



Investment in MEXICO 2017



Contents

- 1. Business environment**
 - 1.1. Facts and Figures
 - 1.2. Business Climate
- 2. Starting or acquiring a business in Mexico**
 - 2.1. Starting a business
 - 2.1.1. Legal forms and registration/application requirements
 - 2.2. Acquiring a business
 - 2.2.1. Mergers, acquisitions and restructurings
 - 2.2.2. Exit issues (tax, liquidation, ...)
 - 2.3. Financing
 - 2.4. IP
- 3. Incentives**
 - 3.1. Subsidies
 - 3.2. Tax
- 4. Reporting, Audit and regulatory environment**
 - 4.1. Financial Reporting
 - 4.2. Audit
 - 4.3. Tax reporting
 - 4.4. Regulatory aspects
 - 4.4.1. Competition
 - 4.4.2. Financial
 - 4.4.3. Corporate Governance
- 5. Business Taxation**
 - 5.1. Corporate tax
 - 5.1.1. General system and rates
 - 5.1.2. General computation
 - 5.1.3. Special regimes
 - 5.1.4. Transfer pricing
 - 5.1.5. Thin Cap
 - 5.1.6. Loss treatment
 - 5.1.7. CFC
 - 5.1.8. Anti-Avoidance
 - 5.1.9. Double taxation
 - 5.2. Withholding tax
 - 5.2.1. Dividends

- 5.2.2. Interest
- 5.2.3. Royalties and technical assistance
- 5.2.4. Services
- 5.2.5. Other considerations
- 5.3. Value Added Tax (VAT)
 - 5.3.1. General system and rates
 - 5.3.2. Taxpayer and registration
 - 5.3.3. Taxable transactions
- 5.4. Other taxes
 - 5.4.1. Transfer taxes/Stamp duties
 - 5.4.2. Real estate tax
 - 5.4.3. Mining Industry
 - 5.4.4. Excise Duties
 - 5.4.5. Insurance Tax
 - 5.4.6. Energy Incentives
 - 5.4.7. Others

6. Logistical services and customs

7. Immigration, Employment and Personal tax

- 7.1. Immigration
- 7.2. Employment regulations
- 7.3. Personal income tax
- 7.4. Social security and payroll taxes
- 7.5. Pensions and insurance
- 7.6. Expatriates

8. Anti-Money Laundering Law

9. Legal Framework for Data Protection in Possession of Private Parties

10. Financial Society of Multiple Objects



1. Business environment



1.1. Facts and Figures

- Land area -1,964,375 sq km
- Population-112.5m in 2010, according to estimates from the US Census Bureau
- Main towns
Population (m), 2010 (INEGI data for metropolitan areas):
Mexico City (capital): 20.1
Guadalajara: 4.4
Monterrey: 4.1
Puebla: 2.7
- Climate-Tropical in the south, temperate in the highlands, dry in the north
- Weather in Mexico City (altitude 2,309 meters)
Hottest month, May, 12-26 C (average daily minimum and maximum); coldest month, January, 6-19 C; driest month, February, 5 mm average rainfall; wettest month, July, 170 mm average rainfall
- Languages-Spanish is the official language. Over 60 indigenous languages are also spoken, mainly Nahuatl (1.2m speakers), Maya (714,000), Zapotec (403,000) and Mixtec (387,000)
- Measures-Metric system
- Currency-Peso (Ps). Average exchange rates in 2017 Ps 19.99: US\$1 Ps 21.24 €1
- Time-Six hours behind GMT in Mexico City
- Mandatory holidays-January 1st; the first Monday of February; the third Monday of March; May 1st; September 16th; the third Monday of November; 1st of December every six years, when it corresponds to the transition of the Federal Executive Power (when the new President takes office); and December 25th.

Mexico belongs geographically to North-America; ethnologically it belongs to Latin America. Mexico is the most populous Spanish-speaking country in the world. About 78% of the people live in urban areas. According to the last census results, the Mexico metropolitan area had a population of 20.1 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 million¹, of which 57,481,307 are women and 54,855,231 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%.

Information data

Annual data	2016 ^a Historical averages (%)	2012-16
Population (m)	128.6Population growth	1.3
GDP (US\$ bn; market exchange rate)	1,031.7Real GDP growth	2.5
GDP (US\$ bn; purchasing power parity)	2,248.3Real domestic demand growth	2.6
GDP per head (US\$; market exchange rate)	8,021Inflation	3.5
GDP per head (US\$; purchasing power parity)	17,479Current-account balance (% of GDP)	-2.3
Exchange rate (av) Ps:US\$	18.7 ^b FDI inflows (% of GDP)	2.6

^a Economist Intelligence Unit estimates. ^b Actual.

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

Source: The Economist Intelligence Unit, "Mexico: Country fact sheet", February 2017.

Country overview: Highlights

- The government of the president, Enrique Peña Nieto of the Partido Revolucionario Institucional (PRI), will focus on implementing structural reforms approved in 2013-14, while reactivating sluggish economic growth and dealing with the potential anti-trade and anti-immigration policies of Donald Trump in the US, some of which could have serious impacts. However, the government will struggle to reinforce security and build confidence.
- Mexico's economy continues to grow modestly
- Mexico's economic split is fairly even, with manufacturing making a sizeable contribution to overall Gross Value Added (GVA), given that it is a major car producer, that is balanced by relatively large financial and services sectors.
- Given that Mexico is well integrated within the world economy, the global economic slowdown is a major risk to the country's future output development, as is further weakness in global oil prices, given that Mexico is a notable oil producer. Its considerable reliance on the US economy is another substantial risk.
- Uncertainty about US policy and a decline in business and consumer confidence will result in real GDP growth averaging just 1.4% in 2017-19. We then expect growth to pick up in 2020-21, to 2.8% on average, as domestic and external conditions improve. The success of the structural reforms will be diluted by lobbying and deal-making, weak institutional effectiveness and, in the case of the energy reform, low global oil prices. Low oil prices will dampen fiscal revenue and force restraint in capital spending.
- Mexico is undergoing a demographic boom, but the benefits from this will be constrained by poor levels of education and the fact that a high proportion of the labour force (almost 60%) is employed in informal, low-productivity jobs. The consumer market boasts an expanding middle class and fairly high income levels compared with most of Mexico's regional peers. However, wages are low by OECD standards, and high levels of inequality and poverty will weigh on consumer demand.
- In spite of some success in diversifying export markets, Mexico's economic fortunes will remain closely tied to those of the US. Foreign direct investment (FDI) has underperformed, but pick up further once the energy and telecommunications reforms are well established. US efforts to

reduce the outsourcing of jobs will diminish FDI in Mexico modestly but the country will remain attractive due to low wages and a weak peso. However, many domestic sectors will continue to struggle, owing to weak competitiveness.

Key indicators	2016	2017	2018	2019	2020	2021
Real GDP growth (%)	2.0	0.9	1.8	1.5	2.6	3.0
Consumer price inflation (%)	2.8	4.6	3.5	3.9	3.7	3.6
NFPS balance (% of GDP)	-2.6	-2.5	-2.7	-2.6	-2.5	-2.3
Current-account balance (% of GDP)	-2.8	-3.2	-3.0	-3.4	-2.7	-2.4
Lending rate (%)	4.6	6.7	6.5	5.2	4.7	5.0
Money market rate (av; %)	4.5	6.5	6.3	5.0	4.5	4.8
Exchange rate Ps:US\$ (av)	18.7	22.8	24.5	24.8	24.6	23.5

Source: Economist Intelligence Unit, Country Forecast 2017

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 Mexico City, 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, totaling 4,301 kilometers.



Source: The Economist Intelligence Unit "Mexico Basic Data", February, 2017

Political situation

After spending most of his term focusing on the passage and implementation of a structural reform agenda, the president, Enrique Peña Nieto of the Partido Revolucionario Institucional (PRI), will be forced to shift his efforts to defend Mexican interests against an increasingly hostile US administration led by the newly inaugurated president, Donald Trump. Mr. Trump has called for the renegotiation of the North American Free-Trade Agreement (NAFTA) that was signed in 1994 and underpins the two countries' economic ties. He has also insisted that a wall will be built on the US-Mexico border, which Mexico will pay for. Barely one week into his term, Mr Trump has already triggered a diplomatic row with Mr Peña Nieto, which resulted in the cancellation of a planned meeting between the two presidents on January 31st. Tensions between the two countries will remain high, particularly given the uncertainty over how far Mr Trump will push his anti-trade and anti-immigration proposals.

Ensuring sustained economic growth

Mexico is better equipped than most other emerging markets to ride out occasional bouts of volatility and its economy is on track to post fairly solid GDP growth in the year ahead. The continuing strength of the US economy, Mexico's main trading partner, will fuel export-led growth, while increased public expenditure, especially on infrastructure projects, promises to improve the country's performance.

Growth rates will gradually rise, reaching 2.9% per year in the last years of the decade. External demand should strengthen while private investment will continue to rise, eliminating much spare capacity. Mexico's energy reforms should eventually add about 1.5% to annual growth of GDP but the fall in oil prices means that the associated investment boom will be spread over a much longer period than initially thought. The potential rate of growth is currently about 2.6% but the IMF expects structural reforms will eventually lift it to 3-3.5%. The country's economic outlook is closely tied to the performance of the US economy.

Mexico's major challenge in the future is to implement the ambitious reforms that the government has passed. This includes reforms in the fields of energy, education and telecommunications. Energy reform is a key to opening up investment opportunities. Education reform is crucial for the long-term success of the economy. Telecommunication reform is important to attract more foreign investment.

International Issues

The victory of Donald Trump in the US presidential election has led the Mexican peso to plummet, reflecting investor concerns over the future of trade and investment between the two countries. Weak confidence will weigh on consumption and investment, and growth will struggle to pick up in the short run. Domestic issues of crime, corruption and structural reform implementation will also remain high on the agenda particularly as the 2018 election nears.

Mexico has several problems with Washington. The major source of tension is the various proposals to tighten immigration controls in the US. Relations with Guatemala are strained owing to its contacts with the Chiapas rebels in the southern part of that country.

Billions of dollars in illegal money are believed to leave the country each year. The cross-border transfer of funds is a primary means of evading taxes, depriving the government of tax revenues crucial for providing public goods. In addition, the national statistics institute estimates that

crime cuts a full percentage point off Mexican growth and drives public dissatisfaction.

Political stability

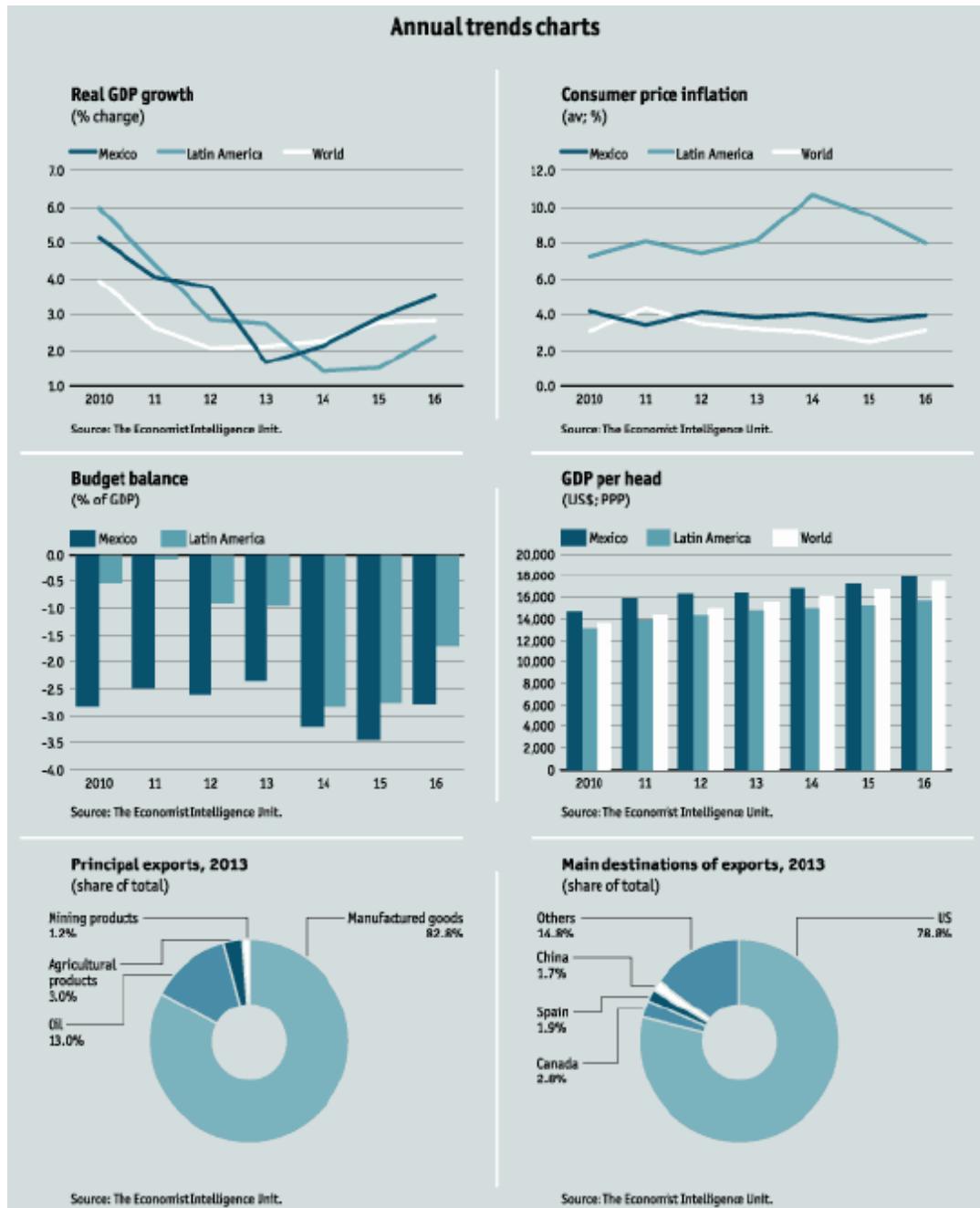
After spending most of his term focusing on the passage and implementation of a structural reform agenda, the president, Enrique Peña Nieto of the Partido Revolucionario Institucional (PRI), will be forced to shift his efforts to defend Mexican interests against an increasingly hostile US administration led by the newly inaugurated president, Donald Trump. Mr Trump has called for the renegotiation of the North American Free-Trade Agreement (NAFTA) that was signed in 1994 and underpins the two countries' economic ties. He has also insisted that a wall will be built on the US-Mexico border, which Mexico will pay for.

Barely one week into his term, Mr Trump has already triggered a diplomatic row with Mr Peña Nieto, which resulted in the cancellation of a planned meeting between the two presidents on January 31st. Tensions between the two countries will remain high, particularly given the uncertainty over how far Mr Trump will push his anti-trade and anti-immigration proposals.

Election watch

Presidential and congressional elections are set for June 2018. The ruling PRI is struggling to find a viable candidate, given the low popularity ratings of potential contenders from Mr Peña Nieto's inner circle. The interior minister, Miguel Osorio Chong, is likely to be Mr Peña Nieto's preferred choice, especially since a possible rival, the minister of finance José Antonio Meade Kuribreña, may see his chances fade as a result of the petrol price hike. Former first lady Margarita Zavala is an early frontrunner for the Partido Acción Nacional (PAN), but her candidacy is unlikely to go uncontested. The left remains divided between the Partido de la Revolución Democrática (PRD) and the more radical Movimiento Regeneración Nacional (Morena), led by a previous presidential candidate, Andrés Manuel López Obrador. Opinion polls suggest that Mr López Obrador will be a strong presidential contender, given his anti-establishment rhetoric. Moreover, the PRD has suffered from low approval ratings, which may lead it to contest the presidency as a junior ally to either the PAN or Morena. Numerous independent candidates are expected to run, as this will be the first election in which they are able to do so. Owing to high levels of public disapproval of the PRI, we currently expect the PAN to reclaim the presidency in 2018, although there are substantial risks to this forecast. Mr López Obrador will benefit most from

Mr Peña Nieto's low popularity, as well as from any crises that may be the remainder of his presidential term.



Source: The Economist Intelligence Unit, February, 2017

Economy

Economic growth

Uncertainty over the potential fallout from a Trump presidency in the US will have a tangible impact on economic growth in 2017-18 by putting investment on hold and depressing business and consumer confidence. The petrol price hike will have a pronounced immediate impact: we forecast an economic contraction in the first quarter of 2017, which will reduce average growth for the year to just 0.9%. This is a significant downward revision from our previous forecast of 1.8%. Our new forecast assumes that the US will impose modest symbolic tariffs on some imports from Mexico, but it is subject to further downward revisions if Mr Trump chooses to enact a more protectionist agenda. This could include a more punitive renegotiation of NAFTA, a blanket tariff on all Mexican exports to the US, and fines for US companies moving jobs and production to Mexico. These policies raise the risk that the Mexican economy could fall into recession in 2017-18, although our baseline forecast is that they will not be applied in full.

Economic activity has been resilient to sharply lower oil prices, weak world trade growth and monetary policy tightening in the United States. Domestic demand remains the main driver of economic activity, supported by recent structural reforms that have cut prices to consumers, notably on electricity and telecoms services. Growth will be held back in 2017 and 2018, mostly through investment and consumer confidence, following uncertainties about future US policy, although the economy could benefit from stronger import demand from the United States.

Macroeconomic policy is being tightened. Banco de Mexico raised policy rates to counter inflationary pressures and keep inflation expectations anchored near the inflation target and more recently in response to heightened uncertainty in the wake of the outcome of the US presidential election. In order to meet the consolidation path and ensure debt sustainability, the 2017 budget includes expenditure cuts, with the objective of returning to a primary surplus.

The government laid down a consolidation path two years ago to reduce the budget deficit (measured by the public sector borrowing requirement) by 2 percentage points of GDP over 4 years. However, there is scope for reallocating expenditures and further limiting tax expenditures to raise spending on programs conducive to inclusive growth for Mexican families – such as child care, health, poverty reduction, and infrastructure.

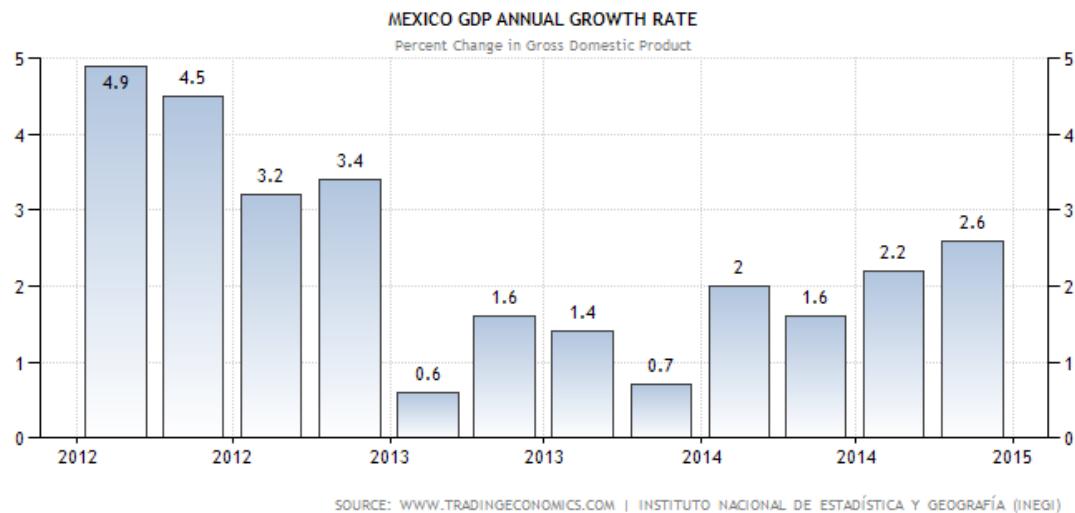
Inflation

Annual inflation rose sharply to 4.8% in mid-January, the highest level since 2008 and well above the 4% target ceiling. Producer prices have also risen considerably, reaching 10.5% in December 2016, suggesting that inflationary pressure is not just due to the petrol price hike. We have increased our inflation forecast for 2017 from 4% to 4.6%, since Banco de México (Banxico, the central bank) will have less room for maneuver to contain it given the pressure on the peso. The risk to our inflation forecast is on the upside given the possibility that fuel prices could rise further once liberalisation begins in February (prices are currently government-regulated). Import price inflation could also weigh in more strongly on the headline figure, in line with producer prices. In the medium term, restrained increases in real wages and ample spare capacity will prevent firmer domestic demand growth from exerting significant pressure on prices.

The peso has remained stable throughout the diplomatic row that erupted between the two countries during Mr Trump's first week in office, trading at around Ps20.21:US\$1, roughly the same level as at end-2016. We expect the currency to weaken in 2017-19 as the Fed lifts interest rates, before gradually regaining some lost strength in 2020-21 as economic conditions improve, leaving it at Ps22.9 by end-2021. Nonetheless, reflecting its position as the most traded emerging-market currency, the peso will be subject to periodic volatility, exacerbated by Mr Trump's erratic policy stance towards Mexico. We expect Banxico to tone down its aggressive defence of the peso through interest rate hikes although measures such as dollar purchases (US\$2bn was bought in early 2016) will be occasionally undertaken.

Mexico GDP growth rate

The Mexican economy advanced 2.4 percent year-on-year in the last quarter of 2016, above 2.2 percent in the first estimate and higher than an upwardly revised 2.1 percent expansion in the previous quarter. Growth was steady for services and accelerated for agriculture while industrial output stalled, compared to a fall initially estimated, final figures showed. GDP Annual Growth Rate in Mexico averaged 2.59 percent from 1994 until 2016, reaching an all time high of 8.50 percent in the second quarter of 1997 and a record low of -8.10 percent in the second quarter of 1995.



The services sector rose 3.4 percent, above 3.2 percent in the preliminary estimate and the same as in the previous quarter. Activities increased faster for internal trade (2.6 percent from 1.3 percent in Q3); transportation (2.7 percent from 2.3 percent); restaurants and hotels (3.1 percent from 3 percent) and business support services and waste management and remediation (6.4 percent from 2.2 percent). In contrast, slowdown was seen for: financial and insurance (7.2 percent from 7.9 percent); professional, scientific and technical (4.4 percent from 7 percent); corporate services (1.7 percent from 6.6 percent); education (0.5 percent from 1.5 percent) and recreation and culture (5.2 percent from 10.8 percent). Real estate activities rose 1.8 percent, the same as in the previous period.

Agriculture went up 6.4 percent, above 6.2 percent in earlier figures but below 6.8 percent in the previous quarter.

Industrial production stalled, compared to a 0.2 percent decline in the earlier release and a 0.8 percent contraction in the previous quarter. Oil went down 10.5 percent and non-oil mining output fell 5.4 percent, offsetting rises in construction (3 percent), utilities (2.8 percent) and manufacturing (1.9 percent).

On a quarterly basis, the economy advanced 0.7 percent, slowing from an upwardly revised 1.1 percent rise in the previous period but higher than 0.6 percent in the preliminary estimate.

