foreign-owned assets in addition to the assets owned by the Mexican company.

As mentioned above, these rules are only applicable to maquilas operating with a company resident in a country which has signed a treaty to avoid the double taxation with Mexico.

Payments abroad

Generally, there are no payments by the maquila to its foreign parent company because the use of the machinery and equipment is provided free of charge through bailment agreements and there is no charge for technical assistance provided by the foreign entity. However, there are no restrictions on charging the maquilas for such concepts or for any other of similar nature such as management fees.

It is important to take into consideration that most maquilas operate on a cost-plus basis (all the expenses incurred by the maquila plus a markup profit margin, determined to comply with the transfer pricing rules, are charged to its customer). Therefore, any charge to the maquila for the above concepts would be invoiced back, increased by the maquila profit.

Payments to non-residents are subject to Mexican income tax withholding, which varies depending on payment in question and the country of residence of the recipient.

5.1.4. Transfer pricing

Transfer pricing has become a very important topic in the tax field. Mexico's tax authorities are increasingly issuing more rules and requirements relating to transfer pricing. Also, the number of transfer pricing inspectors within the tax authorities, as well as the number of transfer pricing audits, has increased dramatically.

A couple of decades ago, transfer pricing was not an issue for Mexican tax authorities, mainly because Mexico's borders were closed to international transactions. However, once Mexico joined the former GATT, cross-border transactions started to increase. Due to this fact, in 1992 some transfer pricing rules were incorporated into Mexico's tax legislation. These rules allowed the tax authorities to restate a taxpayer's profit or loss, using the traditional transaction methods (comparable profit, cost plus and resale price methods). However, there is no evidence that these rules were ever enforced.

In 1994, Mexico joined the OECD and signed the NAFTA. Based on these developments, Mexico was encouraged to include the principles issued by the OECD regarding transfer pricing in its legislation, among other issues.

The first legislation regarding transfer pricing was enacted in 1995 and was intended for the maquila industry (in-bond agreement manufacturing regime), which operates under specific rules for tax and custom purposes. This new legislation established that maquilas were considered to comply with transfer pricing if they obtained a safe harbour return equivalent to a taxable profit representing at least a 5% of the total assets. If a maquila did not apply the safe harbour test, it could request an advanced pricing agreement (APA) from the tax authorities. Maquila rules have gone through several changes, mainly to prevent them from being considered a permanent establishment of the foreign resident. As of 2011, they still may apply a safe harbour test, which must be the greater of a 6.9% on assets or a 6.5% on costs and expenses. If they do not apply the safe harbour test, they need to prepare transfer pricing documentation, taking into account the assets used that belong to the foreign resident. An APA is no longer necessary for a maquila to comply with transfer pricing, but maquilas still have the option to request one.

Based on the increased revenue from the maquila industry and after several years of dealing with transfer pricing, Mexico's tax authorities incorporated in 1997 transfer pricing rules that apply to all taxpayers into the Income Tax Law. These rules have undergone some changes since they were first introduced. Also, starting in 2008, when the Business Flat Tax regime was incorporated in Mexico (IETU as per its acronym in Spanish), this Flat Tax law also includes transfer pricing rules.

Under Mexican domestic tax legislation, all taxpayers are required to price their transactions with related parties on an arm's-length basis. When transactions are carried out with foreign-based related parties, taxpayers are also required to prepare and maintain documentation that supports the arm's length price by identifying related parties and disclosing information regarding the functions, risks and assets associated with each type of transaction performed with related parties.

Also, the use of a transfer pricing methodology, including the information of the comparables used, is required for each type of transaction carried out with related parties. The methodologies provided by Mexican legislation include the following:

- Comparable Uncontrolled Price Method

- Resale Price Method
- Cost Plus Method
- Comparable Profit Split Method
- Residual Profit Split Method
- Transactional Operating Profit Margin Method

If the transactions are carried out with a Mexican related party, they should be priced at arm's length and one of the transfer pricing methodologies mentioned above must be applied to support that the values used in the transactions represent local market values.

Generally speaking, the Mexican tax authorities follow the OECD transfer pricing guidelines. There is a regular exchange of information with the OECD tax specialists to ensure the tax authorities are kept up to date with developments.

All the transfer pricing methods included in Mexico's legislation are contained in the OECD transfer pricing guidelines and are acceptable by the authorities. However, from 2006, taxpayers must primarily apply the Comparable Uncontrolled Price Method and will only be allowed to use another method in the tax legislation when the Comparable Uncontrolled Price Method is not the adequate method to determine that the transaction carried out between related parties is at arm's-length.

Additionally, in order to consider the methodology correct when applying the Resale Price Method, the Cost Plus Method or the Transactional Operating Profit Margin Method, the taxpayer has to demonstrate that the costs and the sales price are at arm's-length. Finally, the taxpayer has to demonstrate that the applied method is the most adequate according to the information available, when compared to the Resale Price Method and the Cost Plus Method.

Taxpayers undertaking related party transactions with overseas affiliates are required to file an informative return with the tax authorities regarding transactions carried out with the related parties during the previous year. The information to be filed consists of the corporate name, country of residence and tax ID number of the related party, the type and amount of transactions carried out, as well as the profit margin obtained from the transactions and the transfer pricing methodology used to test its arm's length nature. In addition, depending on the transaction, additional information with regards to the amount involved in the cross-border intercompany transactions (e.g., accumulated or deducted amount for income tax purposes, amount paid and amount exempt for each specific transaction) must be provided along with information on whether a specific reduced withholding tax as a result of the application of a tax treaty to avoid double taxation was used (including withholding tax rate and withheld amount).

This informative return is due along with the annual income tax return or the statutory tax audit report (Dictamen Fiscal). If the tax authorities consider a taxpayer to have paid insufficient taxes as a result of an unacceptable transfer pricing policy, it is likely that the taxpayer will suffer a penalty ranging from 55 percent to 75 percent of any additional taxes due. Also, if a taxpayer declared a loss for tax purposes due to an unacceptable transfer pricing policy towards the tax authorities, it is likely that the taxpayer will suffer a penalty ranging between 30 percent and 40 percent of the excess reported loss stated.

If, however, the taxpayer has maintained adequate supporting documentation, the penalty imposed may be reduced by 50 percent. There is no specific penalty for failing to maintain updated transfer pricing documentation, although a minor penalty may be levied in such cases owing to a failure to comply with a tax obligation. However, there is a penalty for not filing the informative return, which ranges from approximately USD 4,000 to 8,000.

Also, if the informative return is not filed, payments made to foreign based related parties may be considered as non-deductible.

Recently, the tax authorities have been performing several transfer pricing audits. One of the principles followed in these reviews is that if the taxpayer does not have transfer pricing documentation in place, it has failed to comply with its obligation of maintaining transfer pricing documentation and therefore, all payments to related parties may be considered as non-deductible. This principle has recently been confirmed by the tax court, since it issued a ruling stating that in order to deduct payments made to related parties for tax purposes, the transfer pricing documentation supporting the arm's length nature of said transactions must be in place at the time of the filing of the tax return.

The tax authorities have been very aggressive while performing transfer pricing audits. They have challenged the nature of related party transactions, maintained the view that documentation has to be in place for the specific year in which the related party transaction was performed and tested said transactions. Other disclosure requirements from a transfer pricing standpoint include the information that taxpayers, with the obligation to file the statutory tax audit report, must provide. When filing the statutory tax audit report to the tax authorities, the CPA also has to answer a questionnaire regarding the taxpayer's intercompany transactions, compliance with transfer pricing rules, as well as the taxpayer's supporting documentation. Starting 2010, companies that are required to file the statutory tax audit report but opt not to do so should also disclose certain transfer pricing information that is similar to the transfer pricing information to be disclosed in the statutory tax audit report.

APAs may be negotiated with the Mexican tax authorities. It is worth mentioning that in Mexico APAs are rulings issued by the tax authorities (i.e., confirmation of a specific transfer pricing methodology applied in related party transaction(s)), and not contracts signed by both parties (taxpayer and tax administration). The majority of APAs already concluded have been unilateral agreements issued to maquilas. Such rulings may also derive from an agreement with the competent authorities of a treaty partner (bilateral and multilateral APAs). APAs can cover up to 5 years; the year in which the APA is requested, the preceding taxable year and up to 3 subsequent taxable years. The period covered in bilateral and multilateral APAs depends upon the agreement reached by the tax administrations involved.

5.1.5. Thin Cap

Interests paid to related parties residing abroad arising from debts which exceed a ratio of 3:1 over the accounting capital shall not be deductible.

The proportion of debt over the equity or capital is determined by comparing the average annual debt based on the monthly balances (including the payable interest) which should include all taxpayer's interest bearing debts, against the average capital, which is calculated by adding the initial balance and the final balance and dividing it by two. The capital balance can include the capital contribution (updated pursuant to the inflation) as well as the profits for the fiscal year.

It must be mentioned that an amendment to the MITL allows for another option to determine the average capital which consists in the possibility of using the average amount from the Capital Contribution Account (CUCA) and CUFIN instead of the book equity.

It is important to mention that the payable earned interests must be considered as increasing the balance of the debt as time passes; hence there is a process of increase of the debt in relation to the capital.

Debts contracted for constructing, operating or maintaining infrastructure of strategic areas for the country shall not be considered in the debt to equity ratio. These strategic areas are mainly the following:

- oil and gas
- electricity
- nuclear energy
- radioactive minerals
- mail
- ports, airports, heliports
- Infrastructure

5.1.6. Loss treatment

Net operating losses (NOLs) may be carried forward for ten years and must be restated for inflation. The right to apply a net operating loss is lost when the taxpayer fails to apply such loss in a year allowed. However, the amount lost is limited to the amount that should have been applied, not to the entire balance of net operating losses.