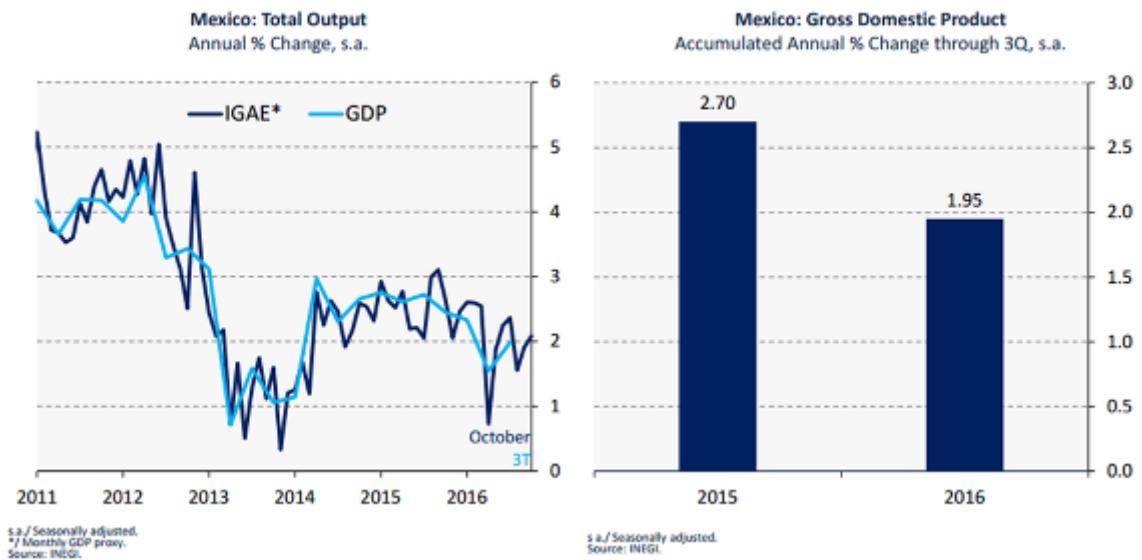
Considering full 2016, the Mexican GDP grew 2.3 percent, below 2.6 percent in 2015. The industrial sector was flat, services increased 3.4 percent and agriculture went up 4.1 percent.

Mexico's figures

The Mexican economy faces a difficult external environment:

- Modest growth of global economic activity and trade.
- Weak exports and industrial production in the United States.
- Low oil prices.
- The normalization of monetary policy by the Federal Reserve.
- A context of generalized uncertainty.
- The situation has been further complicated by the result of the electoral process in the US.
- In addition, a number of challenges of a domestic nature remain:
 - Decline in oil output.
 - Increase in the public-debt-to-GDP ratio

As a result of both domestic and external factors, Mexico's GDP shows a moderate rate of growth and signs of deceleration.



Source: Banco de México, The Mexican Economy, 2017

Exports in Mexico averaged 12849.76 USD Million from 1980 until 2017, reaching an all time high of 36879.05 USD Million in October of 2014 and a record low of 1225.59 USD Million in February of 1980.

Mexico's Imports and Exports

Major export destinations	2016 Share (%)	Major import sources	2016 Share (%)
Exports (fob) to North America	84.0	Imports (cif) from North America	48.7
Exports (fob) to Latin America	5.4	Imports (cif) from Asia Pacific	33.2
Exports (fob) to Europe	5.2	Imports (cif) from Europe	11.5
Exports (fob) to Asia Pacific	4.3	Imports (cif) from Latin America	3.4
Exports (fob) to Other Countries	0.5	Imports (cif) from Other Countries	2.4
Exports (fob) to Africa and the Middle East	0.4	Imports (cif) from Africa and the Middle East	0.5

Source: Euromonitor International, December 2016

Major exports: Manufactured goods, oil and oil products agricultural products & mining products, automotive. **Major imports:** intermediate goods, consumer goods, capital goods, metalworking machines, steel mill

products, agricultural machinery, electrical equipment, car parts for assembly, repair parts for motor vehicles, aircraft, and aircraft parts

- **Major import partners:** 47.4%, China 17.7%, European Union 11.1%, Japan 4.9%.

Unemployment, prices and inflation

Description	2012	2013	2014	2015	2016	2017	2018	2019
Unemployment rate (% of the labor force)	5.0	4.9	4.9	4.9	4.7	4.5	4.3	3.7
Inflation:	2012	2013	2014	2015	2016	2017		
Inflation general index (annual percentage)	4.05	3.25	4.48	3.07	2.61	4.72		

Information February 2017

Source: Banxico

Minimum wages

The minimum wage in Mexico is divided by areas (A and B) and grows at approximately 2-5 percent annually.

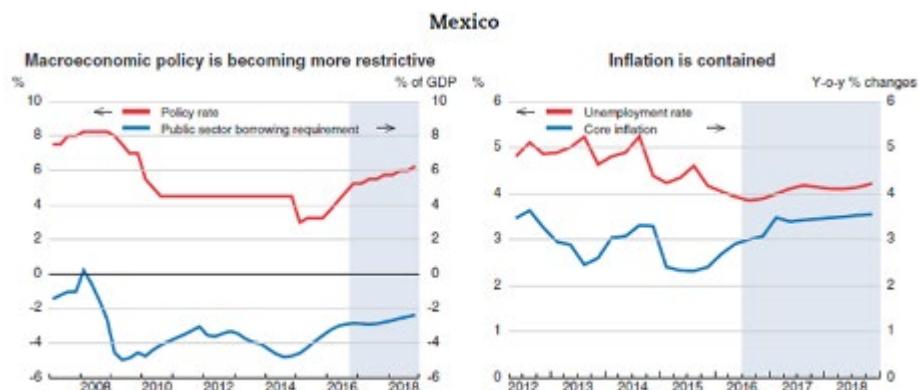
Area /Year	2009	2010	2011	2012	2013	2014	2015 (January – March)	2015 (April-September)	2015 (October onward)	2016	2017
A	54.80	57.46	59.82	62.33	64.76	67.29	70.10	70.10	70.10		
B	53.26	55.84	58.13	60.57	61.38	63.77	66.45	68.28	70.10	73.04	80.04
Unique Zone											

Inflation

Economic activity has been resilient to sharply lower oil prices, weak world trade growth and monetary policy tightening in the United States. Domestic demand remains the main driver of economic activity, supported by recent structural reforms that have cut prices to consumers, notably on electricity and telecoms services. Growth will be held back in 2017 and 2018, mostly through investment and consumer confidence, following uncertainties about future US policy, although the economy could benefit from stronger import demand from the United States.

Macroeconomic policy is being tightened. Banco de Mexico raised policy rates to counter inflationary pressures and keep inflation expectations anchored near the inflation target and more recently in response to heightened uncertainty in the wake of the outcome of the US presidential election. In order to meet the consolidation path and ensure debt sustainability, the 2017 budget includes expenditure cuts, with the objective of returning to a primary surplus.

The government laid down a consolidation path two years ago to reduce the budget deficit (measured by the public sector borrowing requirement) by 2 percentage points of GDP over 4 years. However, there is scope for reallocating expenditures and further limiting tax expenditures to raise spending on programs conducive to inclusive growth for Mexican families – such as child care, health, poverty reduction, and infrastructure.



Source: OECD Economic Outlook 100 database; and Banxico.

Mexico exports and imports

Imports

Mexico main imports are: metallic products, machinery and equipment (50 percent of total imports), mining products (13 percent), chemical products (6.3 percent) and plastic and rubber products (6 percent). Main import partners are: United States (51 percent of total imports), China (16 percent) and Japan (5 percent). This page provides the latest reported value for - Mexico Imports - plus previous releases, historical high and low, short-term forecast and long-term prediction, economic calendar, survey consensus and news. Mexico Imports - actual data, historical chart and calendar of releases - was last updated on March of 2017.

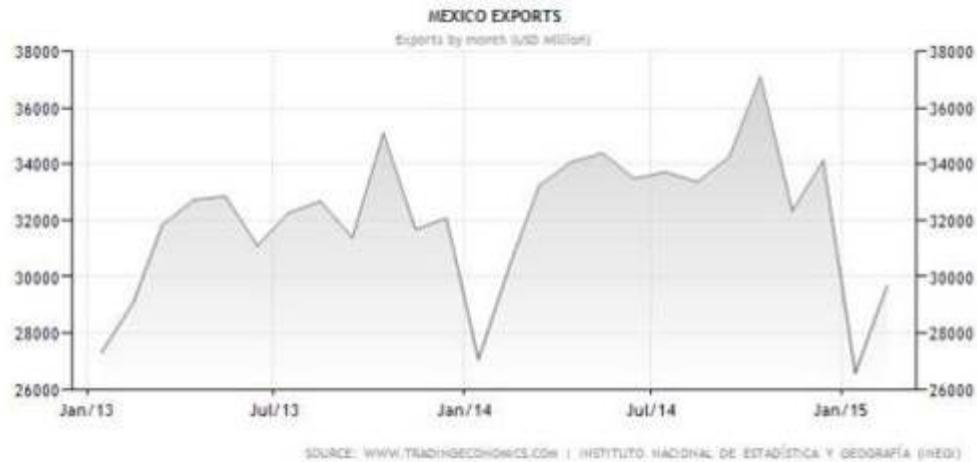


Exports

Exports from Mexico increased 11.4 percent to USD 27.49 billion in January of 2017, following a 6.6 percent rise in December and marking the third straight annual gain. Oil sales (6.8 percent of total) jumped 74.4 percent and non-oil ones went up 8.5 percent. Among non-oil sales, manufacturing increased 7.7 percent, mainly due to food, drinks and tobacco (21.2 percent); professional and scientific equipment (13.4 percent); electrical and electronic equipment (13.3 percent); special machinery and equipment for industries (10.6 percent) and automotive products (4 percent). In addition, shipments of agricultural and fishery rose 20.6 percent. Exports to the US accounted for 81.7 percent of total non-oil shipments and rose 7.6 percent. Auto sales, accounting for 26.5 percent were up 1.5 percent and exports of other products increased 10.8 percent. Sales to the rest of the world increased 12.8 percent, with autos rising 21.1 percent and those of other products up 10.3 percent. Exports in Mexico averaged 12849.76 USD Million from 1980 until 2017, reaching an all time high of 36879.05 USD Million in October of 2014 and a record low of 1225.59 USD Million in February of 1980.

MEXICO EXPORTS





Mexico's relations

International relations

Relations with the US, Mexico's dominant trade and investment partner, and home to more than 33m people of Mexican descent, will remain Mexico's overriding foreign-policy priority. This relationship will face its most significant test in nearly a century given the hostility shown by Mr Trump towards Mexico in his first days in office. The Economist Intelligence Unit expects Mexico reluctantly to accept some renegotiation of NAFTA at the margins, and we do not believe that Mexico will follow through on its threat to withdraw from the treaty entirely. Mexico may also choose to take retaliatory action against US anti-trade proposals, such as a 20% border adjustment tax, particularly if these violate NAFTA or World Trade Organisation (WTO) rules. Mexico will have less leverage against anti-immigration measures although in practice more deportations or even a border wall will not be macroeconomically significant. Mexico will intensify efforts to diversify away from the US which receives over three-quarters of all Mexican exports and supplies half of its imports although this will prove difficult given the proximity of such a large market. Efforts to this end will involve strengthening ties with the Alianza del Pacífico (the Pacific Alliance, which comprises Chile, Peru, Colombia and Mexico), as well as the Mercado del Sur (Mercosur) now that centre-right governments are in power in Brazil and Argentina. Despite Mr Trump's withdrawal from the Trans-Pacific Partnership, Mexico would be keen to sign any follow-up agreement in order to deepen trade links with Asia.

Policy issues

Policy issues

Conservative fiscal and monetary policies underpin macroeconomic stability, but the weakness of the non-oil fiscal revenue base and the

shallowness of credit markets leave the authorities with few tools at their disposal to boost demand. The pace of reform has accelerated markedly under Mr Peña Nieto, with the adoption of transformative structural reforms in 2013-14, including in the energy, education and telecommunications sectors. Persistent constraints on growth include lack of competition in the internal market and a deficient education system, as well as institutional flaws resulting in rampant corruption across all levels of government and limited progress in curbing high levels of crime.

Taxation

The corporate tax rate stands at 30%, and the top rate of personal income tax was increased to 35% as part of the January 2014 fiscal reform. Tax on royalties ranges from 15% to 34%. Depreciation allowances range from 5% to 25%, but can be up to 50% on pollution control equipment. The value-added tax (VAT) rate is 16% throughout the country (a lower border rate has been eliminated); food products and medicines remain exempt from VAT, although a junk-food tax has been introduced for products with high calorific content. Additional changes to various tax regimes, which affect conglomerates and Maquila (domestic assembly for re-export) firms, have also come into effect.

Foreign trade

Import duties range from zero to 35%, with the trade-weighted average tariff at 2.9%. VAT is levied at 15% on all imports, with some limited exceptions, to which a 10% rate applies. In 2015 exports totalled US\$381bn and imports US\$395.6bn, producing a trade deficit of US\$14.5bn and a current-account deficit of 2.9% of GDP.

Major exports 2015	% of total Major imports 2015	% of total
Manufactured goods	89.3	Intermediate goods
Oil	6.2	Capital goods
Agricultural products	3.4	Consumer goods
Mining products	1.2	
Leading markets 2015	% of total Leading suppliers 2015	% of total
US	81.1	US
Canada	2.8	China
China	1.3	Japan
Brazil	1.0	South Korea

Source: The Economist Intelligence Unit, "Mexico Country fact sheet", January 2017.

1.2. Business Climate

Investment regulations

Capital moves freely across Mexican borders. The Exchange Rate Commission (Comisión de Cambios), which sets foreign-exchange regulations, comprises officials from the Department of Finance and Public Credit (Secretaría de Hacienda y Crédito Público—SHCP) and the central bank (Banco de México).

Mexico has various regulations to counter money-laundering. Since 1998, financial institutions have had to report transactions that exceed US\$10,000 to the SHCP. Laws governing money-laundering comply with the basic standards set by the Financial Action Task-Force on Money-Laundering (FATF; known in Spanish as Grupo de Acción Financiera Internacional), of which Mexico has been a member since 2000.

The Financial Intelligence and Investigation Agency (Unidad de Inteligencia Financiera—UIF) of the SHCP investigates suspicious financial transactions that exceed US\$10,000. Other government agencies are often involved in enforcement activity, including the Office for Special Investigations on Organised Crime (Subprocuraduría de Investigación Especializada en Delincuencia Organizada—SIEDO) and the tax authorities (Servicio de Administración Tributaria—SAT).

A 2014 study published by the FATF, in conjunction with the Task Force on Money-Laundering in South America and the IMF, concluded that Mexico had made “significant progress” in addressing deficiencies in its anti-money-laundering and counter-terrorism mechanisms. The study removed Mexico from the FATF’s list of noncompliant or partially compliant countries requiring a follow-up process, after placing Mexico on this list in 2008. Mexico has taken various measures since 2008 to improve compliance, such as amending the Federal Criminal Code (Código Federal Penal) to criminalise money-laundering and the financing of terrorism; improving the efficiency of prevention and combating of money-laundering; establishing financial supervisory and customer due-diligence requirements; establishing an asset-freezing regime for terrorists, financiers of terrorism and money-launderers; and enhancing the effectiveness of the judicial system.

The trafficking of illegal narcotics, mostly to the US, is the principal source of money-laundering funds in Mexico. A 2010 study conducted jointly by the US Department of Homeland Security and the US Immigration and Customs Enforcement Agency estimated that US\$19bn–29bn in illicit cash moves from the US to Mexican drug cartels each year.

The December 2015 report by Global Financial Integrity, a program of the US-based Centre for International Policy, found that during 2004–13 Mexico was the third largest exporter of illicit capital in the world (totalling

US\$528bn). China was largest (US\$1,392bn), followed by Russia (US\$1,050bn).

The SHCP in 2010 introduced new measures to reduce money-laundering by drug cartels by making it more difficult to exchange US dollars for local currency at banks. The changes introduced an upper limit of US\$4,000 cash per month for Mexican account holders. Non-account holders (including foreigners) will be allowed to exchange up to US\$1,500 per month. Businesses will be able to exchange up to US\$7,000 per month.

In 2014 the SHCP decided to modify the 2010 measures for border and tourist area businesses to exceed the US\$14,000 per month US dollar cash deposit if the business had been operating for more than three years.

Exchange controls: Repatriation of capital

No restrictions apply to the repatriation of capital, apart from normal reporting requirements. The repatriation of capital is transacted at market-determined exchange rates. Peso-dollar foreign exchange is available on same-day, and on 24- and 48-hour settlement bases. Most large foreign-exchange transactions are settled within 48 hours. In 2003 the US Federal Reserve (the US central bank) and Banco de México (the Mexican central bank) announced the establishment of an automated clearinghouse for cross border financial transactions.

Amounts exceeding US\$10,000 must be reported to the financial authorities. Profits can be freely remitted from Mexico if the company is registered with the National Securities and Intermediaries Registry (Registro Nacional de Valores e Intermediarios), meets legal-reserve requirements and tax obligations, and abides by normal reporting requirements.

Exchange controls: Profit remittances

No restrictions apply when remitting profits from Mexico if the company is registered with the National Registry of Commerce (Registro Público de Comercio), meets legal-reserve requirements and tax obligations, and abides by normal reporting requirements. By law, companies must distribute 10% of their pre-tax profits to employees and allocate 5% of net profits to their legal reserves, until 20% of registered capital has been set aside.

Exchange controls: Loan inflows and repayment

No limits apply on Mexican individuals or companies borrowing from abroad, nor are there restrictions on nonresident companies and

individuals. According to a regulation issued by Banco de México (the central bank) in 1998, banking institutions have a limit on liabilities denominated in foreign currencies up to 1.83 times their capital. However, the central bank can grant exemptions from this restriction to banking institutions.

No restrictions apply to the remittance of interest and principal on foreign loans, apart from normal reporting requirements.

Exchange controls: Remittance of royalties and fees

No restrictions apply on remitting royalties and fees, apart from normal reporting requirements.

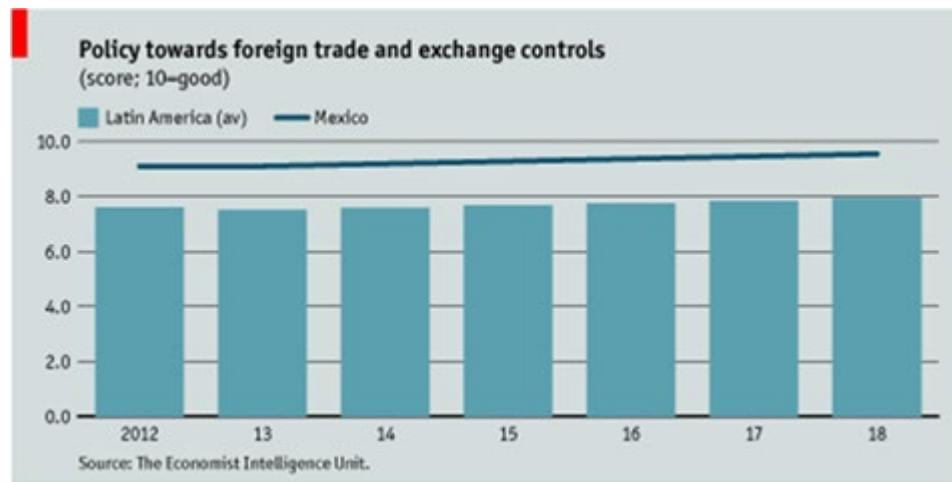
Exchange controls: Restrictions on trade-related payments

No restrictions apply to export proceeds. All such revenues may be held indefinitely in Mexican pesos or foreign currency. No restrictions apply to import payments. No legal restrictions apply on the leading or lagging of payments for exports or imports.

There are no limits to the amounts that can be netted, and commercial banks can offer this service if they have authorisation from the central bank (Banco de México) and the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores). Companies, especially exporters, net their transactions using offshore accounts to reduce peso exposure and avoid foreign-exchange charges.

In 2012 outgoing President Felipe Calderón signed a law effective at end-2013 that established an anti-money-laundering unit in the Attorney-General's office and increases supervision of, and sets limits for, purchases of vehicles, jewelry, real estate, precious metals and cash operations. The law bans cash transactions in certain real estate transactions with a value of more than Ps1m or in the buying and selling of vehicles worth more than Ps200,000. Cash payments for jewelry, precious metals, watches, gemstones and works of art are restricted to prices below Ps300,000. The law also places greater reporting requirements on financial institutions, in the wake of a 2012 report by the US Senate that found the Mexican affiliate of UK banking group HSBC had introduced US\$7bn in cash into Mexico's financial system in 2007–08 without considering the source or characteristics of the transactions. HSBC was subsequently fined Ps379m by Mexico's banking regulator (Comisión Nacional Bancaria y de Valores) for late reporting of almost 2,000 unusual operations and omitting another 39 during the period.

Comparison of country with regional average on policy towards foreign trade and exchange controls over the last 7 years.



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 10 areas limited exclusively to the Mexican State and 3 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,

given their strategic nature, only for the State:

- Hydrocarbons exploration and production, with the participation of the private sector;
- Planning and controlling the National Electricity System, and the electricity transmission and distribution to the public, with the participation of the private sector;
- 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;
- 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, (Manufacture and Commercialization of Explosives, Printing and Publication of Newspapers for Circulation solely throughout Mexico, Integral Port Administration, among others described and listed in the law). It also provides areas where foreign investment can participate in excess of 49 percent, as is the case of construction, operation and exploitation of general railways, 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 kilometers of the borders or 50 kilometers 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.

Branches and Representative Offices

Mexican Law allows the establishment of foreign legal entities' branches or representative offices in Mexico, in both scenarios, the head office board of directors will be in charge to carry out the administration and the business operation of the Mexican branch or representative office, and will be responsible in Mexico for all the activities mentioned before.

A Branch from a foreign entity is authorized to perform commercial transactions in accordance to the Code of Commerce, the General Law of Commercial Companies and the Foreign Investment Law.

Unlike the Branch, a representative office is not allowed to carry out commercial activities in Mexico and usually performs auxiliary functions regarding the foreign Company's activities without performing commercial transactions.

As an example, this kind of entity executes promotional activities, as well as having direct contact with Mexican creditors and clients, among others.

Furthermore, the law provides that in order for foreign legal entities to operate in Mexico through a branch or a representative office, it will be necessary to 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 Ministry of Economy has 15 business days to issue a favorable resolution. However, the law simplifies the approval process by considering an application as authorized once the 15 days have passed without a formal response from the authorities.

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 also before 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 thirty to one hundred times the minimum daily wage in force in Mexico City (\$80.04 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 favorable 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) complying with deductibility requirements.

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.

Policy towards private enterprise and competition

2017-18: Enforcement of competition policy continues to face stumbling blocks in spite of new legislation.

2019-21: New government continues with efforts to reduce red tape and promotion of deregulation schemes for business.