NOLs are initially adjusted by the restatement factor corresponding to the period between the first month of the second half of the period in which the losses were incurred and the last month of that period. The restated losses are again adjusted by multiplying their amount by the restatement factor for the time elapsed between the last month of the period in which they were initially restated, and the last month of the first half of the period in which they will be offset.

NOLs cannot be transferred to another corporation through merger. In a spin-off, the net operating loss may be transferred only in proportion of the capital stock divided or spun-off.

In a merger, the surviving corporation may carry forward its net operating losses to offset the profits generated from the same business activities that gave rise to the loss in question.

Capital losses on company liquidations or mergers are non-deductible. However, capital losses on share transfers can offset capital gains on share transfers only.

In the case of change of shareholders that hold the control of an entity which has losses pending application of previous tax years and the sum of its income for the last three years is less than the updated losses at the end of the last tax year before the shareholder change, the entity may only subtract its tax loss pending at the moment of the merger from the tax profit corresponding to the exploitation of the same business that produced the loss.

Please note that NOLs for IT purposes are not deductible for Business Flat Tax (IETU) purposes. In the event the authorized deductions for IETU purposes exceed the income for this tax, these IETU “losses” can be applied as a credit (amount multiplied by the tax rate) for the fiscal year, as well as against the IETU for the next 10 years.

5.1.7. CFC

Mexico, as with other countries throughout the world, has established anti-tax haven provisions. The Mexican government determined that such laws were required to close the loophole that both Mexican and foreign investors were using to allocate income to tax havens, thus reducing their Mexican taxable income.

In 1997, Mexico enacted anti-tax haven legislation. Since then, Mexico has modified its original legislation, black list approach, to serve a two-fold purpose. One is to discourage the use of tax haven investment mechanisms by Mexican residents by treating obtained in a tax heaven country as being taxable income in Mexico. The second is to penalize through high withholding tax rates, foreign investors that use tax haven countries.

The legislation was designed to preclude Mexican taxpayers from deferring Mexican income taxes through the use of preferential tax regimes or tax havens. Currently, the Income Tax Law's anti-tax haven provisions encompass all types of investments by a Mexican resident, either directly or indirectly.

In this sense, income subject to preferential tax treatment will be considered income that is not taxed abroad or on which the income tax is less than 75% of the tax that would be assessed in Mexico (22.5% in 2011).

To determine if income is subject to preferential tax treatment in accordance with the preceding paragraph, each transaction that generates the income will be considered. When the income is obtained by the taxpayer through a foreign entity of which the taxpayer is a member, partner, shareholder or beneficiary, or through a legal vehicle that is considered a tax resident in a country and is subject to income tax in the respective country, the profit or loss generated by all the transactions conducted through said foreign vehicle or entity will be considered.

Where income is generated indirectly through two or more foreign legal vehicles or entities, the tax effectively paid by all of the foreign legal vehicles or entities through which the taxpayer conducted income-generating transactions must be considered for the purposes of calculating the lower income tax mentioned previously.

This treatment also applies to legal entities incorporated abroad that are not taxpayers or are deemed transparent for tax purposes even though its income does not come from a preferential tax regime.

The definition of tax transparent entities includes those that are not regarded as taxpayers in the country where their principal or actual management headquarters are based and their revenues are attributable to members, partners or stockholders.

Mexican investors, either through direct or indirect ownership, in preferential tax regimes are forced to recognize the income on a current basis and to file an annual information return on the business and the investment activities, undertaken in such jurisdictions.

Income obtained through foreign legal vehicles or entities that carry out entrepreneurial activities, unless said entities' passive income accounts for more than 20% of their total income would not be considered as income subject to preferential tax regime.

The following (amongst others) are considered to be passive income: interest; dividends; royalties; gains on the sale of shares; as well as income from the sale of assets that are not physically in the country, territory, or jurisdiction where the foreign legal vehicle or entity resides, and income from services rendered outside of said country, territory or jurisdiction.

Tax authorities may authorize Mexican payers participating in financing entities not to apply the regulations relating to preferential tax regimes providing certain requirements are met.

Income from royalties, patents or industrial secrets is not subject to a preferential tax regime when the intangible has been developed in the country of residence of the foreign legal entity and the royalty payment is made at market value.

In addition, according to general rule I.3.18.1. income generated through transparent foreign legal entities or figures in which the Mexican taxpayer participates will not be considered as income subject to preferential tax treatment if the taxpayer does not have effective control or if the taxpayer does not control its administration in a way that the taxpayer could decide the moment when it will distribute income or profits, directly or through another person.

General tax rule I.3.18.3. sets forth that the provisions of preferential tax regimes shall not apply to income generated by banking institutions through operations carried out by entities or foreign legal vehicles in which they participate directly or indirectly, of which income is subject to a preferential tax regime, only for the operations that those figures perform with non-resident entities in Mexico that are not related parties of the same or from the banking institutions in Mexico and provided the country in which the entity or foreign legal vehicle is resident has in place a broad information exchange agreement of tax information with Mexico. Where that the entity or foreign legal vehicle does not have an agreement, they would have to comply with the dispositions provided in Article 212 paragraph eight of the Mexican Income Tax Law.

According to general tax rule I.3.18.8. for the purposes of proving that income is not subject to a preferential tax regime, the taxpayer should have a copy of the filing of the annual tax return of income tax of the last fiscal year or its equivalent of the entity or foreign legal vehicle, or a certification by public accountant who belongs to an internationally recognized firm, which certifies that such income is taxed abroad with an income tax equal to or higher than 75% of the income tax which would be caused and paid in Mexico.

Annual information return of income from preferential tax treatment

In February of each year, the taxpayers to whom the aforementioned applies, must submit at the authorized offices, an information return on the income subject to preferential tax treatment that they have generated in the immediately preceding fiscal year or the income generated through legal vehicles or entities subject to said treatment in said year, along with account statements that specify deposits, investments, savings or any other items, or, as applicable, the supporting documentation set forth by the Tax Administration Service through general rules.

For these purposes, income subject to preferential tax treatment is considered to comprise both deposits and withdrawals. The return referred to will be used solely for tax purposes. It is not necessary to file this return if a broad information exchange agreement is in place with the country of residence of the entity subject to the preferential tax regime.

Payments to Preferential tax regimes - Withholding Tax Rates

In the case of payments for commissions, brokerage and agency fees, among others, made by a Mexican resident or Mexican permanent establishment to foreign residents of a tax haven or payments to preferential tax regimes, a 40% withholding tax automatically applies on the gross amount of such payments without any deduction. Payments made to entities or individuals in a preferential tax regime are subject to greater withholding rates. In general terms, the high tax rate applies only in transactions between related parties.

According to a general rule currently in force, the aforementioned 40% withholding tax rate will only apply when the transactions are carried out between related parties and if the foreign resident does not reside in a country with which Mexico has in force a broad information exchange agreement.

In the case of interest payments to foreign banks located in a tax haven, the withholding rate is 10%. If the payment is to a financial institution in which the federal government, through the Mexican Treasury Ministry or Banco de México, holds capital stock, the withholding tax rate is 4.9% provided that in both situations, those entities (a) are the actual beneficiaries of the interest and are registered with the SAT as foreign banks or financial institutions; and (b) file the same information required by the general rules on financing granted to Mexican residents.

Additionally, exceptions may apply to interest payments made to a tax haven. A withholding rate of 10% may apply to certain types of interest paid to banks registered at the Mexican Treasury Ministry and on interest arising from bonds offered to the general investing public. In addition, interest that is exempt from withholding tax under the Mexican Income Tax Law is also exempt from withholding tax even though the payment is made to a tax haven.

Additionally, payments made to residents of preferential tax regimes are deemed not to be at arm’s length, regardless of the fact that the parties may be unrelated.

Therefore, companies must carry out a transfer pricing study to demonstrate that the transaction is carried out using fair market values.

Generally, payments made by a Mexican resident to tax haven countries as defined previously, are subject to a 40% withholding rate. As mentioned previously, the 40% withholding tax rate applies only to related party transactions and only if the foreign resident is not residing in a country with which Mexico has in force a broad information exchange agreement in accordance to the general tax rule I.3.17.15 in force at this time.

Nevertheless, dividends paid to a tax haven country are not subject to any withholding tax.

5.1.8. Anti-Avoidance

Mexico does not have general anti-avoidance rules. However, Mexico does have a number of specific anti-avoidance rules (for example CFC, thin capitalization and transfer pricing rules), as described above.

5.1.9. Double taxation

Foreign Tax Credit regime

Mexican residents are entitled to an ordinary foreign tax credit provided that the foreign income is subject to Mexican income tax.

The foreign tax credit limitation for business activities is 30% of the tax profit from foreign sources determined in accordance with the Mexican Income Tax Law.

In connection with dividend payments, the tax credit limitation is arrived at by computing the tax profit from foreign sources up to the Mexican income tax rate. Certain requirements related to ownership percentages at the first and second tiers must be complied with. If the Mexican holding company does not fully own the foreign subsidiary, the foreign tax credit is determined based on a proportion equal to the participation owned by the Mexican holding company. The second tier entity must reside in a country with which Mexico has in force a broad information exchange agreement in order for the tax paid by said entity to be creditable in Mexico.

When the tax credit allowed cannot be totally applied, the remaining balance may be carried forward for ten years.