Policy towards foreign investment

2017-18: Overhaul of Petróleos Mexicanos (Pemex, the state-owned oil company) and better terms offered to public-private partnerships. Initial profit-sharing contracts allowed in the energy sector, but low oil prices affect attractiveness.

2019-21: Focus on promoting design in automotive, aerospace and other high value-added sectors. Stronger investment links with Asia and Latin America encourage diversification of foreign direct investment.

Foreign trade and exchange controls

2017-18: The US continues to dominate trade flows, despite some diversification of trade partners. Quotas will persist for sensitive products but low-tariff environment will persist, even though the risk of protectionist US measures is high.

2019-21: Large network of free-trade agreements and greater investment by China facilitate more sustained export growth.

Reforms

There are signs of early benefits from the structural reforms, especially on productivity growth, which has picked up recently. Trade openness, foreign direct investment, integration into global value chains and incentives to introduce innovative technologies have boosted selected activities, such as auto production. However, many other activities lag behind and more needs to be done to motivate people to participate in the formal labour market, while ensuring satisfactory work-life balance, and equipping workers with the necessary skills to be productive. Further reforms are needed to address the misallocation of productive resources, due to overly stringent local regulations, weak legal institutions, high rates of corruption and insufficient financial inclusion. Reforms should also aim at eradicating extreme poverty, reducing income inequality and informality, raising female participation, and encouraging more responsible business practices.

The outlook is linked to external developments

Despite benefitting from stronger US import demand, the expansion of the Mexican economy is projected to be affected by policy uncertainties in the United States. However, the economy will continue to be supported by a competitive exchange rate, solid credit expansion, and continuing improvements in the labour market aided by the government's structural reforms and the low inflation environment. On the other hand, declining oil production and public spending cuts weigh on the economy.

Risks to the projections include uncertainty about external policy developments, additional reductions in oil production, and softer business confidence and private investment. Inversely, an increase in oil prices could bring positive developments for both the current account and fiscal deficits. Domestically, full implementation of structural reforms, in particular education, is key to support longer-term growth.

Economy

Inflationary pressures rose in early 2017 and are expected to accentuate during the year, due to a large extent to the increase in the prices of gasoline and their programmed liberalization over the course of 2017.

- Against the background of higher international prices and the depreciation of the peso, to avoid an adverse impact on public finances, gasoline and diesel maximum prices increased throughout the country by an average of 14.2-20.1% in January vs. December.
- The current schedule foresees a gradual liberalization process across regions, to allow prices to be fully determined by market mechanisms. This process should be completed by the end of the year.
- In the meantime, domestic fuel prices in the not-yet-liberalized regions will be adjusted on the basis of their international reference, while also taking into account logistic and other costs, such as applicable taxes and profit margins.

In addition, inflation in 2017 may be affected, among others, by:

- The liberalization of gas prices.
- The increase in the minimum wage in early 2017.
- The possibility of a more depreciated equilibrium real exchange rate in light of the results of the US presidential election.
- The risk of further increases in the prices of agricultural goods and livestock.

As the Bank of Mexico inform, this situation, coupled with the challenges the economy may face in coming years, underlines the need to strengthen economic fundamentals.

- A monetary policy focused on attaining a low and stable inflation is central in this regard.
- Mexico's public finances represent a source of nervousness among market participants.
- Thus, the measures announced by the government to set the public-debt-to-GDP ratio on a declining trajectory are of utmost relevance.
- It will also be essential to preserve financial stability.
- Finally, enhancing the economy's competitiveness and the domestic sources of growth has taken on added importance. This implies the continuation of efforts of structural adjustment and reform of the institutional framework underway, and the implementation of actions in other areas as needed.

Energy Reform

Although the president, Enrique Peña Nieto, won plaudits for his ability to get his reforms through Congress during the early part of his six-year term, energy security has come under scrutiny in the wake of falling oil prices, cutbacks at PEMEX, fuel theft from pipelines, rampant corruption and a breakdown of the rule of law. This has been evident in states such as Tamaulipas, which has the country's largest fields of recoverable shale gas, but is also a battleground for warring drug cartels.

Mexico enjoys relative stability from a political risk perspective when compared with some other oil producers, but the success of the energy reforms will be dependent on the government's ability to strengthen the rule of law, clamp down on corruption, deal more effectively with organized crime and boost capital investment in fossil fuels. Positive steps in this direction would enhance energy security and raise the country's profile as a reliable producer of hydrocarbons.

As a result of the Energy Reform –meaning a historical change in the Constitution by passing 21 secondary and regulatory laws– the Oil & Gas and Power industries are living a new experience by integrating private investors and operators from Mexico and abroad. This also means

understanding and managing the legal framework together with many regulatory entities newly created –or given additional scope of responsibilities–, and large companies, who can share their international expertise and best practices or who have contributed to the structure of such regulatory entities.

The Energy Reform provide the private sector with great opportunities to enter the Oil & Gas and Power & Utilities industries, and manage sources of renewable and non-conventional (*shale gas*) energy. For the first time in 80 years, such reforms are enabling national and foreign investors and operators to actively engage this sector..

The new legal framework in a wide range of industries –laid down by 11 structural reforms–, with the Energy Reform being the most relevant because of its magnitude and socioeconomic scope, means an internal alignment of all the stakeholders: companies, organizations, regulatory bodies, and the old State-owned companies (PEMEX and CFE), which today are Productive State Enterprises.

One of the key drivers to change paradigms has been the transparency and legal certainty message the country has sent to stakeholders as a result of the research, diagnosis and implementation of best international practices examples in countries like Norway, Brazil and Colombia.

With the succesfull conclusion of Round ONE and historic results for 1.4 deep waters and the TRION farm-out between PEMEX and an Australian company; Round TWO is now well on its way with the first three bids inclusive of Exploration & Extraction on shallow waters and onshore blocks.

Mexico has bet on Natural Gas as its fuel of choice for the next couple of decades, leveraging the low price in the United States (less than US\$ 3.00 per million BTU), and its Gas Pipeline expansion plans. Some US\$ 14billion will be put in to almost 5000 additional kilometers of pipelines by 2019, expanding dramatically the existing Gas Pipeline Network.

Mid & Downstream will also offer opportunities for private companies to import, transport and sell fuels such as gasoline and diesel. PEMEX will no longer be the exclusive owner of the current 77 storage terminals spread through the country, as it will also no longer be the sole brand owner of Gas Stations through its franchise model. The first gas stations under the Gulf and OXXO Gas brands, have recently started operations. Mexico has 11,500 gas stations.

The National Electricity System currently at 65,452 MW of generation capacity, with 48,530 MW being generated by conventional energy and 16,921 MW by clean energy, expects a 73% increase of new installed capacity by 2029: 60 Gigawatts and US\$ 116 billion for generation, transmission and distribution. Transmission wise, some 25,000 kms will be added as interconnection points with North and Central America.

The Wholesale Electricity Market started to operate as of January 1st of 2016, breaking decades of State controlled tariffs and opening the market for private generators creating a spot market which will work via short term, mid term and long term auctions. The first long term auction for clean energy resulted on 103 bidders with 11 companies being awarded a total of 2,753 MW and almost 75% going to solar technology. A second long term auction is on the way as of May of 2016 geared once again towards clean energy (solar, photovoltaic, wind, hydraulic and geothermal).

Long term goals for Clean Energies aims at achieving a 35% share of clean energies from total generation capacity by 2024, 40% by 2035 and 50% by 2050. Some 32,000 MW of clean energy capacity are scheduled to be on line by 2029.

New investment vehicles such as the FIBRA E and CerPI allow for the monetization of stable infrastructure and energy cash flows (bronfield assets), with a broad investor base similar to the MLP's (FIBRA E). CerPI is a private equity listed vehicle that can co-invest with local and external private equity structures in a traditional GP-LP framework.

Mexico is one of the top economies in Latin America, and it is also one of the three top oil and gas producers in the region. Mexico has a vibrant economy and has shown stable macroeconomic indicators for two decades (exchange rate, interest rates, inflation, and unemployment) as a result of the economic policy and ordered management of the public finance led by the Bank of Mexico (Banxico). With a population of 112 million, and a strong Manufacturing base –where the Automotive and Maquila industries stand out– Mexico is a key country to do business with. On the other hand, Mexico's economy is one of the most open in the world, and the country is a member of the North American Free Trade Agreement (NAFTA); Mexico has also signed other free trade agreements that have opened the doors to markets in 40 countries in Latin America, Europe and Asia. Mexico has a solid –and expanding– public infrastructure; highways, ports and airports, and has attracted significant investments in the Aerospace Industry in recent years. One can also find in Mexico some of the most renowned public and private universities of the Americas, a strong and open banking system, and a robust and responsible business group. These are just some of the many reasons Mexico is one of the preferred destinations for foreign direct investment.

Even though this might add some uncertainty and due to the new energy model of the reform, the first approaches have been carried out according to official schedules, something investors have recognized and that has increased their interest in being involved.

Mexico's main natural resources include crude oil, silver, copper, gold and lead. Mexico is also a key producer of metals, minerals and building materials, and concessions have been granted to large Mexican and foreign companies over the years. Mexico is the first producer of silver in the world, and according to the Ministry of Economy, the country is among the top ten producers of gold, lead, zinc, bismuth and celestite, among others. It has also been the premiere destination for mining investments in Latin America in 2013. Foreign direct investment grew more than 224% in previous six-year presidential term. With a strong economy, the foreign exchange market is stable and the country has reserves higher than USD190 billion. In addition, the central bank (Banxico) hired hedging insurance on the price of oil for 2015 –USD76.40 per oil barrel– and it has a USD70 billion credit line from the International Monetary Fund.

Interest rates have remained flat despite the market volatility and inflation. Many energy and natural resources companies trade in the Mexican Stock Exchange (BMV for its acronym in Spanish), and analysts say there are funds and credit available for those who enter these industries. Commercial and development banks—especially investment funds—, have billions of pesos to fund projects and provide in the Energy Sector.

Mexico's economic policy encourages foreign investments, as most of them focus on the Oil & Gas and Power industries. Temporary or final imports of machinery, equipment, supplies and technology are facilitated by customs and the tariff system, and there are no major restrictions to import capital goods.

Mexico is among one of the main destinations for foreign investment in Latin America, as it provides a positive business environment and it ranks 39 among the 189 economies compared by the World Bank's *Doing Business 2015* report. It also has a privileged geographic position, border with the United States, access to the Pacific Ocean the Gulf of Mexico and the Caribbean Sea.

Mexico has a world-class private banking, including national and foreign capital banks, and a significant segment of the development bank. The National Infrastructure Program includes a number of projects that will drive the Energy Sector, which, together with the Automotive Industry -4th

world exporter- as an example, serve as important reminders of the well diversified economy. Other key sources of income include the Tourism Industry and remittances from emigrants that contribute between USD15 and USD20 billion a year.

The country's economy is solid, diversified and has multiple aspects that result in proactive activities and business opportunities in the sectors mentioned above. Even though the price of crude oil has recently fallen by more than 50%, and the volatility of the peso, the country's position depicts a positive scenario in a complex geopolitical environment.

Mexico has well established policies so as to regulate different basic industries and sectors including Telecommunications, Banking and Insurance, Transportation, Energy, and Natural Resources. However, an active strategy has been created to simplify this regulation and create the conditions for a more open competition. Thus, new companies have entered the Mexican market: telecommunications, insurance, power & utilities companies, service providers, and International Oil Companies (IOC's).

The State will drive the strategy through the Energy Ministry and different regulatory authorities, like the CNH, and the Regulatory Commission of Energy (CRE for its acronym in Spanish). The opening of the Energy Sector has removed most of the restrictions for a transparent process and open competition and projects to bid, including with PEMEX and the CFE.

From these political, economic and legal perspectives we can say the Energy and Natural Resources Sector is stable, and it will continues its growth as one of the most important sectors in Latin America in the medium and long-term, gaining more stability.

Much of the land freight moves through a rail network operated by three private groups whose trains can run at speeds of 100 km/h or more. The routes link the industrial centers of Guadalajara, Monterrey and Mexico City , with ports such as Manzanillo, Lazaro Cardenas, Tampico, Veracruz and Coatzacoalcos, and border crossings of Ciudad Juarez and Nuevo Laredo; all, important trade routes with the United States. The ports have a draft of up to 16 meters. Another considerable amount of charge moves by about 9,000 km of toll roads and 80,000 km of state roads.

Transparency, corporate governance and sustainability are the pillars of the National Development Plan (2013-2018), which goal is to foster economic and social growth and prosperity.

Energy security a priority

Nevertheless, successful implementation of the energy reforms could go some way towards restoring the credibility of the current government and to increasing foreign investment in the economy. Reliable access to oil, gas and electricity supplies is an essential underpinning of a country's energy security, and by swiftly addressing this, Mr. Peña Nieto would be laying the groundwork for Mexico's economic transformation. Success in this undertaking could help to convince investors that the country is on the right path and also undercut the appeal of those political parties that wish to roll back the energy reforms.

Depressed oil prices complicate picture

Disruptions in global oil markets mainly as a result of the rise in US crude inventories, have complicated the picture for the federal government's investment program, however, new opportunities such as the recently announced 7 additional farm-outs with PEMEX and Round 2, shed some light on stakeholder's expectations. The EIA (U.S. Energy Information Administration), sees the Brent averaging US\$ 52 and WTI averaging US\$ 51 per barrel this year.

A sustained period of low oil prices will put many Mexican operations on hold. PEMEX has been forced to make adjustments, and the government at all levels will be under heavy pressure to use public resources more efficiently and to tackle corruption. Attracting foreign investment to the energy sector under current circumstances presents a major challenge, but it can be achieved if the administration is serious about strengthening the rule of law and fighting corruption.

The Mexican case -corruption

Mexico's tax rate is one of the lowest of all OECD countries. Critics argue that there are far too many tax exemptions and that the tax revenue base is too narrow. In response, the government has raised several taxes in recent years. These include a higher maximum income-tax rate for top earners, a new mining tax and other levies. To boost trade, officials have reduced the time required to issue import-export permits and simplified the tariff code identification system.

Public and private monopolies still dominate much of the economy. In many important industries, 70-80% of the market is held by only one or two companies. As a result, Mexicans pay as much as 40% more than they should for basic goods and services. However, new anti-monopoly laws just recently put in place have begun to alter the structure of key industries such as telecommunications.

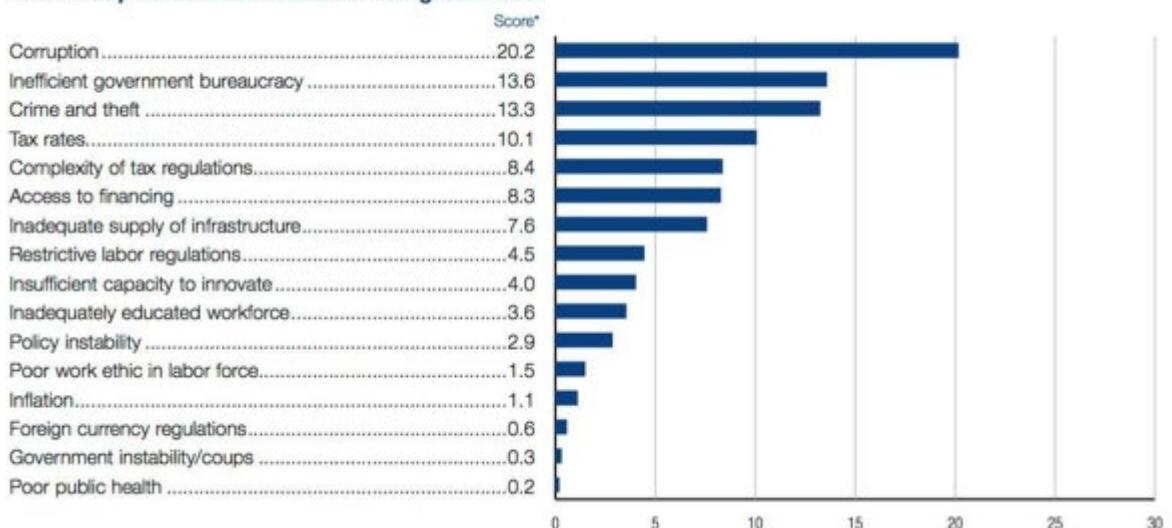
In 2014, Mexico's Congress approved sweeping changes to the energy industry which will allow private oil companies to invest in the Mexican industry for the first time since 1938. The government expects at least a decade of annual auctions. By the end of 2019, Mexico plans to have auctioned more than a third of the country's prospective resources.

Government corruption is rampant. It is estimated that corruption cost approximately 9% of GDP in 2014. In addition, more than 40% of Mexican businesses admit to paying a bribe. A much needed reform of the judicial system has been launched.

According to research from the Mexican Statistics Agency, Mexicans see corruption as one of the most important issues facing the country, second only to insecurity. It has become the main topic of discussion in political campaigns and the priority for organized civil society.

The World Economic Forum's Global Competitiveness Report 2016 found that Mexico's weakest link is its institutions, and corruption is the most problematic factor for doing business. This presents a significant barrier to social stability and economic growth.

The most problematic factors for doing business



On 17 June 2016, both Houses of Congress approved two new general laws and reformed five others after long deliberations, sessions and a sum of efforts from political parties to change the content of the citizens' initiative.

The new anticorruption system is now based on three pillars: a coordinated and widespread system of internal audit and control, as an effective tool to prevent corruption; a very strict and comprehensive regime of administrative responsibilities to stop the expansion of the phenomenon; and a strong new criminal regime to make justice a normal practice.

Anticorruption reforms and innovative policies should naturally be bottom-up ideas. However, conceiving new ideas is a meaningless process without the proper leadership to push them forward.

The fight against corruption is a multilateral responsibility, and it needs a new kind of creative and positive leadership from different sectors of society to ensure systemic change.





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 or a representative office of the foreign company or through a subsidiary incorporated 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 corporate capital is represented by partnership interests.
- Sociedad Anonima or “S.A.” - Entity similar to the US Corporation, in which all its members have limited liability and its capital stock is represented by common shares.

On June 2014, a reform to the General Law of Commercial Companies was approved in order to allow Corporations (S.A.) to include in its By-Laws restrictions on the transmission of shares, causes of exclusion of shareholders and the issuance of shares with different or limited rights, as follows:

Issue of shares: with the restriction for casting votes for certain matters or without the right to vote.

Veto right: the issuance of shares that grant the right to veto to some of the resolutions take during the shareholders meeting or that require the favorable vote from one or more shareholders.

Rights for separation, exclusion and retirement of the shareholders: Is possible to establish the thresholds for separation, exclusion or retirement of shareholders, and regarding the amortizing of shares, the mechanism, price or the rules for its determination.

Shareholders agreements: the possibility to enter in agreements between shareholders in order to establish the sale of their shares, the

rights of first refusal, and the forms of administration and designation.

These provisions are similar to those establish in the Securities Market Law for the Sociedad Anonima Promotora de Inversion or SAPI's for its Spanish acronym.

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

- Sociedad Anonima Promotora de Inversion or "S.A.P.I." for its Spanish acronym - As of June 2006, this 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; particularly, the S.A.P.I. allows the shareholders to have more flexibility to establish specific rules in the company's by-laws regarding the acquisition of its own shares. The S.A.P.I. is recommendable for Joint Venture projects or for entities that aim to become Publicly Held Companies.
- Sociedad Anonima Bursatil or "S.A.B." for its Spanish acronym - This form is reserved for those entities that issue shares listed in the Mexican stock Exchange (BMV).
- Sociedad Anonima Promotora de Inversion Bursatil or "S.A.P.I.B." - 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).

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 in 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.

On March 14th, 2016 the General Law of Commercial Companies was amended in order to include a new type of legal entity known as a

“Simplified Stock Company” (“SSC”). This reform is effective as of September of 2016.

The main characteristics of the SSC are:

- Its annual income may not exceed \$5,000,000.00 Pesos (five million pesos 00/100 Mexican currency). This amount will be updated on a yearly basis.
- The management will be entrusted to a Sole Director, who must be shareholder of the SSC.
- It can be incorporated by one or more individuals, who may not be simultaneously shareholders of other legal entities, if their interest in such companies allows them to have control over the company or its management.
- It will be incorporated through an electronic system implemented by the Ministry of Economy for this purpose, thus it will not require the formalization of its By-Laws by a Notary Public.
- The general provisions for Corporations (SA) establish in the General Law of Commercial Companies will also be applicable for the SSC, as well as the provisions regarding mergers, transformation, split-off, dissolution and liquidation.

Organizing a Mexican Corporation

As of January 2012, there is not a fixed amount as a minimum capital of an S.A., S. de RL and any other. When the subscription is for cash, at least on 20% of the share capital is payable at the time of subscription; 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.

Stockholders’ and Partners’ liability is limited to the amount of their contributions to a S.A. or S. de R.L.

Number of shareholders

There must be at least two shareholders to organize an entity, the General Law of Commercial Companies 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 either be individuals or corporations.

Besides the above, it is important to mention that there is a maximum of

shareholders for the S. de R.L. established by Law, which rises up to 50 partners.

Joint and several liabilities

Article 26, section X of the Fiscal Federal Code in force since January 1st, 2014, establishes that partners or shareholders are jointly and severally responsible for any tax liability or contributions that should have been paid by a company during the time they discharged their duties as such on the corresponding legal entity, on the proportion that is not legally guaranteed before the tax authorities.

The jointly and severally liability aforementioned only applies to those partners or shareholders that have or had the effective control of the legal entity and it will be determined according with their capital stock registered when the contribution omitted should have been paid.

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:

Advantages	Disadvantages
<ul style="list-style-type: none">Any VAT paid may be refunded if the purchaser is a Mexican tax residentA step-up in the tax basis of fixed assets and intangible property is allowed for income tax purposesThere 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 contingencyVehicle can be properly structured from the beginning, including exit strategy	<ul style="list-style-type: none">Time required to establish the vehicle to complete the asset purchaseEmployees transferred typically demand seniority recognition from the new employer, unless they receive a severance payment from the old employerProperty transfer tax may applyGoodwill is not tax deductibleVAT may increase the cost of the transaction in certain circumstances

Share acquisition

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

Advantages	Disadvantages
<ul style="list-style-type: none">• 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• There is no real estate transfer tax• The acquisition of shares is not subject to VAT	<ul style="list-style-type: none">• 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 purposes• Deferred tax liabilities are acquired• It may be more difficult to finance tax-efficiently

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 (tax, liquidation, ...)

Mexico has 56 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 (return of capital) can generally be made tax-free. Where a payment in excess of the paid-in capital account (CUCA for its Spanish acronym) and the previously taxed earnings account (CUFIN for its Spanish acronym) is made and so the profit distribution is taxable (excess), it will be taxed as dividend distributions paid in excess of the CUFIN balance.

The amount 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), and/or the capital reduction per share exceeds the CUCA per share. Then this amount is compared to the CUFIN per share to determine if a taxable profit is distributed and should be taxed as a dividend.

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. 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 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 for corporate income tax purposes 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 capital redemption is treated as a taxable profit 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
=	Profit distribution

The profit so determined may be tax exempt for corporate income tax purposes 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 is paid.