Countries with which Mexico Currently has a Bilateral Income Tax Treaty in Force

Argentina*	Denmark	Israel	Russia
Australia	Ecuador	Italy	Singapore
Austria	Finland	Japan	Slovak Republic
Bahrain**	France	Luxembourg	South Africa
Barbados	Germany	The Netherlands	South Korea
Belgium	Greece	New Zealand	Spain
Brazil	Hungary	Norway	Sweden
Canada	Iceland	Panama	Switzerland
Chile	India	Poland	United Kingdom
China	Indonesia	Portugal	United States
Czech Republic	Ireland	Romania	Uruguay

****The treaty in force with Argentina only applies for international transport.***

***** In force starting January 2013.***

Tax Treaty Benefits

In order to enjoy the benefits of tax treaties, the resident of a treaty country must provide evidence that it is a bona fide resident of the particular treaty country for income tax purposes. In addition, the foreign resident must comply with certain formal requirements provided by the Income Tax Law, such as registration of foreign banks and certain types of interest with the SAT, the filing of a CPA's report (dictamen) when applicable and the designation of a legal representative when allowed to pay income tax on a net basis. Otherwise, relief under the treaty will not be granted and the rates provided in the Mexican Income Tax Law will apply. Some scholars consider that these requirements should not be applicable when not expressively included in the Tax Treaty since the Mexican Supreme Courts has stated that Treaty Law overrides the domestic law.

In the event that a withholding party applies income tax rates greater than the rates indicated in a tax treaty, the foreign resident will have to request a refund for the difference between the reduced treaty rates and the income tax rate applied.

Invoice requirements

Mexican taxpayers seeking to deduct or credit based on tax receipts/invoices issued by foreign residents without a permanent establishment in Mexico, can use these vouchers when it contains at least the following requirements:

I. The legal name, tax domicile and, in its case, taxpayer identification number (Tax ID) of the person who issues the invoice.

II. Place and date of issue.

III. Federal Taxpayer Identification Number (RFC) of the person to whom the documentation is issued.

IV. The quantity and type of merchandise or a description of the service provided must be indicated.

V. The unit value must be indicated in numbers and the total amount must either be indicated in numbers or written out.

If it is the case, the following requirements set forth in section VII of Article 29-A of the MFFC:

The total amount allocated in number or letter, as follows:

- ✓ Where the consideration is paid in one instalment, this will be pointed out explicitly on the invoice, also indicating the total amount of the transaction.
- ✓ Where the consideration is paid in instalments, a tax receipt for the full value of the transaction in question which clearly indicates this situation will be issued and an invoice for each instalment will be issued.
- ✓ Identify how the payment will be made either in cash, electronic fund transfer, nominative check or by debit, credit, or service card.

The provisions of this rule, regarding the sale or the granting of use or enjoyment (leasing), shall apply only when such acts or activities are carried out in Mexico according to the Mexican VAT Law.

5.2. Withholding tax

5.2.1. Dividends

Mexico does not levy withholding tax on dividends paid by Mexican resident companies.

For Mexican corporate income tax purposes, dividends paid out of the entity's previously taxed profits account known as the CUFIN account may be distributed without any further taxation. The CUFIN is an account that administrates the balance of book retained earnings that have already paid corporate tax in Mexico.

When dividends do not come from said account or exceed the balance thereof, the dividend or exceeding amount will be subject to corporate taxation. The dividend corporate tax shall be determined by applying the corporate tax rate on the grossed up dividend. For 2010, 2011 and 2012, the 30% corporate tax rate is applied to the dividend grossed up by a factor of 1.4286. For 2013, the 29% corporate tax rate is applied to the dividend grossed up by a factor of 1.4085. For

2014 onwards, the 28% corporate tax rate should be applied to the dividend grossed up by a factor of 1.3889.

This tax amount is payable by the Mexican Entity and is creditable against its annual corporate income tax of the year and against its monthly and annual corporate income tax of the following two years.

According to the Mexican Corporate Law, corporations will only be able to distribute profits when they have already gained such profits in previous years and the financial statements have been approved by the shareholders meeting.

5.2.2. Interest

Interest is considered to be Mexican sourced when the capital is placed or invested in Mexico or when the party paying the interest is a Mexican resident or a non-resident with a PE in Mexico.

The term “interest” includes yields on any kind of loans, whether or not secured by a mortgage and whether or not entitled to participate in the profits; yields from public debt, bonds and debentures, including premiums or prizes; discounts for the placement of securities, bonds or debentures; commissions or payments made to open or guaranteed loans; payments made to third parties for the acceptance of a guarantor; the authorization of a guarantee or the assumption of responsibilities of all types; gains obtained from the sale of credit instruments placed among the general investing public; gains on the transfer or shares issued by investment; funds in debt instruments and adjustments made to the principal based on the application of inflationary index factors or any other form, including adjustments to the principal when the debt or operations are denominated in investment units (Unidades de Inversión or UDIS).

In the transfer of credit instruments payable by Mexican residents acquired by residents of Mexico from residents abroad, any gains obtained are deemed interest subject to tax.

Additionally, in dealing with the gain on the transfer of loans, where the purchaser is a resident of Mexico or a resident abroad with a PE therein, a procedure is established for determining the gain on which to apply the withholding rate applicable to the beneficial owner of the interest. For more details, refer to the interest withholding tax section.

Withholding tax rates applicable to interest paid generally vary according to the foreign beneficiary, the borrower domiciled in Mexico or in some cases, the purpose of the loan.

- 4.9% Foreign financial entities in which the federal government, through the Mexican Treasury Ministry or Banco de Mexico (Central Bank), holds capital stock, provided that such entities are the effective beneficiaries of the interest, are registered for that purpose with the SAT and have filed with the SAT the information required by general rules on financing granted to borrowers located in Mexico.

- 4.9% Interest from publicly traded credit instruments and gains from the alienation thereof; interest received from certificates, acceptances, credit instruments, loans, or other credit payable by Mexican financial institutions, as well as those placed through banks or stockbrokers in a country with which Mexico has a double taxation treaty, if and when for the documents in which the financial transaction is stated a notification is filed before the Security and Exchange Commission (Comisión Nacional Bancaria y de Valores, CNBV) describing the main characteristics of the bid and adhering to the general provisions issued by such Commission and the information required by general rules on financing granted to borrowers domiciled in Mexico(1).
- 10% Finance entities owned by foreign governments and foreign banks including foreign investment banks and non-bank banks provided that they are the effective beneficiaries of the interest, are registered with the SAT, and have filed the same information required by general rules on financing granted to borrowers domiciled in Mexico. Non-bank banks should also comply with the requirements established by the SAT relating to placement percentages and deposits received (2)
- 10% Entities that place or invest in Mexico, capital derived from the placement abroad of securities with the general public according to the general rules issued by the SAT.
- 10% Securities available to the general public placed abroad through banks or stock brokerage houses in non-tax treaty countries provided that for the documents in which the financial transaction is stated a notification is filed before the CNBV describing the main characteristics of the bid and adhering to the general provisions issued by such Commission.
- 10% Excess of face value over sale value of credit rights transferred by a Mexican resident creditor or a foreign resident creditor with a PE in Mexico.
- 15% Foreign reinsurers.
- 21% Interest other than those indicated above, paid by Mexican banking institutions.
- 21% foreign suppliers who sell machinery and equipment forming part of the acquirer’s fixed assets.
- 21% Financing to acquire machinery and equipment and in general to furnish working capital, if these circumstances are mentioned in the agreement and such creditors are registered for this purpose with the SAT.
- 30% Interest other than that stipulated above.

(1) In the event of non-compliance with the above stated requisites, the applicable rate will increase to: 10%
(2) In 2011, the interest paid to foreign banks, including foreign investment banks and non-bank banks provided that the actual beneficiary of the interest resides in a

country with which Mexico has a double taxation treaty and complies with the requirements established in said treaty, is subject to a withholding tax rate of: 4.9%

No tax is imposed on interest from loans granted to the federal government and Banco de Mexico (Central Bank) or on interest derived from bonds issued by them provided such bonds are acquired and paid abroad. In addition, no tax is levied on interest derived from loans with a minimum three year term that are granted or secured on preferential conditions by financial entities engaged in promoting exports provided they are registered for this purpose with the Mexican Tax Authorities. Furthermore, no tax is charged on interest derived from loans granted or secured on preferential conditions by financial entities to institutions authorized to receive donations provided such entities are registered with the Mexican Tax Authorities.

5.2.3. Royalties

Income from royalties, technical assistance and advertising is considered to be Mexican source when the goods or rights on which royalties and technical assistance are paid are used or enjoyed in Mexico or when the person making the related payment is a tax resident of Mexico or the Mexican permanent establishment of a foreign entity.

The tax rate varies, depending upon the goods or rights used or enjoyed. The applicable withholding tax rates are as follows:

- Railcars: 5 %
- Technical assistance and other royalties not included below (including the use of Industrial, Commercial or Scientific (ICS) equipment): 25 %
- For the temporary use or enjoyment of patents or certificates of invention or improvement, trademarks or brand names and for advertising: 30% for 2012.

When the same agreement involves royalty payments for different items subject to the 25% or the 30% rate, then the corresponding tax rate should be applied to payments for each type of item. If it is not possible to identify the portion of payment corresponding to each item, the payment is subject to the 30% tax rate.

Revenue from the sale of property or rights subject to productivity, use or further disposition such as patents, trademarks, literary, artistic or scientific rights, amongst others, is characterized as royalty income and the above rates, depending on the type of property or right sold, shall be applied to the revenue obtained by the foreign resident with no deduction allowed.

5.2.4. Services

In the case of income from fees and in general income for the provision of independent personal services, the source of wealth will be considered to be in Mexican territory when the service is rendered in Mexico. The service will be presumed to be rendered totally in Mexico when a portion thereof is shown to be rendered in Mexican territory, unless the taxpayer demonstrates that a portion of the service is rendered abroad, in which case, income tax will be calculated on the portion of the consideration corresponding to the portion of the service rendered in Mexico.

Unless demonstrated otherwise, the service will also be presumed to be rendered in Mexican territory when said service is paid by a Mexican resident or a foreign resident with a permanent establishment in Mexico to a foreign resident that is a related party in accordance with Article 215 of this Law.

Income tax will be calculated by applying the 25% rate to total income obtained, without any deductions, and income tax must be withheld by the person who makes the payments if he is a Mexican resident or a foreign resident with a permanent establishment in Mexico with which the service is related. Otherwise, taxpayers will pay the corresponding tax by filing a tax return at the authorized offices within fifteen days following the obtainment of the income.

Please refer to the CFC section for the possible application of a 40% withholding tax rate.

If the foreign entity is resident of a country with which Mexico has in force a tax treaty to avoid double taxation, lower withholding tax rates could apply.

5.3. Value Added Tax (VAT)

5.3.1. General system and rates

Mexican VAT is paid on a cash flow basis. Certain exceptions are established as mentioned in the following paragraphs.

Any person carrying out taxable transactions is subject to this tax. However, the final consumer is the ultimate payer of this tax. The system of the law requires that this tax is passed on to each transaction regardless of the status of the consumer, whether a tax-exempt organization or federal and local governments.

The invoice issued to support such transactions must expressly indicate the amount of both the operation and the tax transferred. In sales to final consumers not entitled to credit or deduct this tax, this detail is not mandatory and the VAT should be included in the selling price.

In the case of sales, the rendering of services, the granting of temporary use or enjoyment of goods and the importation of intangible goods, the tax is payable at the time when the price is actually received. In addition, when tax withholding is required, it should be made at the time of payment. The tax base is the gross income and no credits are allowed against the withholding.

In order to regulate the time when the actual payment is made, it is necessary to verify the date on which cheques received are cleared by the bank, since this is the date the payment is received and VAT is due.

Due to the cash flow method, credit invoices will only be used in case the payment of the invoice to be credited already took place. In the event that (bank) guarantees are issued in favor of the taxpayer, they only constitute a guarantee of payment until they are actually collected or the documents pending to be collected are transferred to a third party, except when they are transferred for collection purposes. There is a specific procedure provided in the law for determining the tax when documents pending collection are transferred to debt collecting agencies.

The only acts or activities not giving rise to tax under the cash flow system are interest derived from credits granted by financial institutions through the use of credit cards and financial leasing operations where the tax on interest arises as it accrues.

Advance payments or deposits received by the vendor, the rendering of a service or the person granting temporary use or enjoyment of an asset, form part of the agreed price or consideration, regardless of the name given thereto.

5.3.2. Taxpayer and registration

All individuals and legal entities that carry out VAT taxable transactions in Mexican territory are subject to VAT.

In Mexico, the same tax identification number applies for all tax obligations, including VAT.

It is possible but in practice somewhat difficult to obtain a Mexican tax identification number only for VAT purposes. Mainly, the foreign resident must carry out VAT taxable activities but not trigger a permanent establishment for income tax and business flat tax purposes.

Taxpayers must file a VAT return by electronic means and should pay the VAT no later than the 17th day of the following month during which the taxable transactions are carried out.

5.3.3. Taxable transactions

The VAT Law establishes that all individuals and entities are required to pay VAT at a general rate of 16% (0% rate applies in some cases and 11% in the border region) when they carry out the following acts or activities in Mexico.

1. Sale of goods;
2. Rendering of independent services;
3. Granting of temporary use or enjoyment of goods;
4. Import of goods or services.

The VAT transferred to taxpayers and VAT paid on imports relating to expenses for the acquisition of goods, services or temporary use or enjoyment of goods, used exclusively for performing taxable activities, which are deductible for income tax purposes, may be credited.

Tax shall not be creditable when these expenses are used exclusively for performing exempt activities and activities that are not subject to VAT. In cases where the taxpayer is only liable for tax on a portion of its activities, the crediting of VAT shall apply in the proportion of the turnover of taxable activities compared to the total turnover of the activities performed during the month in question.

Determination of the VAT payable

Tax is determined monthly and considered as final payment. Should a credit balance be obtained in any month, the refund of this can be requested in full or credited in subsequent months (i.e. carry forward).

The input VAT must be supported by invoices complying with tax requirements showing the amount of taxes passed on.

There are important exceptions for which no VAT is payable. The most significant of these are land, construction projects destined for housing; books and newspapers, as well as certain other rights; used personal property, except that sold by businesses; partners' interests and securities; and local and foreign currencies and pieces of gold or silver, including troy ounces. Certain services are exempt from the payment of this tax. The most important of these are services rendered directly by the federal and state governments, including the Federal District and municipalities that give rise to the payment of duties except in the case of service, use, supply, or exploitation of water.

Taxes transferred to the federal government, the Federal District, states and municipalities, as well as their decentralized entities and public social security institutions, may only be compensated when they are identified with activities that are subject to the payment of taxes pursuant to the law.

Other tax exempt services are those rendered by public institutions for social security; education rendered by accredited institutions; insurance against agricultural risks and life insurance, as well as the related commissions paid to agents and underwriters; medical services rendered by a recognized physician; commission obtained by pension funds administrators, interest on loans granted or paid by credit institutions, except for those from credit cards and the ones paid by individuals not engaged in business activities; the rendering of independent personal services or leasing of real property; and financial derivative transactions.

In the case of interest from loans granted by financial institutions, current accounts in the use of credit cards, instalment sales and financial leasing, the tax will be paid on the difference between the nominal interest and the inflation following a procedure provided by law.

No tax is payable for the temporary use or enjoyment of real estate destined for housing or farms used for agricultural purposes or cattle breading. The granting of temporary use or enjoyment of property is understood to be any act regardless of the juridical form employed for carrying it out by which permission is given for the temporary use of tangible goods in exchange for some consideration.

Every importation of goods or services is subject to the payment of VAT, with the exceptions mentioned below. In the case of the importation of tangible goods, tax is payable as soon as the goods are available to the importer and is payable at the customs or tax building; in the case of temporary importation, the tax is payable when the importation becomes final.

VAT cannot be paid on a consolidated basis, even when such treatment has been elected for income tax purposes. Further, parties withholding the tax must issue the required certificates of withholding and file an informative tax return in February of each year.

Taxpayers with exempt transactions or taxable transactions that are taxable at different tax rates must record those transactions separately in their accounting records. The taxpayer must issue an invoice that supports the taxable transactions and show separately the amounts of the transactions and the tax passed on.

Commission agents must distinguish between and record separately in their books, those transactions performed on behalf of their principals and those performed for their own account.

Inventory shortages are also taxable unless the taxpayer can substantiate that such shortages do not involve any transfer or disposal of property.

Withholding of VAT

VAT should be withheld in the following instances:

- When legal entities make payments to individuals for independent service rendering or leasing of goods, or when they acquire waste or scrap to be used as raw materials in industrial activities or for its trading.
- When individuals or business entities acquire tangible goods or make lease payments to residents abroad that do not have a permanent establishment in Mexico.
- When banks acquire goods by means of payment in kind or court awards.
- When legal entities receive land motor vehicle transportation services for goods rendered by individuals or legal entities.
- When legal entities receive commission services rendered by individuals.
- When business entities that are in a temporary importation program in order to produce goods to be exported, acquire goods authorized by their programs from national suppliers.

Exportation of goods

Beginning July 1, 2006, foreign tourists who leave the country by air or sea may opt for the refund of the tax paid on goods acquired provided the amount purchased is at least 1,200 Mxp per establishment.

Minor taxpayers

The tax calculation procedure for those who pay taxes under the minor taxpayers' regime established that their tax liability shall be determined in the general terms of the subject Law. The payment based on the estimated value of the taxpayer's activities is optional for these minor taxpayers.

Invoices

Invoices on which VAT is due shall indicate expressly whether the consideration is payable in a single payment or by instalments. When the consideration is due in a single payment, the invoice should indicate the total amount of the operation and the equivalent of the tax being transferred. If the consideration is payable by instalments, the invoice issued to support the transaction should indicate the amount of the instalment being paid and the tax thereon being transferred. When the consideration is payable by instalments, taxpayers shall issue simplified vouchers for each instalment payable after the date of issuance of the invoice. Also, taxpayers shall enter thereon the amount of the instalment supported by it, the form of payment thereof, the amount of tax being transferred, the amount of tax withheld, if applicable, and the number and date of the document issued, to support the relative sale or granting of temporary use or enjoyment of assets or rendering of services.

As of January 1, 2011 it is mandatory to issue electronic invoices in case the amount of the invoice is higher than $ 2,000 and/or the total turnover is more than

$ 500,000 on a yearly basis (where is this arranged in the law). Please note that a digital stamp, which must be covered by a certificate issued by the Mexican Tax Authorities, is obliged on the electronic invoice.

5.4. Other taxes

5.4.1. Transfer taxes/Stamp duties

Except for the real estate acquisition tax described below, and the taxes described throughout this document, Mexico does not generally impose transfer taxes or stamp duties.

5.4.2. Real estate tax

Real estate acquisition tax is a local tax which was substituted for stamp tax and is imposed on transfers of real estate or similar operations by which property or rights thereto are transferred, including donations resulting from death and contributions to an association or company, as well as conditional sales, promises to buy, assignment of rights or mergers and spin-offs of companies. Likewise, foreclosed assets and payment in kind with real estate (liquidation, capital redemptions, profits or dividends of civil associations or mercantile companies) and the transmission of usufruct or the bare property, as well as the extinction of usufruct, unless it is extinguished by death of the usufructuary, regardless of whether the usufruct has been constituted for a certain time or for life, are acts subject to this tax.