The profit 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 capital redemption. For this purpose, the amount of the reimbursement per share is considered to qualify as gross income.

The Tax Reform of 2014 requires that individuals residing in Mexico and non-resident persons who receive dividends or profits, which were generated in 2014 and onwards, must pay an additional 10% tax. This tax will be paid through withholding which must be made by the legal entity who distributes or paying the dividends. In that order, when a profit is determined from a capital redemption that exceeds the CUCA balance, the additional 10% tax will be generated when the profit was not generated before January 1st, 2014.

For these purposes, the Mexican legal entities are required to keep a registry of their profits generated before 2014 and another for those profits generated from 2014 and onwards.

2.3 Financing

Mexican taxpayers can receive loans either from national banks, foreign banks, domestic 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.

Also, it is worth mentioning that 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 within 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 the protection of intellectual property:

- Industrial Property Law, enforced by the Mexican Trademark Office (IMPI for its Spanish acronym), mainly for inventions, trademarks, industrial designs, and appellations of origin; and
- Copyright Law enforced by the Mexican Copyright Office (INDAUTOR

for its Spanish acronym), primarily for computer programs (software), 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; in which case the patent will be granted to the original applicant abroad provided that he or she files the corresponding petition in Mexico within twelve months following to the initial application of the patent in the origin Country. Such patent protection is available for chemical, pharmaceutical and biotechnological products and processes, among others.
- 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.
- Trade names have a valid duration for 10 years, since the application date, and they are 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 and it can also be renewed for additional 10-year periods for as long as the trademark is in use. 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.
- The agreements regarding the transmission or license of certain rights protected under the Industrial Property Law must be recorded before the Mexican Trademark Office (IMPI for its Spanish acronym) in order

to have effects against third parties.

- Administrative procedures have been simplified to expedite the granting of patents and the registration of trademarks.
- The electronic system of the Mexican Trademark Office (IMPI for its Spanish acronym) has been recently relaunched for initially filing the registry applications regarding trademarks, commercial notices and trade names; this system also allows users to exchange official communications with the authority, including electronic notices and ultimately the issuance of an electronic property title.

The Mexican Trademark Office (IMPI) 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.

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). However, the law also provides for the protection of computer programs (software) as literary works.

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

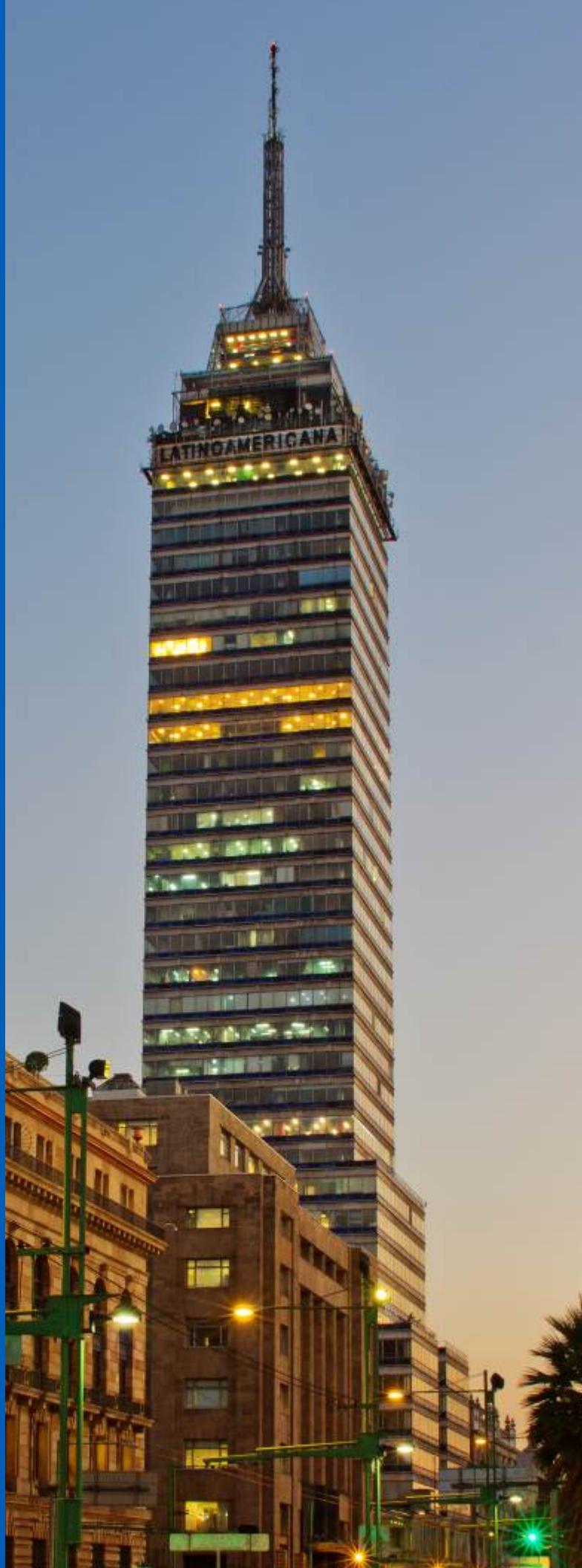
- Copyright protection generally means that certain uses of the work are lawful only if they are done with the authorization of the owner of the copyright.
- The Mexican Copyright Law recognizes two types of rights, the “economic rights” which are merely rights to remuneration. In addition to economic 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 their work.
- Also, as part of the moral rights the author is not included; the author has the right to oppose the mutilation or deformation of his/her work.
- 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 (usually no longer than 15 years unless exceptional circumstances).

- The transmission of economic rights and licenses shall be documented by written agreements, otherwise such acts will be void; also, the transmission of economic rights must be recorded before the Mexican Copyright Office (INDAUTOR) in order to have effects against third parties.
- Moral rights are, however, generally inalienable although their exercise may be waived by the author.
- Copyright generally vests in the author of the work. However, the law provides for exceptions and, for example, regards the employer as the original owner of software copyright if the author was, when the work was created, an employee and was employed for the very purpose of creating such work.
- The law provides that protection is independent of any formalities, that is, copyright protection starts as soon as the work is created without requiring any specific registration.
- 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 of the economic rights starts at the time of the creation of the work and ends 100 years after the death of the author.
- This law only is applicable to 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 breeding, forestry or fishing activities (primary activities) are exempt from income tax when their gross revenues do not exceed 20 times the annual minimum wage for the geographic area in which the taxpayer is located for each partner and the aggregate does not exceed 200 times the annual minimum wage corresponding to the Mexico City area.

Additionally, when their income exceeds the above threshold but does not exceed 423 times the annual minimum wage for the geographic area in which the taxpayer is located, a tax credit of 30% is granted to the tax payable as calculated in accordance with the corresponding articles. When the taxpayer's income exceeds the mentioned limit, the tax payable is 30%.

Additionally, there are others incentives:

1. Retirement insurance premiums and personal savings accounts.
2. Employers who hire persons with motor disabilities or impaired vision.

3. Tax benefits for trusts engaged in the construction or acquisition of real properties (Mexican REITs – FIBRAs for the Spanish acronym).
4. Deduction of land by real-estate developers' incentive.
5. Tax incentive for investment projects and distribution in domestic cinematographic and theatre productions.
6. Incentive for venture-capital investments in Mexico.
7. Deduction of special taxes paid in the acquisition of diesel, for use in machinery different to motor vehicles.
8. 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.
9. Deduction of toll roads for those which render public and private transport of people or goods.
10. Incentive for equipment of power supply for electrical vehicles.
11. Incentive for research and development of technology.
12. Incentive for high performance sports.

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.

Due to the latest tax reform for 2017, fiscal incentives were granted to taxpayers who obtained income from their activity in the immediate preceding fiscal year of up to 100 million pesos, also known as micro, small and medium-sized enterprises (SMEs), consisting of making an immediate deduction of the investment of new fixed assets using the percentages found in the Decree, instead of those provided for in articles 34 and 35 of the Mexican Income Tax Law, since the importance of these companies is recognized with respect to the generation of jobs, as well as to boost their competitiveness and facilitate their insertion as suppliers of the productive chains.



4. Reporting, Audit and regulatory environment



4.1 Financial Reporting

Statutory requirements for books and records

The Mexican Commercial Code and Income Tax Law require that certain summary accounting records be maintained in electronic data processing system.

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.

Financing reporting standards 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) and IFRS. 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 Mexican Financial Reporting Standards (FRS) and are intended to be in convergence with International Financial Reporting Standards (IFRS).

Since June 1, 2004, CINIF has issued 48 FRS, some of them, effective for years after December 31, 2016. 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 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
- Segment information
- Statement of financial position
- Business acquisitions
- Consolidated or combined financial statements
- Interim financial information
- Effects of inflation
- Financial assets and liabilities compensation
- 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, joint ventures 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
- Financial assets and liabilities transfer or cancellation
- Impairment of long-lived assets
- Obligations associated with the withdrawal of property plant and equipment
- Joint venture
- Employee's benefits
- Taxes on income
- Leases
- Capitalization of comprehensive financial results
- Construction-type contracts
- Share-based payment
- 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.

Some of the main aspects of presentation, disclosure and valuation of financial information covering FRS in force are:

Presentation and disclosure

- The Presentation of Other Comprehensive Income (OCI) after the net result in the Income Statement, changing the name of the financial statement to Comprehensive Income Statement and giving two options of presentation; in one or two financial statements.
- Instead of the Changes in Financial Position Statement, the financial statements shall include Cash Flow Statement.
- Beginning January 1, 2016, 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 but if a waiver is obtained from the creditor prior to issuance of the financial statements there is no need to apply this classification. This requirement is the same as that established by US GAAP, but departs from IFRS.
- Employee statutory profit sharing and expenses or incomes related to properties, plant and equipment is reported under ordinary expenses, as a component of operating expenses in the corresponding captions, instead of as a component of other income and expenses.
- Non-controlling interest consolidated subsidiaries is presented as a separate component within shareholders' equity on the balance sheets. Under U.S. GAAP non-controlling interest is presented between liabilities and shareholders' equity.
- 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.
- Disclosure of the officer or body authorizing issuance of the financial statements, as well as the date on which such authorization was granted.
- 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.

Accounting changes

Retrospective recognition of the effects of accounting changes.

Inflation accounting

Recognition of the effects of inflation on the financial information is allowed only when the entity operates in an inflationary economic environment.

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 Balance Sheet presented and income, costs and expenses on the Comprehensive 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.

- Accounts receivable are reported at realizable value, net of allowance for doubtful accounts. The realizable value of long-terms receivables is determined considering their present value.
- Inventories are stated at the lower of historical cost and net realizable value.
- Cost of goods sold represents the cost of inventories at the time of sale, increased, as applicable, for reductions in the net realizable value of inventories during the year.
- Investment in subsidiary and/or associated companies is primarily accounted for under the equity method.
- Investment in joint ventures is accounted for under the equity method.
- 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. 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.
- 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.

- 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.
- 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. 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.
- 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.

- 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.
- Compensated absences are also accrued during the period this benefit is earned by the employee.
- 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, IFRS and FRS, and assistance should be obtained when trying to evaluate Mexican FRS financial statements.

Recently issued financial reporting standards

The CINIF has issued the FRS and Improvements listed below:

- FRS C-2 “Investment in financial instruments”- FRS C-2 is effective for years beginning on January 1, 2018. It establishes the special rules for accounting recognition of investments in financial instruments, mainly those held for trading purposes, and the classification of financial instruments based on the business model of an entity for all instruments as a whole.
- FRS C-3 “Accounts Receivable”- FRS C-3 is effective for years beginning January 1, 2018, and is applicable retrospectively; however, early adoption is allowed as of January 1, 2016 provided that it takes place concurrently with the adoption of FRS related to financial instruments whose effective date and early adoption are in the same terms. One of the primary changes resulting from the adoption of this FRS is that, from initial recognition, the time value of money shall be considered. Therefore, should the effect of the present value of the account receivable be significant in light of its term, an adjustment must be made to take into consideration such present value.
- FRS C-9 “Provisions, Contingencies and Commitments”- FRS C-9 is effective for years beginning on or after January 1, 2018; early adoption

is allowed as of January 1, 2016 provided that it takes place concurrently with the initial adoption of FRS C-19 "Financial instruments payable". FRS C-9 supersedes Bulletin C-9 "Liabilities, Provisions, Contingent Assets and Liabilities and Commitments". The first-time adoption of this FRS does not produce accounting changes in the financial statements.

- FRS C-16 "Impairment of financial instruments receivable"- FRS C-16 is effective for years beginning on January 1, 2018. It establishes standards for the accounting recognition of impairment losses of all financial instruments receivable; it indicates when and how an expected impairment loss should be recognized and establishes the methodology for determination.
- FRS C-19 "Financial instruments payable"- FRS C-19 is effective for years beginning on or after January 1, 2018 with retrospective effects and early adoption is allowed as of January 1, 2016 provided that it takes place concurrently with the adoption of FRS C-9 and the FRS related to financial instruments whose effective date and early adoption are in the same terms - Some of the main points covered by this FRS include the following: It provides for the possibility of measuring, subsequent to their initial recognition, certain financial liabilities at fair value when certain conditions are fulfilled. Long-term liabilities are initially recognized at present value.
- FRS C-20 "Financing instruments receivable"- FRS C-20 shall be effective for years beginning January 1, 2018, and is applicable retrospectively. Early adoption is allowed as of January 1, 2016 provided that it takes place concurrently with the initial adoption of FRS related to financial instruments whose effective date and early adoption are in the same terms and supersedes the provisions set forth in Bulletin C-3 in this regard. Some of the main aspects resulting from the adoption of this FRS are as follows: Classification of financial instruments within assets. To determine such classification, the concept of intention to acquire and hold financial instruments has been removed. Instead, the concept of business management model is adopted, either for obtaining a contractual yield, generating a contractual yield and selling in order to achieve certain strategic objectives, or generating earnings from the purchase and sale thereof, in order to classify them in accordance with the respective model. The valuation effect of investments in financial instruments is also focused on the business model. An embedded derivative that modifies the cash flows of principal and interest is not separated from its host receivable financial instrument. The entire receivable financial instrument shall be measured at fair value, as if it were a negotiable financial instrument.

- FRS D-1 “Revenue from contracts with customers”- FRS D-1 is effective for years beginning on January 1, 2018 and eliminates the supplementary application of International Accounting Standard (IAS) 18. It establishes standards for the accounting recognition of revenue arising from contracts with customers.
- FRS D-2 “Costs from contracts with customers”- FRS D-2 is effective for years beginning on January 1, 2018. It establishes standards for the accounting recognition of costs of sales of goods or provision of services.
- FRS D-3 “Employee benefits”- FRS D-3 is effective for years beginning on or after January 1, 2016 with retrospective effects and early adoption is allowed as of January 1, 2015. FRS D-3 supersedes the provisions in FRS D-3. Main changes include the following:
 - **Post-employment benefits** – Among others, the following were modified: the accounting recognition of multi-employer plans; government plans and plans of entities under common control; the recognition of the net defined benefit liability (asset); the bases for determining the actuarial hypothesis in the discount rate; the recognition of the Service Cost of Past Periods (SCPP) and of the Early Settlement of Obligations (ESO).
 - **Remeasurements** – In recognizing post-employment benefits, the corridor approach is eliminated in the treatment of the plan’s profits and losses (PPL); therefore, they are recognized as accrued and recognized directly in Other Comprehensive Income (“ORI”), requiring their recycling to the period’s net profit or loss under certain conditions.
 - **Recognition in profit or loss of PM, SR and gains or losses from Early Settlement of Obligations (ESO)** – In post-employment benefits, the totality of the Service Cost of Past Periods (SCPP) of Plan Modifications (PM), Staff Reductions (SR) and the gains or losses from Early Settlement of Obligations (ESO) are immediately recognized in profit or loss.

Corporate taxation

In Mexico, the main federal tax is the Corporate Income Tax (CIT). The CIT generally applies for residents in the country on worldwide income, permanent establishments of non-residents on attributable income and

non-residents with Mexican-source income. 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.

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
Interest income and foreign exchange gains	Taxable and included in inflationary effect determined under the income tax rules
Bad debts and other allowances for receivables	Deductible when the requirements of the Income Tax Law are fulfilled ⁽¹⁾
Inventory purchases	Non deductible when made, up to December 31, 2004 ⁽¹⁾
Cost of goods sold	Deductible, since December 31, 2005 ⁽¹⁾ . Transition provisions are established at January 1, 2005
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⁾
Goodwill	Non deductible
Accruals	Amount due to specific creditors payable on defined dates may be deducted; all others are non-deductible ⁽¹⁾
Employee profit sharing (EPS)	The EPS is a deductible item from the taxable profit in the year it is paid.
Negative goodwill, reported as gain on business acquisitions beginning in 2005	Non taxable
Tax losses carried forward	Tax losses may be carried forward for ten years, adjusted by inflation ⁽¹⁾
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

Interest charged or paid on loans to individuals and legal entities	Taxable / deductible complying with requirements
Royalties received or paid by related parties	Taxable / deductible complying with requirements
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.
Dividends	Taxable when received from abroad
Salaries and wages	Regarding remuneration payments made to employees that are partially exempt, only 47% of the payments considered as exempt for the employee.

(1) *These items usually result in temporary differences.*

 Under the self-assessment regime, advance corporate tax is payable in 12 installments. The annual tax return must be filed within the first 3 months of the following year. From 1 January 2014 the use of electronic invoicing for all taxpayers is mandatory.

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), are 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.

Some business taxpayers can take the option to file audited financial statements accompanied by a statutory tax report for review by the Federal Tax Administration, a branch of the Treasury Ministry.

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

Statutory tax reports

Taxpayers with annual income obtained in the previous year exceeding MXP \$100,000,000 or with total assets exceeding MXP \$79,000,000 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 July 15 of the following year of the corresponding tax year. 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.

Moreover take into account that certain taxpayers are required to file an information return regarding its tax situation by June 30th of the following year if they fall within the assumptions established by the Mexican Federal Tax Code.

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 20 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.

Statutory tax reports

Taxpayers with annual income obtained in the previous year exceeding MXP \$100,000,000 or with total assets exceeding MXP \$79,000,000 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 July 15th of the following year of the corresponding tax year. **Taxpayers not included in these situations are not allowed 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. **If the taxpayer do not elect to file this report, and if it complies one of the suppositions that are defined by the Mexican Federal Fiscal Code, it will have to file an information return regarding its tax situation by June 30th of the following year.**

4.4 Regulatory aspects

4.4.1 Competition

Antitrust Law (Federal Law of Economic Competition or FLEC)

This law became effective in July 2014, its enforcement corresponds to the Federal Commission of Competition (COFECE, for its acronym in Spanish), which is an autonomous entity

The FLEC forbids anticompetitive conducts such as monopolies, monopolistic practices, illegal concentrations, cartels, activities and barriers that, under certain terms, diminish or obstruct the competition and free markets in the production, processing, distribution and commercialization of goods and services.

Furthermore, the FLEC forbids both absolute and relative monopolistic activities which may be declared void as well as subjected 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 with the purpose or effect to displace other market agents, substantially obstruct their access to the markets or establish exclusive advantages in favor of one or various individuals or legal entities, under certain circumstances, may be deemed as monopolistic activities pursuant the FLEC.

The FLEC provides that COFECE 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.

Moreover, the FLEC provides exceptions to the aforementioned obligation to notify the COFECE, i.e. those resulting from a corporate restructure, in

which the economic agents involved belong to the same group of companies.

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

Directors of corporations must prepare the following financial information within the following three months after the close of the year-end: (i) a balance sheet; (ii) an income statement; (iii) a statement of shareholders' equity; (iv) a statement of changes in financial position; (v) and the necessary footnotes disclosures. A management report containing all the foregoing information should be ready at least 15 days prior to the shareholders' meeting. 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.

Fifteen days after approval by the shareholders, the financial statements, footnotes disclosures and statutory examiner's report may be published in the If there are any votes against the approval of the financial statements, these must also be 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 highest decision-making body of a company is the Shareholders' Meeting, which must be held at least once a year within the first four months following the close of the company's fiscal calendar year.

This meeting approves, rejects or modifies financial statements, may appoint or revoke the sole administrator or the members of the board of directors and also the statutory examiner(s) (comisario).

On the other hand, the Extraordinary General Meetings are those held to deal with any of the following subjects: (i) Extension of the term of the company; (ii) early dissolution of the company; (iii) increase or decrease of fixed portion of the company's capital; (iv) changes in the company's corporate object; (v) change of the company's nationality; (vi) transformation of the company; (vii) merger; (viii) issuance of privileged stock; (ix) repayment by the company of its own stocks; (x) issue of bonds; (xi) any other modifications to the deed of incorporation; and (xii) such other matters as require a special quorum under the law or the deed of incorporation.

Usually and unless the bylaws state otherwise the 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, extraordinary shareholders' meetings require a quorum of 75 percent of the capital stock unless the by-laws require a higher percentage. Resolutions must have a favorable vote of the shares that represent 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 on behalf of the shareholders.

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

The minutes of extraordinary shareholders' meetings must be formalized before a Mexican Public Certifier and registered before 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. The Stock Company (*Sociedad Anónima*) and the Limited Liability Company (*Sociedad de Responsabilidad Limitada*) are required to keep Corporate Books in order to properly record the meeting minutes.

At the request of shareholders possessing 25% of the shares represented at a general meeting, the decision on any point on which they consider themselves not to be sufficiently informed will be postponed for three days

later, without the need of a new call. This right may only be exercised once, for the same matter.

Whenever a General Meeting of Stockholders adopts resolutions in regard to changes in the purpose of the company, nationality or transformation of the company, any shareholder who has voted against shall have the right to withdraw from the company and to be reimbursed for its shares on proportion to the assets of the company as shown on the last balance sheet, provided that such Shareholder makes a request to this effect within 15 days following the date on which the meeting adjourns.

Management structure

Mexican corporations can be managed by a sole administrator/manager or a board of directors/managers (depending on what the deed of incorporation provides). These administrators or directors may or may not be shareholders. The necessary quorum for a board of directors meeting is at least 50 percent of the directors and resolutions are passed by a majority vote of those present. However, in the event of a tie, 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 management location and hence, it may be deemed appropriate to hold certain meetings in Mexico. The resolutions of the board of directors must be recorded in the corresponding Corporate Book kept by the corporation for such purposes.

Legal representatives

Legal representatives of corporations can be Mexican nationals or foreigners. Regarding foreigners, they need to prove their legal entering into the country to be able to represent the company before the tax authorities.

Furthermore, the legal representation of the corporation corresponds to the Sole Administrator or the Board of Directors and their faculties are usually 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 and materials, noise, vibration, thermal energy, lighting, odor and visual pollution and wild life. It also sets out enforcement procedures and other provisions concerning the respective responsibilities of the Federal and State Governments.

Along with the aforementioned, there are other laws that regulate specific aspects of the environment that should be taken into consideration, such as the General Law for the Prevention and Management of Residues, the National Waters Law, the General Law of Wildlife, the General Law for Sustainable Forests Development, the Federal Law of Fishing and Aquaculture, the General Law of Climate Change, the Law for the Bio-security of Genetically Modified Organisms and the General Law of Environmental Responsibility.

SEMARNAT

The Ministry of Environment and Natural Resources (SEMARNAT for its acronym in Spanish) 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 environmental impact and allowable level of emission of pollutants.

Although several of Mexico’s States and Mexico City have also enacted environmental laws, SEMARNAT and the National Water Commission (CONAGUA for its acronym in Spanish) are the only federal governmental entities actively engaged, at present, in enforcement and the only entities empowered to enact and enforce laws regarding hazardous waste, environmental impact statements and environmental licenses for the use and protection of hydric resources.

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

The Environment Law provides a licensing system based upon media-specific discharge limitations for air, water and soil 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, regulations that specify the allowable discharge levels for specific contaminants.

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 or obtain: (i) an Operating License; (ii) an Environmental Annual Report; (iii) an Environmental Impact Statement; (iv) a residual water discharge license; (v) an air pollution discharge license; and (vi) register, file and maintain documents concerning hazardous waste.

Environmental Impact Statement

The Environmental Impact Statement (MIA for its acronym in Spanish) is a procedure used by the SEMARNAT to review the significant and potential impact that a certain project or activity may have on the environment and also, to establish the conditions and limitations to which those projects or activities must restrain to reduce or avoid such impact.

The Federal Government has exclusive jurisdiction over certain activities; those activities are listed in the Environmental Law and its Regulation. Nevertheless, the State and Local Governments have the faculties to review and authorize Environmental Impact Statements as well, as long as they are not based on any on the activities specifically reserved to the Federation.

Whenever a certain project or activity is considered particularly dangerous, is mandatory to also present a Risk Study. The Risk Study and the Environmental Impact Statements should always take into consideration all the applicable Official Mexican Standards (NOM for its acronym in Spanish).

In this sense, it is worth mentioning that 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.”

Upon receipt of the statement the Federal or State Government may fully authorize the activity, establish particular conditions for its approval, or deny a license for the activity.

Official Mexican Standards

The NOM are defined by the General Law of Metrology and Standardization as technical regulations issued by competent agencies of mandatory compliance, which states rules, specifications, attributes, directives, characteristics or requirements applicable to products, processes, facilities, systems, activities, services or production or

operating methods as well as those on terminology, symbols, packaging, marking or labeling.

SEMARNAT has issued and enforced NOMs in environmental matters such as sewage, atmospheric pollution, hazardous wastes, special handling waste, wildlife protection, noise pollution, environmental impact, smudge and bio-solids.

These NOMs should always be observed before and during the execution of any project or activity to which they may be applicable.

Environmental License

For the operation and functioning of any establishment whose activity's supervision is reserved to the Federation, should obtain an Environmental License. The SEMARNAT authorizes and regulates this license which gathers all other licenses, permits and authorizations.

The environmental license is only applicable to certain activities such as those related to oil, chemistry, paints, concrete, paper, glass, energy, hazardous materials treatment and any other economic activity that by virtue of its nature and complexity requires the intervention of the Federal Government.

Once granted, is permanently valid as long as the Environmental Annual Report (COA for its acronym in Spanish) is presented in the first quarter of every year, and all the other obligations derived from this license are fulfill.

Operating License

All "fixed sources" which emit odors, gases, solid particles or liquid particles into the air, (e.g. most manufacturing plants, including those plants which were operating prior to the enactment of the Environment Law), must obtain an operating license from the corresponding State Governments.

The Operating License has the same purpose that the Environmental License, but it is regulated by the State Governments. It is applicable to all the other activities not reserved to the Federal Government. The State Governments may grant or deny the license or require changes to be made.

Environmental Annual Report

The Environmental Annual Report is an instrument to report and compile

information regarding pollution transferred to the atmosphere, water, soil and hazardous materials, used by the SEMARNAT to update its data base.

This report is one of the mandatory obligations to anyone who has an Environmental License or an Operating License and/or: (i) produce atmospheric pollution, (ii) discharge black waters in a federal reception body; (iii) generate more than 10 tons of hazardous waste per year; (iv) performs activities of reuse, recycling, incineration, treatment by deep injection, treatment of contaminated soils and transport of hazardous waste.

This report, among others, includes information regarding the quantity of pollution transferred to the environment; the amount of recycled waste; the control and prevention activities being executed to reduce or avoid the impact on the environment and information regarding the treatment methods used inside the company.

The Environmental Annual Report keeps the validity of the Environmental License or the Operating License, updates the SEMARNAT's data base, and helps the Federal Government to formulate and review the environmental policy and criteria.

Registry as generator of hazardous waste

According to the General Law for the Prevention and Management of Residues and its Regulation, hazardous waste is defined as any waste that is corrosive, reactive, explosive, toxic, flammable, infectious biohazard.

The Registry as Generator of Hazardous Waste is mandatory to anyone who generates hazardous waste. Depending on the volume of the waste that is being generated, this registry may be filed before the SEMARNAT or the State Government and other obligations may be applicable.

Environmental Responsibility Law

The Federal Law of Environmental Responsibility regulates the environmental damage caused by any activity and gives the Federal Government the capacity to establish the responsibility and pursue any environmental felony that may be committed.

This Law defines an environmental damage as the loss, change, detriment or negative modification on the habitat, the ecosystems, the natural

resources, their chemical, physical or biological conditions, the interactions given among those, and the environmental services that they provide.

According to this Law, any individual or company, that by any action or omission, cause direct or indirect environmental damage, will be held responsible and obligated to repair those damages. When the damage caused is irreversible, an environmental compensation may be applicable.

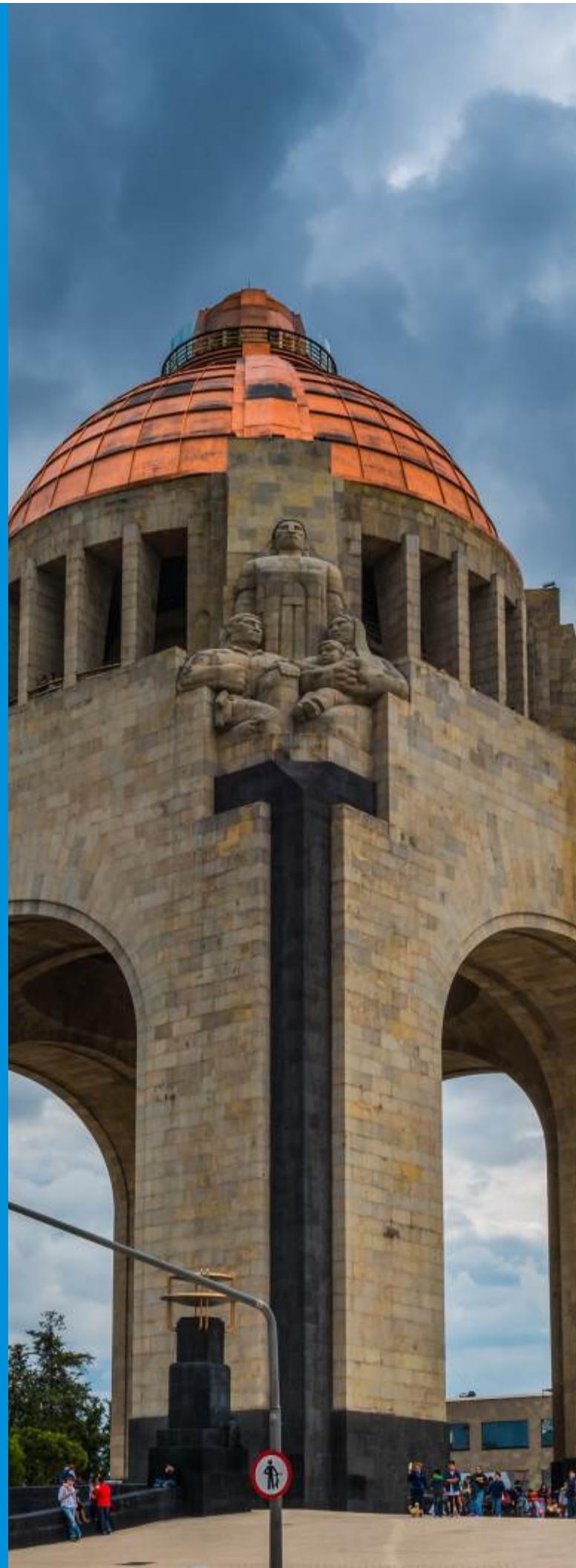
The environmental compensation consists in investments or actions that generate a substantial improvement to the environment that compensate the damage caused and its negative effects.

Besides the environmental compensation, a fine may be imposed to anyone who causes an environmental damage. This fine could be for up to \$48'024,000.00 MXN (approximately \$2'366,000.00 USD). Notwithstanding the aforementioned, companies or individuals may also be subjects to criminal liability.





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 additional guidance.

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 main 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' main administration.

Residence

Legal entities are deemed Mexican tax residents when their main business administration or place of effective management is established in Mexico.

In this respect, the Regulations to the FTC consider 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. Value Added Tax
 - c. 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 years (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.

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' favorable 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.

Favorable 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 filing a return amending the original return is set forth as an obligation expressly provided for in any Law.

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 offences 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 defense 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 defense 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 \$1,285,670 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 30 business days in which to file through the tax mailbox 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 unfavorable decision is issued and administrative relief has been exhausted, the decision may be appealed at the federal tax court within 45 business days (this legal period may be shortened to 15 business days if a summary appeal applies to the unfavorable decision). 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

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.

The corporate income tax rate is 30%.

Starting 2014, the regime for individual taxpayers has been amended in order to extend the tax base via restricting deductions and increasing the maximum rate. Three new rates and income thresholds have been added to the progressive rate table: 32% as from MX \$750,000.01; 34% as from MX \$1,000,000.01; and 35% as from MX \$3,000,000.01.

Taxable income

The Mexican Income Tax Law (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.

Please note that starting 2014, contributions made to create or increase the reserves of employee pension or retirement funds, complementing those required by the Social Security Law [Ley del Seguro Social], and seniority-premium funds will be deductible; nonetheless, the deduction derived from this concept shall not exceed the amount obtained by applying the factor of 0.47 to the amount of the contribution made in the corresponding fiscal year. If the benefits provided by the taxpayers to their workers (that in turn are exempt income for the workers) do not decrease with respect to those granted in the immediately preceding fiscal year, the applicable factor would be of 0.53.

Additionally, payments made to employees that are exempt remunerations for the employees would only be deductible for an amount equal to 47% of such payments. However, in the case that such payments do not decrease with respect to those granted in the preceding year the amount to be deducted would increase to 53%.

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

- The deductions must be strictly necessary for carrying out the taxpayer's trade or business;
- The digital invoices must comply with tax requirements²;
- The payments must be made with a nominative cheque, except as stated in the corresponding regulations (wire transfer, etc.);
- The deductions must be recorded in the accounting records;
- Any IT withholdings applicable must have been made and remitted to the tax authorities;
- Related information returns must be filed timely;
- Corresponding VAT must be evidenced and collected.

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;
- Food coupons must be granted exclusively through an "electronic purse", to facilitate the better control.
- Travel expenses must be made outside of a 50 km radius from the taxpayer's tax domicile.

² All taxpayers should issue electronic invoices complying with law requirements and monthly filings.

- Transfers made from bank accounts, the source account must be in the name of the taxpayer, both regarding expenses exceeding an amount of \$2,000 and salary payments.
- Regarding fixed assets, the amount to be deducted must be determined by applying the maximum percentages set forth by the MITL.
- In relation to royalties and technical assistance payments, it is provided that the person providing the service must have the knowledge to do so, that the service is rendered directly to the Mexican customer and not through third parties and the service is effectively provided.
- The value of the goods granted by the central office to its Mexican permanent establishment cannot, in any case, be higher than the value determined at customs.
- Payments made to a foreign resident residing in a country considered as preferential tax regime must have been agreed at arm's length.
- Arm's length terms and conditions must be used in intercompany transactions and support documentation must be kept in accordance with Mexican rules.
- Payments made to a foreign company that controls or is controlled by the taxpayer will not be deductible when said payments are for interest, technical assistance or royalties when:
- The entity receiving the payment is transparent (unless the shareholders or partners are subject to income tax for the amount of income received and the amount is equal to the consideration that would have been agreed in comparable transactions by independent parties).
- The payment is "non-existent" for tax purposes in the country or territory where the foreign entity is located.
- The foreign entity does not consider the payment as taxable income in accordance with applicable tax provisions.

Among others, the following items are not deductible:

- IT, Cash Deposits Tax (up to 2013) or Business Flat Tax (up to 2013) 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.

Non-deductible expenses also include payments made by a resident in Mexico that are, in turn, deducted by a related party resident or non-

resident in Mexico. This restriction would not apply when the related party that deducts the payment made by the taxpayer accrues the income earned by the taxpayer in the same tax year or the next.

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 less the non-deductible expenses for payments made to employees (47% or 53%) that are not taxable to these employees.

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

Generally speaking, in order to distribute the EPS, the amount is divided in two; one part is distributed based on the working days during the year and the other part will be distributed in proportion to the accrued salaries during the year for each employee.

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.

There is no exemption for the profit sharing as such if the employees are in the operating company. Directors, administrators and general managers of companies do not participate in the profits. Please consider that the courts have interpreted this to include only high level management (General Manager, CEO, CFO type positions).

On the other hand, there is a limit of one month of salary applicable in specific cases where the income is derived solely from the individual labor, and that of those engaged in the care of assets that produce lease income or the collection of loans and interest.

In addition, 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. Each case must be analyzed by the corresponding labor experts since there was an important labor reform last year.

5.1.3 Special regimes

Tax consolidation/integration

With the justification that is a regime that is confusing and difficult to inspect, the current tax consolidation system is eliminated starting 2014 with transitory rules applicable for the recapture of benefits.

An optional regime has been proposed for corporate groups, although it is in fact similar to the repealed regime. This regime is referred to as the "integration" regime.

The main differences are as follows:

- a) Deferred tax calculated based on an "average" factor
- b) Determining the "overall tax result factor"
- c) Removing the free flow of dividends and taxes
- d) Tax deferment period reduced from 5 to 3 years
- e) Minimum shareholding of 80% instead of 51%
- f) With regard to leaving the current tax consolidation being repealed, transitory articles establish an alternative procedure to that set forth in law in order to establish the effects caused by deconsolidating the group.

Please note that the Mexican integration regime is not a true consolidation but is a 3 year deferral scheme.

The individual tax result of each entity has to be determined by applying the general rules for Mexican entities in terms of the MITL and after that

the integrating entity has to compute the global or integrated tax result with a specific formula.

Once the integrated tax result has been determined, the integration ratio has to be applied to the amount obtained and multiplied by the percentage of participation (% of equity held) the amount obtained will be the proportion of the deferral income tax payable after the third year after the determination, adjustment for inflation must be computed.

It is worth mentioning that such ratio is the proportion of the tax losses and profits divided by the profits without considering the losses, meaning the proportion of the deferral is equal to the proportion of the tax losses generated at the group level over the profits; therefore, in a group of entities without current tax losses no deferral would apply.

In general terms, the proportion aforementioned will be the tax subject to be deferred and in the proportion of the integration held. The difference between the total payable income tax and the deferral tax will be the amount payable for the current year.

Below you will find the general requirements that entities must fulfill in order to apply the integration regime as well as certain formalities that must be met.

Requirements of integrating company	Requirements of integrated company
<ul style="list-style-type: none">• Must be resident in Mexico.• Be the owner of more than 80% of the voting shares of one or more integrated entities, directly or indirectly.• In no case more than 80% of its voting shares are owned by other companies, unless they are a tax resident in a country with which Mexico has in force a comprehensive information exchange agreement.• The shares publicly traded through a recognized stock exchange will not be computed for this purpose.	<ul style="list-style-type: none">• Will be considered an integrated entity, those in which more than 80% of its voting shares are property, directly, indirectly or in both forms, of an integrating company.

- **In case of companies not issuing shares, the value of their partnership interest will be considered.**

The entities below are not eligible to be considered as “integrating” or “integrated” entities:

- Nonprofit entities
- Financial institutions or capital investment companies
- Non-resident entities, even if they have in Mexico a permanent establishment
- Entities that are in a liquidation process
- Partnerships, non-profit associations, as well as cooperative associations
- Entities under a coordinated tax regime (auto transportation)
- Joint ventures
- Entities under a Maquila program
- Entities that before entering to the “integration regime” have tax losses pending amortization from prior years
- Entities providing public air transportation services
- Income tax exempt entities.

Therefore, the group of entities that comply with the requirements before mentioned will be eligible to apply the integration regime.

The group of entities must request an authorization with the Mexican Tax Authorities (MTA) in order to be considered as part of the integration regime.

The authorization aforementioned must be filed at the latest by August 15 of the year prior to the application to the benefits and the determination of the integrated tax result of the group.

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 not owned by the Maquila and originating abroad and imported on a temporary basis, with such goods subsequently being exported. The program may also include certain services that could qualify as exports such as inventory management, call centers and data processing.

Up to the end of 2006, Maquilas were operating under an executive decree (“the Maquila decree”) at which time it was merged with the PITEX program (another export program similar to the Maquila). A new executive decree was issued denominated “Decree for the Promotion of the Manufacturing, Maquila and Export Service Industry (IMMEX). This new decree maintains all benefits previously granted to Maquilas and was intended to simplify the operation of the two aforementioned predecessor programs.

One important modification incorporated in the IMMEX Decree is that it recognizes the rendering of export services. It includes a complete list of services that could be considered as exports 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 (initially most Maquilas were located in border zones but Maquilas may now be found in different states to take advantage of available labor) and their business 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 shelters).

Entities operating in the maquiladora program are not restricted from carrying out other business activities such as lease or sale of goods. However, this could affect the entity's compliance with the definition of “Maquila operation” for tax purposes as described below.

In order to operate as a Maquila, it is necessary to obtain the corresponding authorization from the Ministry of Economy. The authorization is granted once the entity has been duly incorporated in Mexico and a federal tax identification number has been obtained (Registro Federal de Contribuyentes). In addition, the Mexican entity will have to enter into a Maquila agreement with a non-resident related party or parties which will supply goods and machinery and equipment that will be imported temporarily. These non-residents are known as principals or the customers/clients of the Maquila and are generally a Maquila's parent company.

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

The relationship between the Mexican Maquila and its non-resident related party or parties is managed through the Maquila agreement, in which the terms and conditions of the manufacturing procedure or services to be provided are defined, including the use of the non-resident entities' machinery and equipment. It is important to mention that throughout the years, different types of Maquilas have been developed such as service Maquilas, manufacturing Maquila, controller Maquila or shelter operations, under which raw materials owned by non-resident entities or by the Maquila itself are transformed using equipment provided by the non-resident entities or owned by the Maquila.

There are several alternatives available for the use of this program and the program could be adjusted to almost all types of agreements in order to manufacture goods in Mexico by taking advantage of specialized labor, the proximity to the US and the commercial agreements signed 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 complete legislation to allow Maquila 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 evolved in order to eliminate or reduce negative consequences, considering 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

Maquila is 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%.

Estimated income tax installment payments must be made every month based, on the prior year's taxable income.

Due to the tax reform for 2014 that resulted in substantial changes to the income, there are several issues that should be taken into consideration when dealing with Maquila:

- A definition of “Maquila operation” was introduced to the tax legislation and the conditions of this definition must be met in order for non-residents to avoid constituting a permanent establishment in Mexico with respect to their operations with Maquila under Maquila agreements.
- For the shelter Maquila, previously such Maquila operations did not trigger a permanent establishment in Mexico when operating under this scheme. However, from 2014, protection for non-residents from a permanent establishment in Mexico under such operation is limited to four years of operations. Once those years are expired, non-residents would need to define if it remains as a shelter scheme without the protection from a permanent establishment, take the option to remain without the protection from a permanent establishment but paying the corresponding taxes through the shelter Maquila for up to four years or withdraw or restructure their operations.
- There is additional deduction available for entities that perform Maquila operations and comply with the definition of Maquila operation for tax purposes. On December 26, 2013, an executive decree was issued that grants an additional income tax deduction equal to 47% of the tax-exempt employee remuneration granted by these entities.

Definition of “Maquila operation for tax purposes”

The definition of Maquila operation for tax purposes establishes the following requirements:

- ✓ The machinery and equipment provided by the non-resident principal must represent at least 30% of the total machinery and equipment used in the Maquila operation. When computing the 30% threshold, the machinery and equipment cannot be previously owned by the Maquila itself or by any other Mexican resident related party.

Some rules were issued for Maquila that were operating as such up to December 31, 2009 and that were complying with transfer pricing rules. Under these rules, these Maquila had more flexibility for the use of machinery and equipment that was previously owned by the Maquila or by related parties.

However, starting 2016 all Maquila should comply with the obligation to use at least 30% of machinery and equipment owned by the non-resident principal.

- ✓ Raw materials must be provided by the non-resident 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.

- ✓ Maquilas are allowed to have other types of income from activities such as rendering services, leasing goods and selling goods; however, this income cannot exceed 10% of the total Maquila income.

Notwithstanding, Maquila are not permitted to sell in the Mexican market, the finished goods that is manufactures.

- ✓ The principal/client of the Maquila must be a resident of a country that has a double tax treaty with Mexico.
- ✓ Maquila has to comply with transfer pricing rules, as discussed below.

[Value-added tax \(VAT\)](#)

As a result of the tax reform for 2014, the VAT legislation was modified and as a result Maquila no longer have the VAT exemption when importing goods temporarily, unless the companies are certified by the customs and tax authorities in Mexico for this purpose. This certification applies for operations cleared after January, 2015. Please refer to the Logistics Services and Customs chapter for more details.

On the other hand, Maquila services provided by maquiladoras are considered as exports of services for VAT purposes, subject to the 0% tax rate. This rate is also applicable to the submaquila or sub-manufacture services provided by other Maquila if the goods are exported.

Generally, maquiladoras generate VAT receivable balances in their favor that can be refunded or used as a credit against other federal taxes. The VAT receivable balance is generated from the tax paid to their local suppliers of goods and services, as well as the VAT paid on temporary importations (in those cases where the maquiladoras are not certified). There is a specific treatment applicable to Maquila that allows them to consider all the VAT paid relating to the export operation (providing that the supporting documentation complies with the tax requirements), is creditable and subject to refund.

One important issue to consider is the acquisition or sale of products in Mexican territory carried out by non-residents when the goods are delivered to or by Maquila. 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 exempt the payment of this tax when the goods are transferred between Maquila, sold between non-residents or sold by Mexican vendors to the non-resident 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 evolved. New transfer pricing rules were introduced, starting January 1st 2014, to complement the aforementioned new definition of Maquila operation, under which there are only two available options to comply with transfer pricing.

1) Safe harbour

In order to meet the safe harbour requirements and avoid the permanent establishment exposure for non-residents, the taxable income of the Maquila is required to be the greater of:

- 6.9 percent of the value of the assets owned by the maquiladora and the non-resident 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 non-resident principal.