In addition, certain acts carried out through trusts are subject to this tax.

The tax is payable on the greater of the acquisition price (i.e., transaction value), the determined cadastral value by application of the unitary values of the land (i.e., property tax value), constructions affixed to it, special facilities of common type, accessory elements or complementary works or the appraisal value (i.e., fair market value) determined by the tax authorities, applying the rates in force in the law of the state where the property is located.

For instance, in the Federal District, the rates range from 3.163 to 4.565 percent for real estate values ranging from $73,531 Mxp to those in excess of $1,764,749 Mxp, respectively. In several other states, this tax is computed applying a rate of 2%.

Generally speaking, in the Federal District, the tax must be paid during the first 15 days of the month following that in which the agreement is formalized. The notary public that notarizes the operation is held jointly responsible with the purchaser for the payment of the tax.

In addition, property taxes apply to the owners of properties. These are generally collected locally.

5.4.3. Excise duties

Individuals or corporations importing goods into Mexico must pay import duties, which are assessed based on the customs value of the goods. In accordance with GATT (General Agreement on Trade and Tariffs) valuation principles, the customs value comprises of the price paid or payable at the date of importation, plus additions incurred by the buyer for its delivery, including for example freight and packaging charges between the exporting place and the port of entry into Mexico. The duty rate is applied to the aforementioned value, in accordance to the tariff classification number of the goods, as provided in the General Import and Export Duty Law.

In general terms, duties are payable on the importation of goods intended to remain in the country for an undetermined period. Goods imported into Mexican territory during 2010 were subject to a weighted average tariff rate of nearly 2%.

With some exceptions, the vast majority of goods that qualify as originating in accordance with the North American Free Trade Agreement (NAFTA), the Mexican-European Union Free Trade Agreement and other trade agreements entered into by Mexico with other countries, are either duty free or benefit from a preferential duty. Furthermore, it is worth noting that such trade agreements have a scheduled gradual phase-out of the import duties applicable, if any.

Further, though there are a number of exceptions, exports of goods from Mexico are subject to 0% duty rates.

5.4.4. Insurance tax

Mexico does not impose an insurance tax.

In the case of premiums paid or transferred to foreign reinsurers by a resident for Mexican tax purposes or by a non-resident with a PE in Mexico, the income tax rate is 2%. The tax must be withheld and paid by the person making the payments.

5.4.5. Other

Special Tax on Production and Services

In accordance with the Special Tax on Production and Services Law, entities or individuals carrying out the following activities are liable for the tax:

- Sale of alcoholic beverages, beer, energy drinks, tobacco, gasoline and diesel fuel.
- Rendering of services such as commissions, mediation, agency, representation, consignation or distribution derived from the alienation of the products mentioned above.
- Gambling and betting.
- Telecommunication services.

Applicable Rates

The tax is determined by applying the following rates on the activities carried out:

The general VAT rate is 16 percent; however, the following special rates apply:

- Zero percent rate generally for sales of patented medicines and food products. The importation of such products is not subject to the payment of tax. Also, this rate applies to exports of goods and certain specific services.
- 11 percent when the operations for which the tax is due are carried out within the border zone, except for transactions involving real estate.

Alcohol, Fermented Alcoholic Beverages and Beer

. From 0 to 14 degrees G.L. 25%[4]
. More than 14 degrees, until 20 degrees G.L. 30%
. More than 20 degrees G.L. 50% [5]
. Alcohol, denaturalized alcohol 50%

Other beverages

. Energy drink and concentrates, powders and syrups to prepare energy drinks 25%

Tobacco

. Cigarettes 160%
. Cigars and other tobacco 160%
. Cigars and other tobacco handmade 30.4%

Gambling and betting

. 30%

Telecommunication services

[4] For beer, the rate will be 26.5% for 2012 and 26% for 2013.

[5] The rate will be 53% for 2012 and 52% for 2013.

. 3%

Gasoline and diesel

The rate applicable to gasoline and diesel fuel will be the one resulting for each agency of Petroleos Mexicanos (PEMEX) and its subsidiaries, based on specific computations.

Importation of goods

In accordance with the law, the tax is triggered when the petition (pedimento) is filed with customs, when the temporary importation became definitive or when the goods are illegally introduced in Mexico and this is detected by the tax authorities.

Taxable Base

The taxable base for importation of goods is the value declared for general import tax purposes increased by the amount of contributions and rights that must be paid for the importation, except the VAT.

Rendering of services

To calculate the tax for the rendering of services, the amount paid for such services will be considered the taxable base. In this case, the tax will be triggered when the payment is collected.

Gambling and betting

The tax is calculated by considering the total value of the amounts actually received from participants of said gambling and betting. In the case of games or betting where bets are placed, the value of the total bet amount shall be deemed as the base, while in games or betting where the bet is made using devices instead of cash amounts, the base shall be the total value of the equivalent amounts in Mexican currency supported by such means. Prizes and the amounts returned to participants may be deducted from the base amount. No tax shall be levied on said activities when performed by non-profit organizations authorized to receive deductible donations for Mexican Income Tax purposes provided they use the totality of the funds obtained for the purposes for which they were created, after discounting the prizes actually paid.

Similarly, exemption from this tax shall apply where betting participants acquire such capacity without being subject to the payment, the acquisition of a good or the engagement of a service or acquire such capacity gratuitously for the mere fact of having acquired a good or engaging a service and provided the betting organizer does not obtain more than 10 permits to hold betting in any given calendar year and that the total amount of prizes offered in a given calendar year does not exceed 3% of revenues earned in the immediately preceding year.

Telecommunication services

The tax is computed based on the amount paid for such services as this will be considered the taxable base. In this case, the tax will be triggered when the payment is collected. No tax should be paid on telephone services rendered in a country side with a population no larger than 5,000 habitants, telephone services rendered for public use, telecommunication services permitting public net exchanges and internet access services.

Obligations

The law establishes, amongst others, the following obligations:

- Taxpayers should keep the accounts and issue vouchers or invoices in which the transferred tax is specified when alcoholic beverages and beer are sold when it is required by the buyer.
- Producers and importers of alcoholic beverages and cigarettes are obligated to label and seal their products.
- Taxpayers engaged in sale of table wines shall be obligated to inform on a semi-annual basis of the selling and the volume of products sold.
- Taxpayers must file annual informative returns of the goods produced, sold or imported during the year.

Information on tags or seals

To verify the proper use of tags or seals the tax authorities may require from the taxpayers information or documentation thereon. Such documentation should be provided within 10 business days of such request.

Tax on New Automobiles

Sales of new automobiles manufactured in Mexico, the importation of new automobiles or models not more than ten years old are subject to this tax. The seller or importer is responsible for paying the tax.

For the importation of vehicles by manufacturers and dealers, the tax will be due and payable at the time the vehicle is sold to the consumer and not upon its importation. This procedure eliminates the financial burden for the manufacturers and dealers.

The tax basis is the automobile manufacturer's sales price offered to the consumer or its dealers, including its accessories, or the value used to compute the general import tax, including optional equipment, but does not include the VAT included in such sales. The tax rate ranges from 2 to 17 percent for automobiles with a sales price ranging from $0.01 Mxp to those in excess of $ 372,584.29 Mxp respectively. For values greater than $571,573.54 Mxp the tax will be reduced by 7% rate on the difference between the total price of the automobile and this excess amount. The tax is calculated per fiscal year, except in the case of certain imports. Taxpayers must make provisional payments at the latest by the 17th day of each month, by means of filing a return by electronic means.

The annual tax, reduced by the provisional payments, must be paid by means of a return filed at the authorized offices within the three months following the closing of the same tax year.

This tax is not payable in the following cases:

- On the definitive export of automobiles, in terms of the customs legislation.
- In the sale to the consumer by the manufacturer, assembler, dealer or trader in the field of vehicles, with a sale price, including optional equipment, common or property, without reducing the amount of discounts, rebates or allowances, not exceeding the amount of MXP$193,231.20 in the listed price. The value-added tax will not be considered in the listed price.
- In the case of cars whose price sale is between $ 193,231.21 and up to $ 244,759.53, the exemption shall be fifty percent of the tax payment established by this Law.
- On the import of tax exempt vehicles in accordance with the law, or with treaties or international agreements rendered by Mexico, whenever one fulfils the requirements and conditions indicated by the Mexican treasury and by means of general rules.

It is relevant to consider that beginning in 2009, there is an exemption of the referred tax for legal entities or individuals selling to the general public or carrying out definitive imports of automobiles propelled by electric rechargeable batteries, as well as those that have electric power propulsion and internal combustion engines or hydrogen engines.

6. Logistical services and customs

Logistical services and customs

Importers' Registry

Entities and individuals importing merchandise from abroad and wishing to trade with them in Mexico must enrol in the importers' registry. In order to apply for this authorization, the entities should be Mexican residents or foreign residents having a permanent establishment in Mexico. Accordingly, they must have duly obtained a Taxpayer ID from the Federal Taxpayers Registry and be in compliance with all the general tax obligations.

Non-tariff regulations and restrictions

Mexico has a complex non-tariff regulations and restrictions system, which includes: import restrictions, import licensing and registration (for certain kind of merchandise), restrictive standards and labelling requirements and burdensome sanitary and phytosanitary regulations.