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

There is also the possibility to submit this statement at a later date jointly with the return known as DIEMSE (Informative return applicable to manufacturing, Maquila and export services entities).

2) Advanced Pricing Agreement

Alternatively, the Maquila may obtain an advanced pricing agreement (APA) from the Mexican tax authority.

For this alternative, Maquila companies must include in the computation of the transfer pricing methodology all assets owned by the Maquila and the non-resident principal that are used in the Maquila activity.

An APA may cover a five-year period, the year in which the APA is requested, the prior year and the three years following the year of request.

Starting 2016 (and including years 2014 and 2015) the Mexican tax authorities allowed a simplified APA methodology, commonly known as “Fast Track” through which eligible Maquila can negotiate an APA under a methodology approved in advance by the tax authorities. This methodology was developed to expedite the APA approval process.

Notwithstanding the above, since this methodology is not properly established in the Mexican legislation at this time is uncertain if the same will be maintained for the following years. At this time Fast Track is being used to negotiate the APA that were submitted up to December 2016.

Payments to non-resident

Generally, there are no payments by the Maquila to its non-resident, principal or 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 Maquila for such concepts or for any other items of a similar nature such as management fees.

It is important to take into consideration that most Maquila operate on a cost-plus basis (all the expenses incurred by the Maquila plus a mark-up profit margin, determined to comply with 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 the type of payment in question and the country of residence of the recipient if double tax treaty benefits are applicable.

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-bound agreement manufacturing regime), which operated under specific rules for tax and custom purposes. This new legislation established that Maquila 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 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. Currently, they still may apply a safe harbour test, which must be the greatest 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 negotiate an APA, taking into account all assets used in the maquiladora operation including the assets owned by both the foreign resident and the Maquila.

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.

Under Mexican domestic tax legislation, all taxpayers are required to price their transactions with related parties at arm's-length. 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 nature of the intercompany transactions 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 functional analysis and the information of the comparable companies/transactions 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.

On December 23, 2016 the Mexican Tax Authorities published the General Tax rules for 2017, which include a definition of transfer pricing adjustment and also indicate the mechanics and requirements to conduct said adjustments with a tax effect, that is, to accumulate or deduct the Transfer Pricing adjustments.

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.

In addition, in order to consider the correct methodology when applying the Resale Price Method, the Cost Plus Method, taxpayers must demonstrate that the sales and the costs, respectively, 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 foreign related parties 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 additional information of the economic analysis including the profit margin obtained from the transactions, the transfer pricing methodology used to test its arm's length nature, the Standard Industrial Classification (SIC) Codes used, the number of comparable companies, identified, (segmented) financial information used in each economic analysis, range of arm's length values, among other information. 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 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 except for the questionnaire.

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 Maquila. Such rulings may also derive from an agreement with the competent authorities of a treaty partner (bilateral and multilateral APAs). Unilateral APAs can cover up to 5 years; the year in which the APA is requested, a rollback 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.

As a result of the documents issued by the Organization for Economic Cooperation and development (OECD) to address Base Erosion and Profit

Shifting (BEPS) in some tax jurisdictions, Mexico has the new article 76A of the MITL applicable to 2016 that expands the transfer pricing disclosure requirements. In particular, the following taxpayers must be aware that additional disclosure requirements are applicable for 2016:

- Taxpayers whose revenues the immediate tax year were equal to or greater than \$671,414,320 pesos. Note that this amount will be annually updated.
- Corporate taxpayers with shares quoted in public stock exchanges
- Corporate taxpayers ruled by Chapter VI of Title II of the MITL which refer to the optional regime for group of companies
- Parastatal entities of the public administration.
- Foreign taxpayers with a permanent establishment in Mexico only with regards to the activities conducted by said permanent establishment

Those taxpayers must file the following information return:

- *Master information return for the multinational group:* it must contain the following information with regards to the multinational group:
 - Organizational structure
 - Description of the activity, intangible, financial activities with related parties.
 - Financial and tax position
- *Local information return with related parties:* it must comply with the following information:
 - Description of the organizational structure, business and strategic activities as well as the related party transactions.
 - Financial information of the taxpayer and comparable transactions or entities used as comparable in the transfer pricing analysis.
- *Country-by-country information return:* the member of a group of multinational entities, it must contain the following information:
 - Information at a tax jurisdiction level about the worldwide revenue distribution and taxes paid.
 - Location indicators of economic activities in the different tax jurisdictions of a multinational group in the corresponding tax year, which shall include tax jurisdiction; total income, distinguishing between third party and related party amounts; profit or loss before taxes; corporate income tax actually paid and corporate income tax generated in the fiscal year; capital accounts; accumulated profits or losses accumulated; number of employees; fix assets and inventory.
 - List of all the entities that integrate the multinational group and its permanent establishments, including main economic activity of the entities of the multinational group; jurisdiction

where the entity was incorporated, in the case it is different from its tax residency; and all the information taxpayers find suitable to facilitate the understanding information previously described.

The country-by-country information tax return shall only apply to anyone that falls within one of the following provisions:

- Mexican parent companies, meaning those that comply the following requirements:
 - Mexican residents
 - Have subsidiaries in terms of the Mexican GAAP (NIF by its Spanish acronym) or permanent establishments located outside Mexico.
 - Are no subsidiaries of a foreign resident.
 - Must prepare consolidated financial statements according to the Mexican GAAPs.
 - Prepare consolidated financial statements including the financial results of entities that are located in foreign tax jurisdictions.
 - Have obtain in the previous fiscal year consolidated revenues equal to or greater than 12,000 million pesos
- Mexican taxpayers or foreign taxpayers with a permanent establishment in Mexico that were designated by the foreign parent company as the company responsible for submitting the country-by-country information return.

The aforementioned information returns must be filed on December of the following year it corresponds, being the first reporting year 2016 which must be filed by December 31, 2017.

It must also be pointed out that the current requirements under Article 76A of the MITL with regards to the Master file go beyond the requirements of the OECD's master file. However, the tax authorities have agreed to review those requirements so that Mexico is totally aligned to the OECD. At the time this document was prepared, the final rules have not been released.

5.1.4 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.

Another option to determine the average capital 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:

- Exploration and extraction of oil and other hydrocarbons
- Planning and control of the national electricity system, public service transmission and electricity distribution
- Nuclear energy generation
- Radioactive minerals
- Mail
- Control, supervision and surveillance of ports, airports and heliports
- Infrastructure

Financial system entities are not subject to these thin capitalization rules.

5.1.5 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.

5.1.6 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 based on a 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 income obtained in a tax haven country as being taxable income in Mexico on current basis. 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%).

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 are considered to be passive income: interest, dividends, royalties, gains on the sale of shares, securities or intangible assets; gains from derivative financial instruments where the underlying concerns debts or shares; commissions and mediation, as well as revenues from the sale of assets that are not physically located in the country, territory or jurisdiction where the foreign entity or figure resides or is located and revenues from services provided outside such country, territory or jurisdiction, as well as revenue from the sale of real estate, from granting temporary use or enjoyment of property and the income received gratuitously.

The tax authorities may authorize Mexican taxpayers participating in financing entities not to apply the regulations relating to preferential tax

regimes provided certain requirements are met.

Income from royalties for the use of or concession for the use of 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 or that the intangible was purchased at market value and that these royalties not generate an authorized deduction in Mexico. The royalty payment must be made at arm's length and that the accounting of the foreign entity is available for the tax authorities. Also, the information tax return must be filed timely.

In addition, according to general rule 3.19.1 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 3.19.2 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 vehicles 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 comprehensive information exchange agreement for tax information with Mexico. Where the entity or foreign legal vehicle does not have an agreement, they would have to comply with the dispositions provided in Article 176 paragraph eight of the MITL.

According to general tax rule 3.19.5 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 which income is subject to preferential tax treatment, a 40% withholding tax automatically applies on the gross amount of such payments without any deduction.

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 where the foreign resident does not reside in a country with which Mexico has in force a comprehensive 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 are the actual beneficiaries of the interest and comply with filing and information obligations.

Additionally, other exceptions may apply to interest payments subject to preferred tax treatment. A withholding rate of 10% may apply to interest arising from bonds offered to the general investing public. In addition, interest that is exempt from withholding tax under the MITL is also exempt from withholding tax even though the payment is made to a tax haven.

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.

Dividends paid to a tax haven country are subject to the same withholding tax rate of 10% applicable to all foreign residents.

5.1.7 Anti-Avoidance

Mexico does not have a general anti-avoidance rule. However, Mexico does have a number of specific anti-avoidance rules (for example preferred tax regime rules (type of CFC), thin capitalization, limitation of some deductibility, limitation of the application of the tax treaty benefits in certain cases and transfer pricing rules).

5.1.8 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 MITL.

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 comprehensive information exchange agreement in order for the tax paid by said entity to be creditable in Mexico.

Regarding the aforementioned, the reform's intention is to clarify the procedure to be followed in order to assess the proportional tax creditable in Mexico that has been paid abroad by the company paying dividends, both at first and second corporate levels through formulas.

Taking into consideration that the dividends received in Mexico may result from different tax years, of which possibly the tax was paid at different rates, as from 2014, taxpayers who receive this kind of payments must keep a record of the years to which such profits being received as dividends correspond as well as the applicable tax rates.

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

The tax treaties currently in force with Mexico are:

Double Tax Treaties		
1 Australia	21 Iceland	41 Republic of Korea
2 Austria	22 India	42 Romania
3 Bahrain	23 Indonesia	43 Russia
4 Barbados	24 Ireland	44 Singapore
5 Belgium	25 Israel	45 Slovak Republic
6 Brazil	26 Italy	46 South Africa
7 Canada	27 Japan	47 Spain
8 Chile	28 Kuwait	48 Sweden
9 China	29 Latvia	49 Switzerland
10 Colombia	30 Lithuania	50 Turkey
11 Czech Republic	31 Luxembourg	51 Ukraine
12 Denmark	32 Malta	52 United Arab Emirates
13 Ecuador	33 Netherlands	53 United Kingdom
14 Estonia	34 New Zealand	54 United States of America
15 Finland	35 Norway	55 Uruguay
16 France	36 Panama	
17 Germany	37 Peru	
18 Greece	38 Poland	
19 Hong Kong	39 Portugal	
20 Hungary	40 Qatar	

Tax treaty benefits

In order to enjoy the benefits of tax treaties to avoid double taxation, 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 tax treaty itself and by the Mexican Income Tax Law, such as filing the tax status informative return, the filing of a CPA report (dictamen) and the appointment of a legal representative where applicable. Otherwise, relief under the treaty will not be granted (or could be granted through refund request) and the rates provided in the MITL would apply. Some scholars consider that these requirements should not be applicable

when not expressively included in the Tax Treaty since the Mexican Courts have stated that Treaty Law overrides the domestic law.

On the other hand, in case of operations with related parties, now the tax authorities are authorized to request a formal document from the legal representative of the non-resident stating under oath that there is “legal” double taxation for the income for which a treaty benefit is being applied, specifying the applicable provisions of foreign law and any other documentation it may deem necessary to attach.

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 expenses based on tax invoices issued by foreign residents without a permanent establishment in Mexico can use these invoices when they contain 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 or at least its legal name.
- IV.** The quantity, measuring unit and type of merchandise or a description of the service provided or the leasing 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.
- VI.** In the case of the sale of goods or the granting of temporary use or enjoyment (leasing), the amount of taxes withheld and transferred tax, detailing each of the applicable tax rates.

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

In 2016, Annex 20 of the General Tax Rules entered into force, which included significant changes on tax invoices. The most relevant change is

based mainly on the structure of the current scheme (which only defines the CFDI and Proof of Withholdings) with complements such as "Payroll" that does not have the traceability of payments, among other gaps that prevailed, which is why four forms of vouchers are envisaged:

- Income: Digital Tax Voucher through the Internet (CFDI version 3.3).
- Expenditures: Proof of Digital Tax through the Internet that covers payments already done (proof of payments).
- Payroll: Proof of Digital Tax through the Internet that covers concepts of Income for wages and in general for the provision of a subordinate personal service (payroll).
- Withholdings and transfers: Digital Tax Voucher through the Internet that includes withholdings and payment abroad information (proof of withholdings).

For the above mentioned Proof of Withholdings and Payment Information when contemplated the creation of a CFDI for the issuance of records of withholdings and information of payments, the CFDI must include the following information:

- Place of issue.
- Tax regime of the taxpayer.
- Fiscal residence.
- Tax identification number in the country of residence.

Invoices issued by non-residents without a permanent establishment must include the following information:

- I. The legal name, tax domicile and, where applicable, the taxpayer identification number (Tax ID) or equivalent of the person who issues the invoice.
- II. Place and date of issue.
- III. Tax ID of the person to whom the documentation is issued or at least its legal name.
- IV. The quantity, unit of measurement and type of goods or merchandise or description of the service or use or enjoyment.
- V. Unit value entered in number and total amount entered in number or letter.
- VI. In the case of the transfer of goods or the granting of their use or temporary enjoyment, the amount of taxes withheld, as well as the taxes transferred, disaggregating each of the corresponding tax rates.

5.2 Withholding tax

5.2.1 Dividends

Since 2014, the MITL establishes that individuals residing in Mexico and non-residents who receive any dividends or profits that are generated as from 2014 will be subject to a 10% withholding tax, which should be considered as a final payment. This is independently of if the distribution is made from previously taxed earnings or not.

For permanent establishments (PE) of non-residents who distribute or pay dividends or profits to their parent company, the PE must pay an additional 10% tax.

Tax treaties to avoid double taxation may be applied to reduce this rate, where applicable.

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 administers the balance of book retained earnings that have already paid corporate income 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 will be determined by applying the corporate tax rate on the grossed up dividend. The 30% corporate tax rate is applied to the dividend grossed up by a factor of 1.4286.

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.

On the other hand, resident individuals must include in their taxable income dividend income and may credit the income tax paid by the Mexican company distributing the dividends or profits against the tax determined on their annual return, provided that the person taking the credit considers as cumulative income, in addition to the dividend or profit received, the amount of income tax paid by said company, relating to the dividend or profit received.

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 guarantee 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 gain obtained is 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.

Withholding tax rates applicable to interest paid generally vary according to the foreign beneficiary, the Mexican payer or in some cases, the type of investment or the purpose of the loan. They are as follows:

- 4.9% for interest paid to 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, and comply with the requirements issued by the MTA through general rules.
- 4.9% for 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 tax treaty to avoid double taxation, 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% interest paid to 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, 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% for interest paid to 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% for interest on 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.

Given the possibility of applying a 10% preferential rate only on the gain on the transfer of shares in Stock Exchanges or registered in the International Quota System (SIC by its acronym in Spanish), an obligation is established for equity investment funds to determine the profit when the securities are not listed in the SIC.

- 10% interest for 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% for interest paid to foreign reinsurers.
- 21% for interest other than those indicated above, paid by Mexican banking institutions.
- 21% for interest paid to foreign suppliers who sell machinery and equipment forming part of the acquirer's fixed assets.
- 21% for interest on financing to acquire machinery and equipment and in general to furnish working capital, if these circumstances are mentioned in the agreement.
- 35% for interest other than that stipulated above.

(1) In the event of non-compliance with the above stated requirements, the applicable rate will increase to 10%.

(2) In 2014, 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 treaty to avoid double taxation 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 and technical assistance

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: 35%.

When the same agreement involves royalty payments for different items subject to the 25% or the 35% 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 25% 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.

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.

5.2.5 Other considerations

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

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.

Please also refer to the deductibility requirements for the Mexican taxpayer making these payments.

[Fiscal Incentives for the 2017 tax year](#)

[Tax incentive for research and technology development:](#)

For the fiscal year 2017, an incentive in the form of a tax credit of 30 percent of the expenses and investments in research and technology development, creditable against income tax for companies was included. Under this scheme, the total amount of incentive will be 1,500 million Mxp, with a maximum amount per taxpayer of 50 million Mxp.

The taxpayers concerned shall submit the project for evaluation before an interagency Committee composed by representatives of the National Council of Science and Technology ("CONACYT" per its acronym in Spanish), the Ministry of Finance, the Mexican Tax Authorities, the Secretary of Economy and the Presidency of the Republic responsible for Science and Technology.

The Committee will evaluate, authorize and determine the corresponding amounts for each project. The Committee will regularly monitor the implementation of approved projects.

Tax incentive to high performance sport:

There is a great challenge in Mexico regarding public health. Practice and development of sport generates benefits in health and quality of life of citizens, to abate sedentary lifestyle and degenerative diseases, and are essential in the formation of Mexican athletes who participates in high-level international competitions. In light of the above, in order to promote sports activities and habits, an incentive was established starting fiscal year 2017 for the contributions made by the taxpayers to invest in specialized sport facilities projects, as well as the creation, development and expansion of programs for Mexican athletes training. This tax incentive will have the following characteristics:

- Tax credit against income tax applicable.
- The total annual credit is 500 million pesos, with a limit of 20 million pesos per taxpayer and per investment project.
- A committee integrated by a representative of the National Commission of Culture was created.
- The committee is responsible for the allocation of tax incentives.

Percentage of deduction for oil and gas infrastructure:

Incentive regarding the percentage of deductions that will apply to fixed infrastructure for transportation, storage and processing of hydrocarbons, platforms and drilling vessels and craft processing and storage of oil and gas.

5.3 Value Added Tax (VAT)

5.3.1 General system and rates

Mexican VAT is paid on a cash flow basis.

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 VAT Law requires that this tax is transferred on to each transaction regardless of the status of the consumer, whether they are 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 of goods, the provision 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 consideration 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.

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.

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.

Only entities having permanent establishment for income tax purposes that carry out activities for VAT purposes are obliged to register for VAT purposes. It is not then possible to obtain a Mexican tax identification number merely for VAT 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 standard rate of 16% (0% rate applies in some cases) when they carry out the following acts or activities in Mexico.

1. Sale of goods;
2. Supply of independent services;
3. Granting of temporary use or enjoyment of (tangible) goods;
4. Import of goods or services.

The VAT assessed to taxpayers and the 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 deducted.

VAT shall not be deductible when these expenses are used exclusively for performing exempt activities and activities that are not subject to VAT. In cases where the taxpayer simultaneously carries out transactions that are subject and transactions exempt to VAT, VAT partial exemption rules will be applicable and the deduction of VAT shall apply according to apportionment rules and, regarding to residual input VAT, 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 payable VAT

VAT is calculated on a monthly basis and is considered as final tax payment. Should a credit VAT position be obtained in any month, the refund of this can be requested in full (through the submission of an additional VAT refund request form) 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, buildings 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 tax 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 VAT law.

Other tax exempt services are those rendered by public institutions for social security; education rendered by accredited institutions; urban, suburban and metropolitan land transportation of passengers, 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.

No tax is payable for the temporary use or enjoyment of real estate destined for housing or farms used for agricultural purposes or cattle breeding. 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 to the Customs Authorities; in the case of temporary importation, the tax is payable when the importation becomes definitive, with the exception of temporary imports carried out by Companies part of the IMEX Program are entitled for the temporary import of goods, imported goods to be warehoused in automotive in-bond

warehouses and goods imported under the strategic in-bonded warehousing system.

VAT grouping is not applicable in Mexico and 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 VAT assessed.

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.

Withholding of VAT

VAT should be withheld in the following instances:

- When banks acquire goods by means of payment in kind or court awards.
- When legal entities make payments to individuals for:
 - Independent service rendering or leasing of goods
 - When they acquire waste or scrap to be used as raw materials in industrial activities or for its trading.
 - 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 individuals or business entities carry out domestic acquisitions of tangible goods or temporary lease of goods to residents abroad that do not have a permanent establishment in Mexico.

Importation of goods

Import for the use or enjoyment of tangible goods when physical delivery is made abroad:

For import purposes for the fiscal year 2017, in the case of temporary use or enjoyment in national territory of tangible goods whose physical delivery

has been made abroad, the basis for calculating the tax will be the amount of consideration.

Moreover, the tax for the use or enjoyment in Mexico of the goods delivered abroad by non-residents will not be paid, as long as such goods has actually paid VAT on the introduction into Mexico. Otherwise, including temporary importation, VAT will apply on each payment through a type of self-assessment mechanism by the Mexican taxpayer.

Export of goods

Businesses residing in the country will calculate the tax by applying the VAT 0% rate to the value of the transfer of goods or the rendering of services when either is exported.

For purposes of this Law, exportation of goods or services is:

- I. That definitive exportation under the Customs Law.
- II. The transfer of intangible goods by persons residing in the country to persons residing abroad.
- III. The temporary use or enjoyment abroad of intangible goods granted by persons residing in the country.
- IV. The utilization abroad of services rendered by residents in the country under the concept of:
 - a) Technical assistance, technical services related thereto, and information related to industrial, commercial or scientific experiences
 - b) Maquila and submaquila export operations pursuant to the customs law
 - c) Advertising
 - d) Commissions and intermediation
 - e) Insurance and reinsurance
 - f) Financing transactions
 - g) Filming or recording, provided the requirements set forth in the regulations of VAT Law
 - h) Call service centers for calls originating abroad, contracted and paid for by a foreign resident without a permanent establishment in Mexico
- V. International transportation of goods, rendered by residents in the country and port services of cargo, carriage, warehousing, custodial, stowage and carriage within ports and port facilities provided that such services are rendered in merchandise exportation maneuvers.

VI. International air passenger and cargo transportation services rendered by persons residing in the country, for that portion of the service which is not considered rendered in national territory.

For fiscal year 2017, the VAT Law was amended in order to provide that the following services related to information technologies when they are used abroad will be considered as exportation subject to a rate of 0%.

- Development, integration and maintenance of IT applications or computers systems.
- Processing, storage, information backup and management databases.
- IT application hosting.
- Modernization and optimization of systems of information security.
- Continuity in the operation of the above services.

The aforementioned shall apply as long as the companies providing services in Mexico fulfill certain obligations, such as that used in full technological infrastructure, human resources and materials, located in national territory; the numeric identifier (IP address) of electronic devices through which services are provided, as well as the provider of Internet service in Mexico and such identifier of electronic devices of a service receive and the internet service provider is located abroad; they include in the tax receipt or tax registration, the Tax ID of the foreign resident who hire and pay for the services, among others. These requirements shall be fulfilled in accordance with the General Tax Rules issued by the Mexican Tax Authorities.

Integration Regime

As a consequence of the proposal to set up the so-called “Integration Regime” (Regimen de Incorporacion) for income tax purposes, that is applicable to certain Small and medium entrepreneurs, VAT payment returns may be submitted every two months and it will no longer be necessary to submit informative returns, provided that details of transactions conducted with suppliers in previous two months, in accordance with the Income Tax Law, are submitted.

Invoices

Since 2005, the Tax Administration Service has been gradually transitioning to this new scheme. The simplification process has eliminated paper invoices through an authorized printer, which was in force until December 31, 2012 and now the Digital Tax Invoice currently in force is eliminated until December 31, 2013. From 2014, the new applicable

universal electronic invoicing standard is the Internet Digital Tax Invoice scheme (CFDI for its acronym in Spanish).

To invoice electronically only requires the Advanced Electronic Signature, process a digital seal certificate and use the free service invoice offered by the Tax Administration Service or, choose from any of the 76 Authorized Provider Certification that you can find in the portal of the Tax Authorities.

An Authorized Provider Certification is one person which is authorized by the Tax Administration Service to validate the CFDI's generated by the taxpayers, assign the folio and incorporate a digital seal from the Tax Administration Service. Also have the obligation to send a copy of the CFDI validate by their customers to the Tax Authorities.

Benefits

Taxpayers using electronic invoice have seen their benefits in terms of safety and speed in the issuing of this, decreased to 85 percent in costs, optimization of internal controls, improvement in technological processes and care service customer, reducing errors in the process of generation, capture, storage and delivery and more control documentary, so have been gradually increasing their use, and decreasing or eliminating the printed receipts issued, decreased attention to time refund applications, eliminating the discretionary payment areas failing people involvement, reducing validation times and capture of invoices received, attested copy removal and as receiver, have more elements to identify false vouchers.

The legal basis of the above comes in the new invoicing rules regulated in Articles 29 and 29-A of the Fiscal Federal Code, the Resolution of the General Tax Rules for 2014 and its annexes corresponding to electronic invoices.

Other comments

Taxpayers must deliver or send their customers digital tax invoices immediately following the day on which the operation is performed and, if necessary, give them a printed representation of digital tax invoice when is requested.

Taxpayers receiving digital invoices (even when these appearing on printed representation) may verify its authenticity by consulting in the website of the Tax Administration Service:

- If the sequential number which protects the CFDI was allowed to issuer.

- The validity of the certificate for the digital seal at the time of issuance of digital tax invoice.

Taxpayers, who issued and receive CFDI, should store them on magnetic, optical or other technology, in electronic format XML as only this format represents the original sample of the 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 immovable 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 1,105% to 4.997% for real estate values ranging from \$94,072 Mxp to those in excess of \$20,887,467 Mxp, respectively. In several other states, this tax is computed applying a fixed rate that ranges from 2% to 4%.

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.

Import 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, but are not included in the price actually paid or payable; 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%. For 2011, this weighted average went up to approximately 3.6%.

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.

5.4.3 Mining Industry

Tax legislation - Specific issues applicable to mining entities

Income tax

Mining entities 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%.

Estimated tax installment payments must be made every month based on the prior year's taxable income.

Income tax deductions commonly related to mining entities

Deduction of exploration expenses over ten years

Mining entities are required to amortize exploration and other outlays for projects during the pre-operating period at the maximum annual rate of 10% on a straight-line basis once the corresponding project or mineral deposit is in the operating stage. Since the income tax legislation does not define the term "pre-operating period," in order to determine when the pre-operating period is over and the project is in the commercial production stage will depend on the conditions for commercial production that management has established, among other factors.

Non-deductibility of certain payments to non-residents

Payments of interest, royalties or technical assistance are non-deductible when paid to a non-resident entity that controls the taxpayer or is controlled by the taxpayer and any one of the following are met:

- (i) the payment is not taxable income to the non-resident;
- (ii) the payment is deemed to be "non-existent" for tax purposes in the country of residence of the non-resident; or
- (iii) the non-resident receiving the payment is deemed to be transparent.

If the non-resident receiving the payment is deemed to be transparent, there could still be a Mexican tax deduction for the portion that the shareholders or members of the transparent entity are subject to an income tax and the payment made by the Mexican entity represents arm's length values.

Mining operations in Mexico are commonly financed with debt/loans from non-resident related or unrelated parties; therefore, special consideration should be taken to comply with thin capitalization rules and transfer pricing rules. In addition, certain financing arrangements may be deemed to be back-to-back loans under which the corresponding interest is deemed to be a non-deductible dividend.

Additionally, it is also a common practice to obtain financing or funds through net smelter return agreements (NSR). Due to the nature of these NSR, it is important to review the specific terms and conditions established since these types of agreements usually include conditions or terms that could be understood to be the sale of goods, royalties or financing and may trigger Mexican withholding tax or have other tax implications.

Limitation of deductibility of certain employee remuneration

Remuneration paid to employees that is exempt income in the hands of the employee is only 47% deductible for income tax purposes. However, this amount may be 53% deductible if the exempt income to the employee is not less than what is was in the prior year. Remuneration that is exempt

income to employees includes social benefits, savings funds, overtime, bonuses and severance pay.

Immediate deduction of fixed assets

Some Mexican taxpayers can take the option to apply an immediate deduction for the acquisition cost of fixed assets.

However, this option is only applicable for taxpayers with income of up to 100 million pesos and this option is not applicable for assets such as: furniture and equipment, automobiles, assets that are not individually identify and airplanes.

All other taxpayers and for all other assets only a straight-line depreciation is available.

Value added tax

Starting 2017, new rules were issued in connection with the right to credit the Value Added Tax (VAT) for companies in exploration stage.

For these purposes, a definition of preoperative period was added in the Law as follows: when dealing with extractive industries it includes the exploration for the finding and quantification of new mineral sites subject to be exploited.

It is also established that the preoperative period should have a maximum duration of one year counted as of the date in which the first request of refund of value added tax is filed unless the taxpayer supports that such period would have a longer period in accordance with the investment project.

Under the new rules, the mining entities would be entitled to credit the VAT paid and request the refund of the same but if after the preoperative period ends they have not started productive activities which are taxable for VAT purposes the VAT paid and credited previously shall be refunded to the tax authorities, updated by inflation.

The above will be applicable except in the cases in which the project was not started for reasons not imputable to the entity, or when the project is not viable or when due to economic circumstances, not attributable to the taxpayer, the extraction of the mineral resources is not viable.

Federal fees

1) Special mining fee

Owners of mining concessions are required to pay an annual special mining fee of 7.5% of net income derived from sales from mineral extraction activities. The determination of net income for this fee does not include interest income or taxable inflationary income. In determining the net amount, all deductions under the Income Tax Act are permitted except deductions for interest, depreciation, the deductible inflationary

component, as well as any taxes paid that correspond to such mining activity. Furthermore, prospecting and exploration expenses are deductible in the determination of the net income for purposes of the special mining fee. Owners of mining concessions are permitted to credit against this new special fee, the amount of any regular per hectare federal fees paid on mining concessions.

2) Extraordinary mining fee

In addition to the annual special mining fee, owners of mining concessions are subject to an annual extraordinary mining fee of 0.5% on total gross income derived from sales of gold, silver and platinum, regardless of the number of mining concessions owned. Owners of mining concessions subject to this fee are required to maintain accounting records in order to identify separately the gross income derived from sales of gold, silver and platinum.

3) Additional per hectare fee when exploration or extractive activities are not carried out

For owners of mining concessions that do not carry out any exploration or extractive activities for two consecutive years within the first eleven years of having title to the concession, a separate 50% fee on the already existing per hectare fee on mining concessions must be required to be paid biannually. If no exploration or exploitation activities are carried out for two consecutive years after having title to the concession for more than eleven years, this separate fee is increased to 100% of the regular per hectare fee.

5.4.4 Import 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 but are not included in the price actually paid or payable, 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. The tariff rate applied to each good is different but the average rates can vary between 0% and 5%.

Goods imported into Mexican territory during 2010 were subject to a weighted average tariff rate of nearly 2%. For 2011, this weighted average went up to approximately 3.6%.

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.

5.4.5 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.

5.4.6 Energy Incentives

CUFIN Account for Investment in Renewable Energy (E-CUFIN)

In the Tax Reform of 2016, the MITL was amended and certain tax provisions were included therein, including article 77-A establishing a CUFIN account for investments made in renewable energy (E-CUFIN). In this sense, a tax incentive is established for taxpayers who are exclusively engaged in renewable energy activities in Mexico in order to create an E-CUFIN that will be calculated taking an annual straight line depreciation of 5% of the investments made in machinery and equipment that was 100% depreciated as being for renewable energy projects.

The main objective of the E-CUFIN is to distribute profits arising from such account without paying any further corporate Income Tax in Mexico. Such dividends arising from the E-CUFIN shall be registered on an accumulative basis by the taxpayers who make the distributions. Taking into account the mechanics to determine the E-CUFIN it is recognized that the dividends arising from such account were distributed before the payment of its corporate Income Tax and therefore, such dividends shall be reduced from the Previously Taxed Profits generated subsequently in order to not duplicate the effect in the regular CUFIN account of the taxpayer.

The term exclusive activity in order to apply the E-CUFIN refers to taxpayers engaged in the generation of energy arising from renewable sources or cogeneration systems of efficient electricity and which total income of the taxpayer is represented of at least 90% of such activities, without including income earned from the transfer of fixed assets or land that were used in such activity.

It is important to mention that taxpayers who have elected to calculate the E-CUFIN, may apply it until such taxpayer generates positive balances of the CUFIN in terms of Article 77 of the MITL. In this sense, from the year in which a positive balance is generated in the CUFIN, taxpayers may not be able to distribute the remaining balance of the E-CUFIN.

Lastly, dividend distributions made from the E-CUFIN shall still be subject to the additional withholding tax rate of 10% if distributed to a Mexican individual or foreign residents with no presence in Mexico. Benefits of the Double Tax Treaties that Mexico has in force may be applied in order to reduce such withholding in Mexico.

FIBRA E

In September of 2015, the Mexican President, Enrique Peña Nieto, announced certain measures to develop the Mexican economy with a particular focus on the energy industry. Under this announcement, the creation of the real estate trust for the Energy Sector and Infrastructure (FIBRA E), which intends to attract capital into the energy sector providing funding and resources for future investments on energy industry projects was created.

In general terms, FIBRA E is a Mexican trust created under the Mexican legislation in which the fiduciary shall also be a Mexican financing institution. Such FIBRA E issues publicly traded certificates of energy and infrastructure investment (CBFEs), which shall be registered in the National Securities Registry and listed in the Mexican Stock Exchange.

The following main benefits are granted to Investors that participate in a FIBRA E:

- In the case of the alienation of CBFEs, legal entities shall consider as taxable the gain obtained in the transaction by reducing to the income obtained in such alienation the average cost of the CBFEs being alienated. In the case of individuals, the sale of CBFEs shall be exempted of taxation if they are transferred through the Mexican Stock Exchange Market or recognized markets.

- Investors that are foreign residents shall consider as definitive tax payment the Income Tax withheld by the FIBRA E by applying the tax rate of 30% over the distributed amount of the taxable profit determined by the FIBRA E. In this sense, the second level of taxation regarding the additional withholding tax rate of 10% would be eliminated.
- Gains obtained from the transfer of CBFEs shall be exempted of taxation if they are sold through the Mexican Stock Exchange market or recognized markets.
- Distributions made by the FIBRA E to foreign exempt pension funds or the gain obtained in the transfer of CBFEs by such pension funds shall not be subject to tax in Mexico, complying with requirements.

5.4.7 Others

Special Tax on Production and Services

In accordance with the Excise Tax Law are required to pay the tax imposed, entities or individuals performing the following acts or activities:

- I. The sale in national territory or, where appropriate, the importation of goods set out in this Law.
- II. The provision of the services referred to in this Law.

Applicable rates

To the value of acts or activities which are indicated below, the following taxes and charges will apply:

- I. In the sale or, if appropriate, in the importation of the following goods:

a. Alcoholic beverages and beer:	
1. With an alcohol content of up to 14° GL	26.5%
2. With an alcohol content of more than 14° to 20° GL	30%
3. With an alcohol content of more than 20° GL	53%
b. Alcohol, denatured alcohol and uncrystallizable honey	50%
c. Tobacco carved:	
1. Cigars	160%
2. Cigars and tobaccos others	160%
3. Cigars and other processed tobacco entirely by hand	30.4%

Note: In addition to the rates established in this numeral a fee of \$ 0.35 per cigarette sold or imported will be paid. For the purposes of this Law is considered that the weight of a cigarette is equivalent to 0.75 grams of snuff, including the weight of other substances with which the snuff is mixed.

- a) Gasoline: the resulting rate for the month in question in terms of the Excise Tax Law.
- b) Diesel: the resulting rate for the month in question in terms of the Excise Tax Law.
- c) Energy drinks as well as concentrates syrups and powders for making energy drinks..... 25%
- d) Flavored drinks, concentrates, powders, syrups, essences or flavoring extracts, which allow to obtain diluted flavored drinks, and syrups and concentrates for preparing flavored beverages sold in open containers using automated, mechanical or electrical apparatus, provided that the goods referred to in this subsection contain any added sugar.

The applicable fee will be \$ 1.00 per liter. Case of concentrates, powders, syrups, essences or flavor extracts, the tax is calculated taking into account the number of liters of flavored beverages in accordance with the manufacturer's specifications, can be obtained.

- e) Fossil fuels, with a fee ranging from 5.91 cents per liter to 39.80 pesos per ton, depending on the type of fuel.
- f) Pesticides. The rate shall apply under the category of acute toxicity hazard.
- g) No basic foods listed below, with an energy density of 275 kcal or more per 100 grams

8%

1. Snacks
2. Confectionery
3. Chocolate and other cocoa products
4. Flans and puddings

5. Candies fruit and vegetables
6. Peanut butter and hazelnuts
7. Candies of milk
8. Foods prepared from cereals
9. Ice cream, snow and ice pops

It should be pointed out that the excise taxes detailed in paragraphs g), h), i) and j) were approved in the Tax Reform for 2014 and are applicable from 1 January 2014.

II. In the provision of the following services:

- a) Commission, mediation, agency, representation, brokerage, consignment and distribution, due to the sale of goods set out in the preceding paragraphs a), b), c), f), i) and j).
- b) Gambling and betting 30%
- c) Be provided in the country through one or more public telecommunications networks. 3%

Gasoline and diesel

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

Importation of goods

In accordance with the law, the tax is triggered when the customs clearance document (pedimento) is filled with Customs Authorities, when the temporary import became definitive or when the goods are illegally introduced in Mexico and this is detected by the tax authorities.

Temporary import arrangements are also applicable to Excise Taxes. An Excise Tax treatment similar to the above seen for VAT is applicable to the temporary imports of goods carried out by Companies part of the IMMEX Program are entitled for the temporary import of goods, imported goods to be warehoused in automotive in-bond warehouses and goods imported under the strategic in-bonded warehousing system

Payment of the tax

This tax is calculated on a monthly basis and payable no later than the 17th of the month following that to which the payment, these will be definitive. When the declaration of monthly payment results in a credit balance, the taxpayer may only compensate against the tax charge that corresponds in the following monthly payments until exhausted.

Taxable base

To calculate the tax in the case of disposals, the value considered is the compensation. 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.

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.

Obligations

The law establishes, amongst others, the following obligations:

- Carry the accounting and separation of rates for operations.
- Issue invoices: without the explicitly transfer and separately of IEPS unless that the sale to another taxpayer this request.
- Submission of tax returns
- Reports of operations:
 - If IEPS is transfer explicitly and separately, quarterly reporting of these transactions.
 - Quarterly information of 50 principal suppliers / customers.

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 \$ 402,740.39 Mxp respectively. For values greater than \$617,835.36 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\$208,555.47 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 \$ 208,555.47 and up to \$ 264,170.27, 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 fulfills 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



CHAPTER 6. Logistical services and customs

6.1 Importers' registry

Entities and individuals importing merchandise from abroad and wishing to trade with them in Mexico must enroll 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.

The import's registry is obtained through the tax authorities' website, having their electronic signature available, in full compliance of tax obligations and the information regarding the customs brokers selected to carry out the foreign trade operations of the company.

6.2 Specific Sectors Registry

In order to import certain goods considered to involve a potential risk to public health or national security (*Goods such as: chemicals, radioactive and nuclear products, explosives, guns and weapons, textiles, steel and steel products, among others.*) it is necessary to be registered in the Specific Sector Importer's Registry.

Like the Importer's Registry, companies must have duly obtained a Taxpayer ID from the Federal Taxpayers Registry, have the Advanced Electronic Signature (FIEL), be in compliance with all the general tax obligations and register at least one Customs Broker.**6.3 Administrative facilities in foreign trade operations**

In the last few years, Customs authorities have authorized several administrative facilities with the purpose of increasing the competitiveness of Companies engaged in foreign trade operations.

In these sense, some of such administrative facilities are the following:

- In the past, individuals and companies that carried out import and export operations in Mexico had to engage a customs broker to assist them in these activities, nevertheless, currently, companies and individuals have the opportunity to engage a customs broker and/or to perform its direct import and export operations through a legal representative related to customs matters who shall be an employee of the individual or corporation.

- Usage of the Customs Clearance Operation Document (“DODA”, for its acronym in Spanish), a document prepared before customs clearance that includes specific information about previously validated and paid pedimentos, which has the purpose of automate and expedite customs inspection and the clearance process.
- Possibility of request to tax authorities a database that contains all the import and export operations carried out by the Company (commonly known as “Datastage”).
- Implementation of the Single Electronic Window (“VUCEM”, for its acronym in Spanish), which allows Companies to perform procedures or submit applications before Customs authorities online, making time and costs more efficient.

6.4 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 kinds of merchandise), restrictive standards and labeling 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.

The non-tariff regulations and restrictions are determined considering the tariff classification of the goods to be imported into Mexico.

6.5 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 fourteen free trade agreements which provide preferential entry to more than 40 foreign markets; it is important to point out that Central America Free Trade Agreement abrogated several free trade agreements; this is the reason why there are less free trade agreements.

Additionally, Mexico has signed several complementation and partial agreements within the Latin American markets. Through these commercial treaties, Mexican exporters have access to over a billion consumers, thus resulting in an enormous advantage to the exporting industry.

Some of the most important agreements are the following:

1. North American Free Trade Agreement - NAFTA (Canada and the United States of America)
2. Mexico - European Union Free Trade Agreement
3. Mexico's Free Trade Agreement with the European Free Trade Association (Norway, Iceland, Liechtenstein, and Switzerland).
4. Mexico-Japan Agreement for the Strengthening of the Economic Partnership
5. Mexico and Central America Free Trade Agreement (Costa Rica, El Salvador, Guatemala, Honduras y Nicaragua)
6. Mexico and Chile Free Trade Agreement
7. Mexico and Colombia Free Trade Agreement
8. Mexico and Bolivia Free Trade Agreement
Mexico and Uruguay Free Trade Agreement
Economic agreement between Brazil and Mexico
9. Mexico and Israel Free Trade Agreement
10. Mexico and Panama Free Trade Agreement
11. Mexico and Peru Free Trade Agreement
12. Pacific Alliance (Trade bloc between Chile, Colombia, Mexico and Peru)

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.

6.5.1 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. 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 NAFTA 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 labor conditions.

However, there is an uncertainty regarding the commercial relationship between Mexico and the United States of America and the status of NAFTA, as both governments have publicly announced their intention to review and, if needed, renegotiate the Agreement.

6.5.2 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.

6.5.3 Mexico and Central America Free Trade Agreement

The Mexico and Central America Free Trade Agreement was signed in November 2011 between Guatemala, Costa Rica, Honduras, El Salvador, Nicaragua and Mexico. However the entry in force was gradually done by each of the countries during 2012 and 2013.

This agreement abrogated several free trade agreements that Mexico had with some of these countries separately.

This agreement will allow to efficient even more the regional trade and build a common vision between the countries to face the challenges in global economy. Also, it will increase and facilitate trade as 98% of the specific rules of origin will be homologated and these countries will have one applicable legislation.

6.6 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 benefits 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

6.6.1 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.

It is important to point out that in 2013, due to the VAT Law Reform, companies must obtain the VAT certification in order to benefit from the tax credit against the VAT determined in the temporary imports cleared from 2015. (Please refer to *VAT Law*)

On the other hand, machinery and equipment imported under the IMMEX scheme will be subject to the corresponding import duties, but can remain in Mexico for as long as the program is approved.

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:

- 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, such as call centers, logistics, customer service, etc. It should be noted that an exhaustive list of activities that may be rendered by the aforementioned entities are determined 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 companies to subcontract manufacturing entities in Mexico that perform manufacturing activities on their behalf.

6.6.2 Sector Promotion Programs (PROSEC)

This program is a tariff reduction measure that allows foreign or domestic producers to request Tax authorities for a reduction or elimination of a tariff rate on the import of goods of specific sectors, regardless of whether the goods to be produced are for export or the domestic market.

In this sense, some of the sectors allowed are electronics, furniture, toys, photographic industry, agricultural machinery, automotive, aerospace, and textiles.

6.6.3 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 before the Ministry of Economy.

6.7 Integrated Scheme of Certification

Mexican corporations that carries out foreign trade operations may file for preferential status before Customs and Tax authorities. This authorization, which generally must be renewed on an annual basis, will benefit the holder's import and export operations with different administrative incentives; we can highlight the followings:

- 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.

There are three modalities of the Integrated Scheme of Certification:

- VAT and Excise Tax Certification
- Authorized Economic Operator
- Certified Comercial Partner (only applicable for customs brokers and transportation companies)

6.7.1 VAT and Excise Tax Certification

Since December 11, 2013, the VAT Law was modified and published for its entry in force on 2014. In regards to the IMMEX companies, there was a substantial modification which establishes that the VAT and excise tax exemption for temporary importations for elaboration, transformation or repair under IMMEX program, bonded warehouses for assembly and manufacture of vehicles, or elaboration, transformation or repair under a Free Trade Zone, will no longer be available unless the companies have a certification issued by the tax and customs authorities (commonly known as "VAT Certification").

This VAT certification it's a modality of the Integrated Scheme of Certification and grants the companies that they will obtain a tax credit equivalent to the 100% of the payable VAT and Excise duty for the temporary importation of goods.

For this purpose, the General Customs Rules establish the requirements and process for the certification for three different modalities A, AA and AAA. However, the general requirements are, among others:

- Operate under an IMMEX program, or to operate under the regimes of "Automotive bonded warehouse", "Elaboration, transformation or repair in a bonded warehouse", or "Strategic bonded warehouse".
- Have a positive tax compliance opinion, including partners, shareholders, legal representatives, director or board members.
- Have an inventor control system in accordance with the provisions set forth by the Tax Administration Service (SAT).
- Submit proof of all personnel registered in the Mexican Social Security Institute (IMSS).

The differences between the modalities are based on administrative and operational benefits additional to the VAT exemption, such as the timeframes for several procedures during the company's operations, the fiscal credit amount to ensure the amount of taxes to be paid and benefits regarding the customs clearance process.

The certification will be valid for one, two and three years depending on the modality obtained, and may be renewed by the companies within 30 days prior to its expiration.

6.7.2 Authorized Economic Operator

For Companies with foreign operations conducted in the two previous years. This was known as the New Integrated Scheme of Certificaction; it's based on the Authorized Economic Operator developed by the World Customs Organization.

The function of the Authorized Economic Operator involves the combined efforts of the Mexican Customs Authorities and the private sector through the implementation of minimum safety standards recognized internationally, increasing security, reliability and accuracy of their customs operations in order to seek different benefits for companies that wishes to participate.

The certification is granted for one year period, with the possibility to renew it every year. The resolution period of time is also 120 days and in case the authorities request a visit, the company should allow it.