These regulations and restrictions are established through agreements issued by the Ministry of Economy and/or jointly with other administrative authorities and are established mainly for the following cases:

- In situations of national security, public health, phytosanitation or environment.
- To regulate the entry of used or waste products, or those that do not have a significant market in their country of origin.
- In response to restrictions unilaterally applied by foreign countries to Mexican exports.
- In accordance with international treaties and agreements signed by Mexico.

Mexico's Trade Partners

During the previous 15 years, Mexico's Foreign Trade Policy has strategically focused on establishing strong commercial alliances with other countries. Such alliances have placed Mexico as a major player in many foreign markets. The Mexican government has negotiated twelve free trade agreements, which provide preferential entry to 49 foreign markets (including the European Union), on three continents. Through these commercial treaties, Mexican exporters have access to over a billion consumers, thus resulting in an enormous advantage to the exporting industry.

These free trade agreements are:

1. North American Free Trade Agreement - NAFTA (Canada and the United States of America)
2. Mexico - European Union Free Trade Agreement (Austria, Belgium, Bulgaria, Denmark, Finland, France, Luxembourg, the Netherlands, Portugal, Spain, Germany, Greece, Italy, Ireland, Romania, Sweden, the United Kingdom, Poland, Estonia, Lithuania, Slovenia, Slovakia, Malta, Hungary, the Czech Republic and Cyprus.)
3. Mexico's Free Trade Agreement with the European Free Association (Norway, Iceland, Liechtenstein, Switzerland).
4. Free Trade Agreement with Japan.
5. Northern Triangle Free Trade Agreement (El Salvador, Guatemala, Honduras)
6. Mexico and Chile Free Trade Agreement
7. Mexico, Colombia and Venezuela Free Trade Agreement. (Venezuela opted out from this agreement in 2006).
8. Mexico and Costa Rica Free Trade Agreement
9. Mexico and Bolivia Free Trade Agreement
10. Mexico and Nicaragua Free Trade Agreement
11. Mexico and Uruguay Free Trade Agreement
12. Mexico and Israel Free Trade Agreement
13. Mexico and Peru Trade Integration Agreement
14. Mexico and Central America Free Trade Agreement

In addition to the abovementioned international trade agreements, Mexico also participates in a number of trade organizations, such as the Latin American Association for Integration (ALADI), the Organization for Economic Cooperation and Development (OECD), the Asia-Pacific Economic Cooperation Mechanism (APEC), and though not a member, holds strong commercial links with the member countries of the Common Market of the Southern Hemisphere (MERCOSUR). Mexico's numerous trade alliances and strategic geographical position have placed the country among the world's major trading countries.

North American Free Trade Agreement (NAFTA)

NAFTA became effective in January 1994. Its approval has created one of the largest trade zones in the world with more than 160 million consumers within its borders. The main purpose of NAFTA was to gradually reduce and eliminate trade barriers between the United States of America, Canada and Mexico.

Currently, 99% of all imports are duty-free. In addition, it intends to eliminate technical barriers, such as import permits and other non-tariff barriers. On the other hand, it seeks to develop fair and expedite procedures for the resolution of disputes.

NAFTA also intends to increase international competitiveness and regional trade between the three participating countries, as well as to protect the environment and provide better labour conditions. NAFTA's main goals are:

- To phase-out tariff and non-tariff regulations and restrictions;
- To avoid dumping practices;
- To increase investment opportunities;
- To protect intellectual property rights; and
- To promote trilateral cooperation.

Mexican European Union Free Trade Agreement

The European Union, as Mexico's second largest trading partner, was one of the driving forces for creating a common market. Consequently, the Mexican European Union Free Trade Agreement became effective in July 2000. Since then, European investment and trade relations with Mexico have increased.

Among its main objectives, the treaty seeks to gradually phase out import duties, administrative and customs barriers, protect intellectual property rights, promote fair market competition and foster cross-Atlantic business ventures and employment opportunities. Though the new trade relations stemming from the agreement are relatively new, the commercial ties that have been established have notably increased foreign investment into Mexico and allowed Mexican goods access to European markets.

In accordance with the treaty, all Mexican manufactured products enjoy duty-free access to the European Union since 2001, while only approximately 52 percent of the European Union industrialized products had duty-free access to the Mexican market. However, since 2007, all European Union manufactured products also enjoy a duty-free entry into Mexico.

Export Promotion Programs

Mexico's foreign trade policy has emphasized the promotion of exports, particularly non-oil exports, mainly through the creation of export programs. These programs are regulated by the Ministry of Economy and grant additional tax and administrative advantages to the exporting industry. The main exporting programs established by the Ministry of Economy are:

- Manufacturing, Maquiladora and Export Service Decree (IMMEX)
- Sector Promotion Programs (PROSEC)
- Drawback

Manufacturing, Maquiladora and Export Service Decree (IMMEX Program)

Since November 1, 2006, the IMMEX program has consolidated both the Maquila and PITEX Decrees into one single export promotion instrument. This program allows industrial or service operations aimed at assembling, transforming, manufacturing or repairing goods originating abroad, which are imported on a temporary basis, to be subsequently exported. Additionally, it entails services that are destined for export.

In general terms, the goods, raw materials and components imported under the IMMEX program enter Mexico on a temporary basis, duty-free and value-added tax (VAT) free provided such goods are returned abroad within the timeframes established in the IMMEX Decree (18 months[6]). On the other hand, machinery and equipment imported under the IMMEX scheme will be subject to the corresponding import duties, but will benefit from a VAT free entry.

Mexican corporations may apply to participate in this program, regardless of how their capital stock is structured. Such corporations may establish their facilities anywhere in Mexico and their purpose must be to export at least 10% of their production.

This program also offers opportunities to companies engaged in export projects through foreign companies that provide technology and raw materials but who are not involved in managing such projects.

To qualify for the IMMEX program, the exporting entity must annually export a minimum of US$500,000, or export at least 10% of the company's total annual sales.

The modalities of IMMEX in which authorized entities may operate are as follows:

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[6] Different timeframes apply for sensitive products such as steel and other so called "sensitive goods", which are granted with a reduced timeframe of 9 months.

a) Industrial: Engage exclusively in transformation and repair processes upon temporarily imported goods destined exclusively for export.

b) Controlling: Consolidate the production of manufacturing activities performed by two or more industrial IMMEX entities.

c) Services: Perform services upon goods imported on a temporary basis, such as storage, distribution, packaging, recycling and minor processes that may not be deemed elaboration, transformation or repair, call centres, logistics, customer service, etc. It should be noted that an exhaustive list of activities that may be rendered by the aforementioned entities are included in an Annex of Foreign Trade Rules issued by the Ministry of Economy.

d) Shelter: Provide administrative and technical services relating to the operations inherent to its authorized activities, such as accounting, payroll services and product supervision.

e) Outsourcing: Enables certified enterprises to subcontract manufacturing entities in Mexico that perform manufacturing activities on their behalf.

Modifications to IMMEX Decree for 2011

On December 24, 2010 the IMMEX Decree was substantially modified. One of the most outstanding modifications relates to an across the board limitation to the tax benefits available to IMMEX companies, (partial income tax exemption and tax credit for flat tax purposes) that do not perform transformation activities as redefined in the Decree.

These changes are in force as of January 1, 2011.

Drawback

Manufacturers that import under a permanent import regime and later return such goods in the same physical conditions as these were imported, may take advantage of the drawback program, which allows the refund of the import duties paid at the time of entry of such goods.

To benefit from this program, such imported goods must be returned within a year from the date in which these were initially imported. In any case, the drawback refund application must also be filed within the mentioned period.

Import License

Nonetheless, importers must be registered with the National Importers' Registry to be allowed to import goods into Mexico; in specific cases, importers of certain specific goods may need an additional license to import the goods.

It should be noted that all import (and export) operations must be conducted by a previously appointed customs broker.

Certified Program

As of 2003, Mexican corporations that import a predetermined value of goods may file for preferential status before Customs. This authorization, which must be renewed on an annual basis, will benefit the holder’s import and export operations with the following administrative incentives:

- May conduct import-export operations through any customs broker, including those that otherwise prohibit the entry or dispatch of certain types of goods.
- Preferential treatment and simplification of customs and administrative procedures.
- Filing preference for specific import licenses of goods listed under certain sectors.
- Preference in the reduction of certain fines and penalties.

To qualify for such authorization, among other requirements, the company must be a Mexican incorporated entity, up to date with its tax obligations and have the financial statements of the last five tax years certified by an independent auditor. If the company is newly incorporated and has not operated for the previous five tax years, the auditor’s certification will be required for the years it has been in operation.

Strategic Bonded Warehouses

In July 2003, the Strategic Bonded Warehouses (SBW) concept came into effect in Mexico, but it was in August 2004 that the defining administrative regulations regarding documentation and procedures were released by the Treasury Ministry, which in Mexico also oversees customs activities. The SBW is a new legal import regime under which foreign or domestic goods may be stored in confined spaces that are managed by private Mexican companies. The principal innovation of the SBW is, unlike imports into traditional bonded warehouses (bonded warehouses owned in Mexico by the financial system) where only warehousing, display, sale, labelling, packaging or sampling activities are permitted under the operating control of the bonded warehouse, at a SBW private companies are authorized to manufacture and transform the raw materials entered in the SBW into finished products.

Goods imported into Mexico and housed in a SBW may remain in the SBW for two years. Machinery, administrative equipment, furniture and general fixed assets may remain in the SBW for as long as they are depreciated for income tax purposes, which generally is a 10-year term. It should also be noted that companies storing goods in a SBW are not required to be authorized under an IMMEX program that entails complicated administrative controls on the part of the companies

Finally, it should be mentioned that since 2006, state governments have been allowed to act as administrators of SBW.

Tax Issues and Import Permits

There are four principal tax and administrative advantages to companies that house goods in a SBW:

1. Foreign goods are not liable for import tariffs or countervailing duties (except when rules of Trade Agreements are applicable regarding the restrictions on refund of customs duties on export products or tariff deferment programs).
2. Sales of goods within the SBW are not subject to VAT.
3. Goods are not required to comply with non-tariff regulations and restrictions (i.e., previous import permits, quotas, country of origin marking, etc.) or Mexican official standards, other than sanitary, environmental or national security standards.
4. Shrinkage is not subject to import tariffs or foreign trade taxes, whereas waste must be destroyed in conformity with administrative controls.

7. Immigration, Employment and Personal tax

7.1. Immigration

The National Migration Institute is a technical body Decentralized Federal Public Administration, under the Interior Ministry, which applies the current immigration legislation. Its user audience includes those who visit us from other countries, and those who want to stay in Mexico on a temporary or permanent, as well as hired foreigners and Mexicans who wish to establish family ties to a foreigner.

7.2. Employment regulations

Labour relations are governed by the Federal Labour Law and its associated Regulations. The law provides minimum working conditions and rights which must be borne by the employer regardless of whether the employees are organized under a union or not. Such provisions cannot be waived by the employee under any circumstances. The law is applicable to all employees in Mexico regardless of their nationality.

The law provides two types of labour relationships: individual and collective. An individual labour relationship is created automatically upon a person being hired to perform a task subject to the control of the employer, whether on a temporary basis or for an indefinite term. Unless the nature of the task is specified or for a permanent term, as provided in the law, employment may only be terminated, without liability to the employer if the employee falls in one of the justified termination causes indicated therein (otherwise severance payments would have to be made). A collective relationship exists when the work force is organized under a labour union and the employer has executed a collective bargaining agreement with such union (see Union's below).

Even if no written agreement exists, the law considers the employee to be under an agreement according to the terms set forth in the mentioned law. It is advisable for the benefit of both parties, to execute a written agreement providing the specific conditions of employment to avoid problems in the event of a dispute before the Labour Board.

7.3. Personal income tax

Resident Taxpayers

Mexican individuals are taxed on their worldwide income which includes all income earned, except the income specifically excluded by the law.

In arriving at taxable income, individuals are allowed the following deductions ("personal deductions"):

- Medical and dental fees and hospital expenses paid in Mexico by the taxpayer or the economic dependents (spouse, children and parents provided that their annual income is less than the annual general minimum wage), without any limitation, after deducting amounts reimbursed by insurance companies.
- Funeral expenses made by the taxpayer or by the economic dependents mentioned above, limited to the annual general minimum wage paid in Mexico, after deducting amounts reimbursed by third parties.
- Donations approved by the tax authorities, the maximum deduction on such items is limited to 7% of the whole taxable income for the immediately preceding fiscal year.
- Interest paid during the fiscal year derived from mortgage credits that do not exceed 1.5 million investment units (UDIS) (i.e. approximately $540,000 USD).
- Premiums paid for medical insurance.
- School bus expenses for children provided that such transportation is obligatory according to the legal provisions of the school's area.
- School fees paid to private institutions the deductible amount of which would depend on the level of education given to the student (from kindergarten to preparatory school).
- Contributions to authorized retirement saving funds up to the maximum amount provided by law.
- Local income tax if imposed by the State in which the taxpayer resides as long as the local income tax rate does not exceed 5%.
- Itemized deductions (with certain adjustments) relating to rental income, independent services and business activities.

The law classifies the income obtained by individuals as follows:

- Personal services
- Business and professional activities
- Leasing of real property
- Sale of property
- Acquisition of property
- Interest
- Prizes
- Dividends
- Other income

Individuals should file a Mexican annual income tax return by 30 April of the following year, except in the following cases.

- When they receive only exempted income or income on which the income tax withheld or paid is considered final.
- When they only receive wages and salaries amounting less than MXP400,000, provided they did not work for two or more employers simultaneously during the year and were employed at the end of the year.

However, see the following condition. This exception does not apply when the employee receives salary payments derived from foreign sources or from entities with no withholding obligation.

- Individuals obtaining a combined annual income of salary and interest income not exceeding MXP400,000, if and when the actual interest (interest versus inflation) does not exceed MXP100,000, are not obligated to file an annual tax return provided that the income tax on the actual interest has been withheld to them. In this case, the tax withheld is considered final. It is important to mention that as of 1 January 2012 this statement will be derogated, as the tax calculated on interest income will be considered as a final payment and the procedure to calculate the tax will change.

Those individuals who obtained total income amounting to MXP500,000 or more during the tax year, including exempted income and income that paid final tax, are obliged to report in their annual tax return the travel expenses reimbursed by the employer, income on sale of principal residence (when the exemption applies), income from inheritances and legacies, as well as income received for prizes. Besides, all prizes, loans, and donations received in the tax year, that in aggregate or individually amount to more than MXP600,000 in the tax year should also be reported.

Failure to comply with the earlier mentioned reporting requirements may result in the income being considered as taxable, even if originally such income was exempt or non-taxable.

The income tax is determined by applying a graduated scale with a maximum marginal tax rate of 30 percent for tax year 2012. This tax rate is reached with a monthly income of MXP32,736.84 and with an annual income of MXP392,841.97. Estimated tax payments and withholdings are credited to offset the final annual tax liability. The deadline to make the tax payments or remit the withholdings to the Mexican tax authorities is the 17th of the following month.

Non-resident taxpayers

Individuals considered non-residents will be taxed on their Mexican-sourced income only and will not be subject to file a Mexican annual income tax return, as monthly tax payments/withholdings will be considered as final or definitive tax payments.

Non-residents are exempt on the first MXP125,900 wages earned; then an income tax rate of 15 percent applies when income exceeds MXP125,900 and a 30 percent rate applies on the income that exceeds MXP1,000,000 within a 12-month period. Individuals should accumulate the income received every month to determine the tax rate to be used to calculate the corresponding income taxes.

For individuals considered as non-residents, the Mexican company will be required to withhold the corresponding taxes when their salaries are paid from the Mexican company or from abroad but the cost of the compensation is charged back to the Mexican company. When the cost of the compensation is not charged back to the Mexican company, the individuals will be required to file individual monthly income tax returns.

Additionally, the Mexican tax law establishes additional options to pay the non-resident income tax as follows:

- the foreign employer withholds and remits the Mexican tax to the tax authorities (it is important to mention that this would require the foreign entity to be formally registered in Mexico as a withholding agent)
- the Mexican company in which the services of the individual are performed could act as the collecting agent of the taxes and be responsible of remitting the non-resident income tax payments for the assignees or
- the individuals could name a representative in Mexico through a power of attorney. The representative would be required to file the non-resident monthly income tax payments on their behalf.

Finally, it is important to point out that when compensation is paid from abroad, the cost of the compensation is not charged back to any Mexican entity and the individuals are less than 183 days in Mexico (consecutive or not) in any 12-month period, the individuals will be exempt totally for Mexican income taxes.

7.4. Social security and payroll taxes

Social security

The current Social Security Law was published in the Federal Official Gazette on November 21, 1996. This law underwent important modifications through the Decree amending a number of provisions of the Law that was published in the Federal Official Gazette on December 20, 2001.

The Social Security Law is intended to guarantee the right to health, medical assistance and welfare services necessary for the social and collective well-being of workers and their families.

Registration in the social security system may be made under two insurance regimes, namely:

- Mandatory regime
- Voluntary regime

Registration is mandatory for those employees economically dependent on an employer either on a permanent or temporary basis, members of production cooperatives and such other individuals as determined by the Federal Executive Branch through issuance of the respective Decrees.

Benefits in cash or in kind specified for each insurance category are provided to employees and are classified under five insurance types, including occupational risks:

- Sickness and maternity
- Invalidity and life
- Retirement, old age unemployment and old age pension
- Nursery/day-care centres and welfare services
- Occupational risk

Social Security in Mexico provides for voluntary registration for other individuals. Such registrations are governed by special rules for purposes of contributions by: self-employed individuals, domestic staff, communal farmers and others.

The Mexican Social Security Institute is financed by contributions from employers, workers and the Federal Government.

The proportions in which these contributions are made are as follows:

Employer	70%
Worker	25%
Federal Government	5%
Total	100%

The minimum wage in force in Mexico City for 2012 is $62.33 Mexican pesos.

Insurance contributions paid to the Mexican Social Security Institute are determined based on each employee’s contributory earnings or what is commonly referred to in Mexico as the base contribution salary of each employee, from one minimum wage up to a contribution ceiling amount equal to 25 times the minimum wage in force in Mexico City.

Occupational risks

Employers are liable for 100 percent of contributions or taxes payable for occupational risk and nursery/day-care centre insurance.

Such costs vary depending on the risk classification assigned to a company, as shown by the table below:

Average Additional percentages

Commercial, professional, administrative, or sales offices	0.54355
Some commercial, warehousing, very light manufacturing and textiles, etc.	1.13065
Light manufacturing and textiles, etc.	2.59840
High risk industry using metals, chemical heat	4.65325
Maximum risk, including construction, mining, heavy industry	7.58875

Annually, the company should determine the risk rate that applies to its activity; increasing or decreasing the current rate as a function of all of the risks associated with its labour force. This rate variation can't be higher or lower than a percentual point per year and the final calculus result should be reported to the IMSS during February of the next year.

Companies that begin their activities may determine its risk degree until a fiscal year (from January 1 to December 31) is completed.

However, companies with ten or less employees can present the annual risk evaluation in voluntary way.

For Occupational Risks or Diseases, the Mexican Social Security Institute provides the benefits in kind such as medical, pharmaceutical, surgical and hospital services, as well as prosthesis and orthopaedic apparatus and cash benefits. For example, disability assistance is paid beginning on the fourth day up to 52 weeks following an incident. This benefit may be extended for an additional 52 weeks or a pension may be granted for permanent total or partial disability. In case of the death of the insured, an orphan pension for children and/or widow/widower's pension to a spouse may be granted, as appropriate.

Employer's social security obligations

An employer's social security obligations include those listed below. Failure to comply with these obligations may result in monetary penalties not only for omission but also for late compliance with such obligations.

- Registration as an employer must be made in the IMSS and INFONAVIT within five (5) business days following the commencement of the first employment relationship.

- In case of non-compliance with the obligation above, the penalty imposed by the Social Security Institute is a fine ranging from 20 to 250 times the general minimum wage for the Federal District.
- Notices for registration of employees must be filed within five (5) business days following the commencement of the employment relationship with the worker in question.
- Failure to comply with the obligation above will result in a fine ranging from 20 to 350 times the general minimum wage for the Federal District.
- Notification of changes in employee salary. Deadlines for filing such notices vary depending on the type of compensation. For fixed salary, notices must be filed within five (5) business days after the date of the salary change. For variable salary, within five (5) business days in January, March, May, July, September and November. In case of a mixed salary, the rules for the element in question will be applicable.
- The penalty will be a fine ranging from 20 to 125 times the general minimum wage for the Federal District.
- Notification of employment terminations must be made within five (5) business days following the termination.
- The penalty will consist of continuing payment of the corresponding contributions through the day following that on which the respective notice is filed.
- Accounting records meeting the established legal requirements must be kept and retained for five years.
- A fine ranging from 20 to 75 times the general minimum wage for the Federal District may be imposed by the Social Security Institute, irrespective of those penalties that might be assessed under other regulations.
- Employer's social security and housing savings fund contributions must be paid within the first 17 days of each month.
- The penalty established by the Social Security Law is a fine ranging from 20 to 75 times the general minimum wage for the Federal District. As for the INFONAVIT, the penalty will range from 301 to 350 times the general minimum wage for the Federal District, taking into consideration also for the assessment of the fine, among other things, the number of affected workers.
- Workers' contributions must be determined, withheld and paid within the first 17 days of each month. In addition, amortization payments of housing credits granted to workers must be filed and paid on a bimonthly basis.
- The Social Security penalty is a fine ranging from 20 to 75 times the general minimum wage for the Federal District, whereas the fine assessed by the INFONAVIT is 301 to 350 times the general minimum wage for the Federal District.
- Supporting documentation evidencing payment of the employer-employee contributions, and the relevant printed forms or magnetic means, must be secured and retained for the regulatory 5-year term.
- Should such evidential matter and documentation not be retained for the regulatory term and be requested by the tax authorities, non-payment of

contributions would be presumed and the applicable penalties would be assessed.

Outsourcing responsibility

In July 2009, a new obligation was added to the Social Security Law, this obligation is related to a joint liability within an outsourcing scheme, where the staff provider doesn´t meet with its Social Security obligations as an employer of outsourced staff.

To regulate this obligation, the data of the contracting parties must be reported to the IMSS quarterly through software authorized by the Institute.

Employer-employee Contributions

Social security contributions are determined on the basis of daily contributory earnings, in conformity with the Law, with the following percentages being applicable:

Insurement Field	Employer's percentage	Insured's percentage	Total
Sickness and maternity.			
In-kind benefits.			
Fixed contribution	20.40%	0%	20.40%
Excess	1.10%	0.40%	1.50%
Monetary benefits.	0.70%	0.25%	0.95%
Medical expenses for Pensioners.	1.05%	0.38%	1.43%
Invalidity and Life	1.75%	0.63%	2.38%
Nursery/day-care centers and welfare expenses.	1.00%	0.00%	1.00%
Retirement	2.00%	0.00%	2.00%
Old-age unemployment and Old-age insurance	3.15%	1.13%	4.28%
INFONAVIT	5.00%	0.00%	5.00%

In the case of invalidity and life, as well as for old-age unemployment and old-age insurance and INFONAVIT, beginning July 1, 2007 the contribution ceiling will be 25 times the general minimum wage on Mexico City.

Payroll tax

Payroll tax is levied on a local basis and will vary depending on the state in which the company operates. However, payroll tax is generally of 2% of the total payroll of the company in the relevant State.

7.5. Pensions and insurance

Pension Plans

It is becoming more common to establish pension plans in addition to social security pensions. In order for such pension plans to be deductible for income tax purposes, they are subject to certain requirements:

- The plan must be calculated based on actuarial studies that should be compatible with the nature of the benefits included on the plan.
- The plan must be in the form of an irrevocable trust with a Mexican credit institution, or be administrated by some financial institutions.
- At least 30 percent of the provision set up for the plan must be invested in Federal Government securities and the remainder must be invested in securities approved by the National Securities Commission.
- The plan must cover all of the employees.

Old-age unemployment (after 60 years of age) or old-age pension (after 65 years of age), are payable by either the Mexican Social Security Institute or the AFORE (Retirement Savings Administrator) to which the employee's individual account was contracted upon meeting the requirement of having made at least 1250 credited weekly contributions. Workers who have not contributed the required 1250 weeks, but to whom at least 750 weekly contributions are recognized, are entitled to in-kind sickness and maternity insurance benefits.

The alternatives to enjoying an old-age pension are as follows:

a) Contracting a life annuity with a public, social or private insurance company chosen by the worker. The life annuity will be annually updated in February based on the national consumer price index, and

b) Maintaining the balance of the worker's individual account in an AFORE and making scheduled withdrawals from the account.

The AFORE is voluntarily chosen by the worker to manage his/her individual account in which the employer-employee and government contributions for retirement, old-age unemployment and old-age insurance, as well as returns, will be deposited. This account is made up of retirement, old-age unemployment and old-age insurance, workers' housing and voluntary contribution sub-accounts. At the time a worker is eligible for a pension, the AFORE will determine the aggregate amount and pay a monthly life annuity as appropriate. In the event of an inadequate amount in the individual account, and once the savings account has been exhausted, the Federal Government in conformity with the Law, will grant a guaranteed monthly pension equal to one month's minimum wage in force at the time so requested by the worker.

Contributions paid for disability and life, old-age unemployment and old-age insurance, as well as the contributions to the National Workers' Housing Fund are managed directly by the AFORE, which is responsible for itemizing and appropriating the amounts to proper sub-accounts. The AFORE is also responsible for investing the resources of individual accounts in SIEFORES (Investment Entities Specialized in Retirement Funds) provided it is authorized by the worker to invest his/her savings in other investment companies.

The AFORES are defined as financial entities that exclusively, ordinarily and professionally are engaged in managing investment companies.

In order to increase the level of transparency of the workers' savings, a dual scheme was legislated for the management of the funds: the AFORES are charged with management of individual accounts and the SIEFORES have the function of investing these resources to generate more suitable returns with lower risks and a greater profitability. Both entities will act as communicating vessels between the individual accounts.

The SIEFORES are investment companies specialized in savings funds that are created by the AFORES for the sole purpose of investing the resources that are obtained by the individual accounts in the manner and under the terms established by the CONSAR (National Commission of Retirement Savings System) and the internal self-regulation programs.

There are three types of SIEFORES:

a) Investment,
b) Debt and
c) Generic

Just like a worker is entitled to change AFORE, he/she may also request for a change of SIEFORE or indicate how he/she wants his/her individual account resources to be invested in many investment companies of the same group.

There are currently about 20 AFORES in Mexico. The main objective of an AFORE is to gain the greatest possible number of workers as clients, thus allowing more competitive commission rates to be charged for management of the accounts.

Invalidity and Life

This insurance protects against the insured's disability and death or a pensioner's invalidity, when not due to an occupational risk, by granting of a pension to the insured/pensioner or the beneficiaries.

Sickness and Maternity

This insurance provides the worker and his/her family with the necessary medical, surgical, pharmaceutical and hospital services. In addition, it provides monetary and in-kind benefits including, among others, subsidies for temporary disability and assistance for nursing mothers.

Nursery/Day-Care Centres and Welfare Benefits

This insurance provides the insured and his/her beneficiaries with nursery/day-care centres for his/her children and general social welfare benefits aimed at improving the quality of life and standard of living of workers and their families.

7.6. Expatriates

Short-term assignees could be considered non-residents by not establishing a principal home in Mexico and could be totally exempt of Mexican income taxes when certain conditions are met or be taxed on lower tax rates on their Mexican-sourced income only. As non-residents, the short-term individual will not be subject to file a Mexican annual income tax return and the tax payments made during the year are considered as definitive or final.

The tax regime applicable depends on the residence status of the expatriate. If a tax resident, then the individual is taxed on his/her worldwide income. If not a resident, then the individual is taxed on Mexican-sourced income, as described previously in 7.3.

Consideration on whether or not the salaries will be charged-back to the Mexican entity and the estimated length of the assignment as the individual could be totally exempt for Mexican income taxes when qualifying as non-resident.

Foreigners who work for Mexican employers are subject to Mexican social security contributions, as previously described in 7.4.

KPMG Contacts:

Jose Manuel Ramírez
josemanuelramirez@kpmg.com
+212 872 6541

Manuel Rico
rico.manuel@kpmg.com.mx
+52 55 5246 8558

Catherine Thibault
catherinethibault@kpmg.com.mx
+52 55 5246 8474