6.8 Foreign trade zones

In July 2003, the Foreign Trade zones (FTZ) 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 Tax Authorities, which in Mexico also oversees customs activities. The BW is an 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 FTZ is, unlike imports into traditional bonded warehouses (bonded warehouses owned in Mexico by the financial system) where only warehousing, display, sale, labeling, packaging or sampling activities are permitted under the operating control of the bonded warehouse, at a FTZ private companies are authorized to manufacture and transform the raw materials entered in the FTZ into finished products.

Goods imported into Mexico and housed in a FTZ may remain for five years. Machinery, administrative equipment, furniture and general fixed assets may remain in the FTZ for as long as the FTZ is in place. It should also be noted that companies storing goods in a FTZ are not required to be authorized under an IMMEX program that entails complicated administrative controls on the part of the companies.

Due to the Tax Modifications on the VAT Law, in order to benefit from the VAT exemption when temporary importing into an FTZ, it is necessary to have the corresponding certification as explained previously (Please refer to section VAT and Excise Tax Certification)

6.8.1 Tax issues and import permits

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

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 deferral programs).
2. 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.
3. Product losses resulting from the production process, transformation or repairs will not cause any contributions or countervailing duties.
4. Not returned waste (scrap) is not subject to import tariffs or foreign trade taxes, as long as it is destroyed in conformity with administrative controls established by the tax authorities.





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

Labor relations are governed by the Federal Labor 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 and provides two types of labor relationships: individual and collective.

An individual labor 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.

An individual labor relationship is created automatically upon a person being hired to perform a task subject to the control of the employer. There are different types of individual employment:

- Indefinite time period.
 - Two categories of recruiting:
 - Trial period (equivalent to 30 days, the purpose of such period is to verify that the employee meets all the applicable requirements and has all the necessary knowledge to do the job; in the case of management positions, the trial period can be extended up to 180 days).
 - Initial Training (equivalent to 3 months, in this case an employee is obliged to provide his subordinate services under the supervision and control of the employer, in order to acquire the knowledge and skills required for the activity for it's going to be hired; in the case of management positions, the initial training period can be extended up to 180 days)

- Seasonal work (the duties are fixed and periodic but intermittent, since the rendering of the service is not required during the whole week, month or year.)
- Determined time period.
 - When the nature of the job to be performed requires it or when its objective is to temporarily substitute one worker for another.
- For one work.
 - When it is required to complete a certain task, and once completed, the employment ends.

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 labor union and the employer has executed a collective bargaining agreement with such union.

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 Labor Board.

Outsourcing regime

In November 30th 2012 a new obligation was amendment at the Federal Labor Law it was the incorporation of the form “employment under outsourcing conditions”, which is defined as the employment whereby the employer, known as “contractor”, performs works or renders services through the employees working under its charge, in favor of another individual or legal entity, who shall set forth the “contractor’s” tasks and oversee during the provision of the services, the execution of the works hired.

As a characteristic of this category, it is established that:

- a) It cannot cover the totality of the activities, either equal or similar in its entirety to the ones performed at the work place.

- b) It must be justified, given its specialized nature.
- c) It cannot cover tasks equal or similar to the ones performed by the rest of the employees working for the beneficiary of the services.

Any failure to comply with these conditions, for the purposes of the labor legislation, shall cause the beneficiary to be considered as the employer, including regarding the obligations related to social security.

Additionally, the beneficiary must ensure that the contractor has all the documents, as well as its own and sufficient resources in order for it to comply with all the obligations derived from the relation with its employees, and it shall verify that all safety/security, health and environmental provisions are met.

It is worth mentioning that the outsourcing regime is not allowed when the labor authority discover that the contractor's employees are intentionally transferred to other entity with the purpose of reducing labor rights.

The regulation of subcontracting regime in the labor law, has caused amendments in the social security and local tax laws regarding the joint and several liability between the contractor and the beneficiary of the services in relation to social security contributions and payroll taxes.

Tax regulations and considerations for outsourcing regime

The income tax deductibility of services regulated by subcontracting regime has as requirement that the contractor should obtain from the supplier a copy of the tax receipts for the payment of wages of the workers provided by the subcontracted service (CFDI), the pay slip signed by the employee assigned, tax return of the employees' withholdings and the payment of workers' contributions to the Mexican Social Security Institute.

The accreditation for value added tax transferred in case of subcontracting has as requirement that the contractor should obtain from the supplier copy of the value added tax return, pay slip of the tax and the information submitted to the tax authorities.

Recently was published in the website of the Tax Administration Service the precedent issued by the Financial Intelligence Unit (UIF) that considers the labor subcontracting as a vulnerable activity and therefore, this regime is subject to the fulfillment of the obligations established in the Federal Law on the Prevention and Identification of Operations from Illicit Sources, when carrying out the administration and management of resources of the beneficiary of the service.

General employer obligations

According with the Mexican Labour Law, the employers should comply, among others, with certain obligations like:

- To have internal rules of work
- Set the different mixed commissions established in the Law
- Pay profit sharing

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.

An individual is considered a Mexican tax resident when establishes his/her place of abode in the country. If such person has his/her place of abode in another country as well, he/she would be considered a Mexican tax resident if he/she has his/her centre of vital interest in Mexico.

For these purposes, the centre of vital interest is in Mexico in either of the following cases, among others:

- a) 50% of the total revenue in the calendar year is derived from Mexican sources.
- b) The main place of professional activity is situated in Mexico.

In relation to "a" above, the total income should be analyzed (salary, interest, dividends, rental income, sale of property, etc). For salary income, it is considered that the source is in Mexico when the service is rendered in this country.

In the absence of proof of the contrary, individuals of Mexican nationality are presumed to be residents of 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 of termination of tax residence is made and for the three following years, unless that country has entered into a comprehensive information exchange agreement with Mexico.

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

- Medical and dental fees, psychological and nutritional professional services and hospital expenses paid in Mexico for the taxpayer or the economic dependents (spouse, children and parents provided that their annual income is less than the annual Measure and Update Unit, UMA by its acronym in Spanish), after deducting amounts reimbursed by insurance companies.(1)
- Medical, dental, nursing, analysis, clinical studies or prostheses, hospital expenses, purchase or rental of equipment for the establishment or rehabilitation of the patient, derived from an incapacity or disability equal to or greater than 50% of the person's normal capacity would also be deductible and not subject to the limit mentioned in note (1); however individual should count with a Certificate or proof issued by institutions of the National Public Health System.
- Funeral expenses made by the taxpayer or by the economic dependents mentioned above, limited to the annual UMA paid in Mexico, after deducting amounts reimbursed by third parties. (1)
- For 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.
- Interests paid (adjusted by inflation) for main residence during the fiscal year derived from mortgage credits that do not exceed 750 thousand investment units (UDIS). (1)
- Premiums paid for medical insurance for the taxpayer or the economic dependents. (1)
- School bus expenses for children provided that such transportation is obligatory according to the legal provisions of the school's area.(1)
- School fees paid to private institutions. The deductible amount would depend on the level of education given to the student (from kindergarten to preparatory school and technical school).
- Supplementary and voluntary contributions to the national retirement savings system or to retirement personal accounts (under certain limitations) capped to five annual UMA's or the 10 percent of the total income of the individual.
- 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%. (1)

- Contributions to authorized saving funds and premiums paid for retirement, up to the maximum amount provided by law (MXP152,000).
- Itemized deductions (with certain adjustments) relating to rental income, independent services and business activities.
 - (1) The total deduction on the aggregate of such items should not exceed the lesser amount between five annual UMA's or the 15 percent of the total income of the individual.

On the other hand, to be considered as deductible, medical, school bus and school fees expenses must be paid over the financial system (check, wire transfer, debit or credit card).

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

Resident 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. 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.

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 35 percent for tax year 2017. This tax rate is reached with a monthly income of MXP250,000.01 and with an annual income of MXP3,000,000.01. Estimated tax payments and withholdings are credited to offset the final annual tax liability.

Persons or entities that pay salary income to Mexican tax resident individuals are obliged to withhold and remit Mexican income taxes on a monthly basis. These income tax withholdings are considered to be a provisional tax payment to be credited toward the annual income tax liability.

On the other hand, Mexican tax resident individuals who receive salary income from foreign employers or from persons or entities who are not obliged to withhold income taxes must pay Mexican income taxes by filing a personal tax return on a monthly basis.

Monthly tax payments are due on or before the 17th day of the month following the month in which the salary was received, using the monthly graduated rate scales. In case the individual is obligated to file monthly personal returns, additional days are granted depending on the individual's taxpayer ID number.

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. For salary income, it is considered that the source is in Mexico when the service is rendered in this country.

Non-residents are exempt on the first MXP125,900 Mexican source income 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 employees 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 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, early retirement, and old age pension
- Nursery/day-care centers 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 2017 is \$80.04 Mexican pesos and the value in force for 2017 for the Unit of Measurement and Inflation Adjustments (UMA) is \$75.49 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 UMA.

Occupational risks

Employers are liable for 100 percent of contributions or taxes payable for occupational risk.

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 labor force. This rate variation can't be higher or lower than a percent 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 orthopedic 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 350 times the UMA.
- 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 UMA.
- 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 UMA.
- 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 UMA 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 UMA. 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 and July 2015, a new obligation was added to the Social Security Law and National Housing Fund for Employees Institute, respectively, 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 and INFONAVIT quarterly through the authorized software by the Institutes.

The amendment to the Law of the Institute of the National Housing Fund Workers (INFONAVIT), article stands out the following:

- Regarding the amendment made to the Federal Labor Law was recognized the outsourcing as an accessible way to increase the productivity of a company.

- The recognition of this regime had derived in some initiatives tended to protect the rights of the employees of outsourcing companies, so, among others; the INFONAVIT issued an initiative as a point of agreement to recognize the outsourcing figure in its own law and grant housing rights to the employees of outsourcing companies.

The above by recognizing the joint and several liability allowing and guaranteeing to the employees the labor fulfillment of their employer and or obliged subjects, among others, consisting on the information presented to the INFONAVIT of the beneficiary of the services and the information of the employees, establishing the same legal figure mentioned in the article 15-A of the Social Security Law.

Given that there are outsourcing companies that do not have the sufficient means to fulfill their labor obligations such as the payment of contributions to the housing fund, considering necessary to impose the joint and several liability to the beneficiary from the provision of services.

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:

As we mentioned above the contribution ceiling will be 25 times the UMA.

Regulation in the field of safety and health at work

From February of 2015 entered into force the Federal Regulations on Safety and Health at Work, which has as its purpose to regulate and establish provisions in this area that must be taken in the workplace, in order to have the best conditions to prevent risks, guaranteeing the right of workers to carry out their activities in healthy and safe environments.

In the regulation are included within the obligations of the employers to count with a Diagnosis of Health and Safety at Work, as well as integrate a program of safety and health at work with base on this diagnosis.

In addition to the above within the main additions to the regulation are the ergonomic and psychosocial factors as diseases of work. Considering as ergonomic risk factors that can lead to those on physical effort, repetitive movements or strenuous postures in the work developed and as psychosocial risk factors those that can cause anxiety disorders and severe stress, derived from the nature of the job, type of working day, among others.

In accordance with the foregoing, are created several obligations for employers, of which stand the obligation to count with an analysis of the ergonomic risk factors of jobs exposed and identify and analyze the jobs with psychosocial risk by the nature of their functions or the type of working shift.

It is important to mention that the new regulation adds that notices of accidents at work may be carried out within the first 72 hours through the public institution for social security to which the worker is affiliated and not necessarily to the Department of Labor and Social Welfare.

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 3% of the total payroll of the company in the relevant State.

In the following States there is an obligation for employers to audit the payroll tax by a third expert: Mexico City, Mexico State, Veracruz, Guerrero, San Luis Potosí, Oaxaca and Quintana Roo.

Also, in the States of Guerrero, Jalisco, México, Nuevo León, among others is established the obligation to withhold the payroll tax to the suppliers of outsourcing services that makes payments of wages for work performed in that State.

Also, in some States, exists the exemption for the payroll tax for a determined period, for example the State of San Luis Potosí, Mexico, Nuevo Leon, among others gives an exemption for the new companies that generate new jobs.

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, early retirement 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.

The contributions for those social security branches are determined with the following quotes over the salary for social security purposes:

Insurance Branch	Employer Quote %	Employee Quote %
Retirement	2	
Early retirement	3.150	1.125

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 SIEFRES (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 SIEFRES 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 SIEFRES 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 SIEFRES:

- 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 more or less 10 AFORES in Mexico. The main objective of an AFOR 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.

Disability 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.

The financial regime of this insurance branch is integrated with the following quotes over the salary for social security purposes, as follows:

Insurance Branch	Employer Quote %	Employee Quote %
Disability and Life	1.750	0.625

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.

In this case, the financial regime is integrated with the following quotes over the salary for social security purposes:

Insurance Branch	Employer Quote %	Employee Quote %
Benefits in kind		
Fix Quota	20.40	
Additional Quota	1.10	0.40
Benefits in cash	0.700	0.25
Benefits in kind for pensioned	1.050	0.375

Nursery/Day-care centers and welfare benefits

This insurance provides the insured and his/her beneficiaries with nursery/day-care centers 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.

The financial regime of this insurance branch is integrated with the following quote over the salary for social security purposes, as follows:

Insurance Branch	Employer Quote %	Employee Quote %
Welfare benefits	1	

7.6 Expatriates

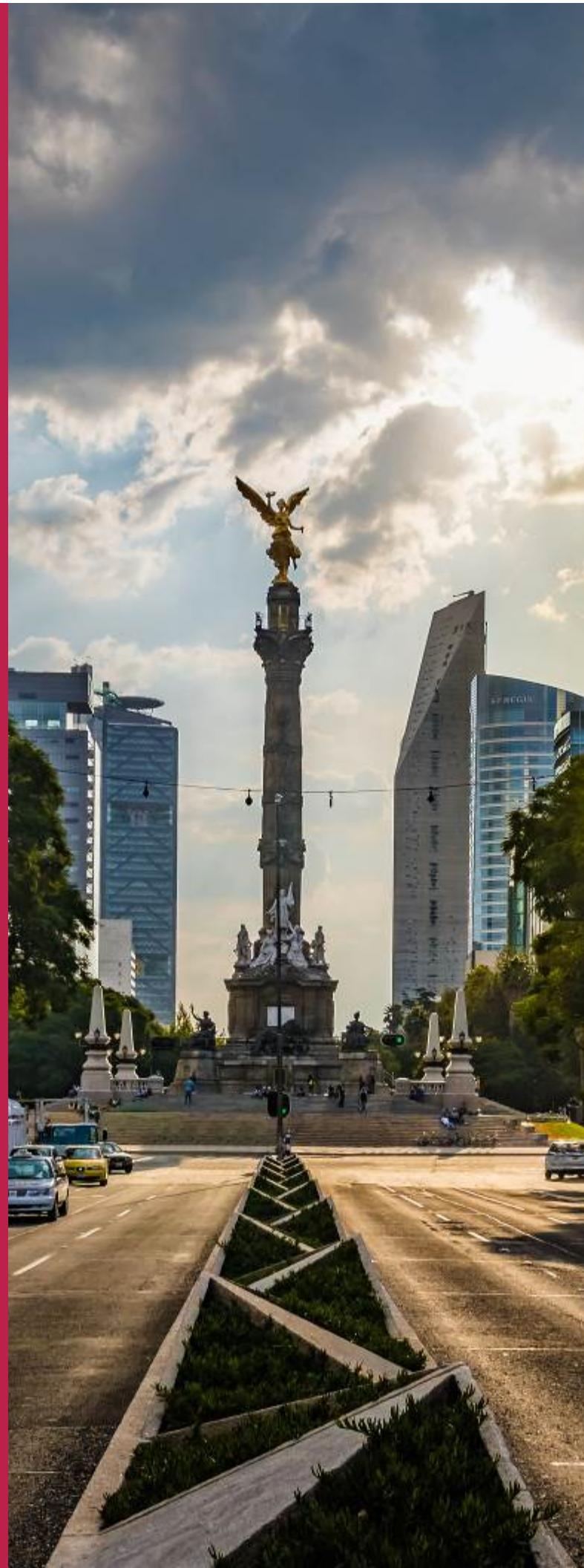
Short-term assignees could be considered non-residents by not establishing a place of abode in Mexico and could be totally exempt of Mexican income taxes when certain conditions are met or be taxed on lower tax rates on their Mexican-sourced income only. As non-residents, short-term individual will not 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, 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.

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



8. Anti-Money Laundering Law



On July 17th 2013, the Federal Law for Prevention and Identification of Transactions with Means of Illicit Origin (henceforth Anti-Money Laundering Law or LFPIORPI for its Spanish acronym) came into force in Mexico, with the purpose of protecting the financial system and national economy, by establishing certain rules and procedures to prevent and detect transactions or activities involving illegal economic means.

The LFPIORPI was complemented by its specific Regulations that came into effect on September 1st 2013 and also by the General Criteria published on August 23 2013 and its corresponding amendments published during 2014.

The responsibility for enforcing and monitoring the compliance with the LFPIORPI rests with the Ministry of Finance and Public Credit and the Specialized Unit of Financial Analysis ("UIF" for its acronym in Spanish).

In addition, the Mexican Criminal Code considers money laundering as a criminal offence and defines it as the "acquisition, transfer, administration, keep, possession, conversion, withdraw from, or by any other reason investment, transference, transport within the national territory, from it to foreign countries or inversely, resources, rights or goods of any nature, with knowledge that it comes or is a result from an illicit activity".

The Anti-Money Laundering Law establishes a group of vulnerable activities that may compromise its purpose depending on the nature and amount of the corresponding operation, and certain group of prohibit activities that cannot be paid in cash (*coins, bills and/or precious metals*). Among the vulnerable activities are the following:

- Offer and/or grant of loans and credits by entities different from Financial Institutions.
- Provide construction services or development of real estate or mediation activities, when a sale of a real estate is also involved.
- Trading of all types of vehicles, either new or used.
- Acceptance of donations by Associations or Civil Partnerships.
- Lease of real estate.

The main obligations imposed upon individuals or entities that perform vulnerable activities are as follows:

- Register before the tax authorities (the process is carried out through an electronic webpage and an updated electronic signature of the individual or entity is required).

- Appoint a legal representative before the authorities (only applicable for legal entities). Once the legal representative has been appointed, he/she has the obligation to enter into the system and accept the designation. Otherwise, the Board of Directors or the Sole Administrator of the entity will be considered as its legal representatives for purposes of this Law.
- Identify their clients or users and request information.
- File a monthly report before the tax authorities regarding the Vulnerable Activities perform in a given period with their clients.
- Prepare a File for each of its clients including certain information and documentation. This File must be available for the authorities upon request.
- Draft an internal Identification Policy to ensure the compliance to the Law, the existence of updated information of the clients or users, among other applicable matters. This Policy must be completed within the following 90 days after the registration of the individual or entity before the tax authorities.

Sanctions

The main consequences of an infringement of the LFPIORPI or its Regulation are administrative penalties consistent in fines. It is worth mentioning that the fines imposed under the terms of the LFPIORPI will be treated as a tax liability subject to the administrative process of execution established in the applicable tax laws.

For the commission of offences, a fine scaled on the type of the offence: (i) for the commission of minor offences may be imposed a fine of up to 2,000 times the minimum wage (\$146,080.00 MXN approximately); (ii) for the commission of moderate offences may be imposed a fine of up to 10,000 times the minimum wage (\$730,400.00 MXN approximately); and (iii) for the commission of serious offences may be imposed a fine of up to 65,000 times the minimum wage (\$4'747,600.00 MXN Approximately) or from the 10% to the 100% of the value of the transaction, when it is quantifiable in monetary terms, whichever the greatest.

In addition, criminal penalties should be imposed to those who commit a money laundering offence typified in art. 400 Bis of the Criminal Code

mentioned above. In these cases, the offenders shall be punished with a sentence of imprisonment of five to fifteen years and a fine from 1,000 to 5,000 times the minimum wage (\$73,040.00 to \$365,200.00 MXN).

Furthermore, the penalties may be increased from one third to one half when the person that commits a money laundering offence is also a member of the Board of Directors, manager, director, employee, legal representative or service provider of any entity subject to the regime of prevention of operations with resources of illicit precedence, or commits such offences within two years after leaving said charge or position.





9. Legal Framework for Data Protection in Possession of Private Parties



Mexico's Federal Law on the Protection of Personal Data Possessed by Private Persons (henceforth LFPDPPP) was published in the official gazette on July 5th, 2010. The Law is "of public order," which means that contract provisions that conflict with it are unenforceable.

The LFPDPPP along with its Regulations provides a series of obligations for individuals and legal entities that handle personal data of any individuals for different licit purposes.

The main objectives of the LFPDPPP are: (i) protect the personal data held by companies and/or individuals, (ii) regulate the use of data only for the purpose(s) that it was delivered for; (iii) impose a control over who is using it and what are they using it for, (iv) enable the Data Owner (individuals) of the personal data to be informed of the treatment of such data. These objectives aim to guarantee the privacy and the right of informative auto determination of the individuals.

The National Institute for Transparency, Information Access and Personal Data Protection (INAI for its Spanish acronym) is the Mexican Authority in charge of the enforceability of the Law.

Main concepts stated in law

- **Personal Data:** Any information regarding an identified or identifiable individual. Personal Data may be classified in: Personal, Sensitive and Financial data.
- **Privacy Notice:** Document generated in physical or electronic manner by the person responsible of the personal data, which is elaborated with the purpose to inform holders the information that is being collected from them and the purpose of such collection.
- **Data Controller:** Individual or entity which alone or with others, gives treatment to personal data on behalf of the one responsible.
- **Data Processor:** The individual or legal entity that, alone or jointly with others, processes personal data on behalf of the data controller.
- **Third Party:** Mexican or foreign individual or legal entity other than the data owner or data controller.

Scope of the LFPDPPP

The Law regulates the processing of Personal Data. The definition of the term "processing" includes the collection, use, disclosure, storage, access, management, transfer and disposal of Personal Data.

In addition, the LFPDPPP incorporates the principles of data protection recognized in the document entitled "*International Standards on Data Protection and Privacy*" namely the principle of legitimacy, consent, quality, aim, proportionality, accountability and information. In general, these principles ensure that the data will be treated for the purposes intended, with full knowledge of the Data Owners.

The Law applies to Personal Data that are processed, transferred, or disposed by private persons or entities. "Personal Data" includes any information pertaining to an identified or identifiable individual.

The Mexican companies that in virtue of the performance of their activities, gather personal data from their clients, suppliers and employees, should comply with the provisions stated on the LFPDPPP.

Obligations of the data controller or person in charge

Among the principal obligations of the Data Controllers are the following: i) provide Privacy Notices to Data Owners in order to obtain their informed and previous consent; ii) inform to each Data Owner about the data and information collected from them and the purposes of their use by Data Controllers; iii) designate a person, or a personal data department (data manager), to process the Data Owner's applications regarding the exercise of his/her access, rectification, cancellation and opposition rights (ARCO for its acronym in Spanish), iv) inform the Data Owner, if the case, of the data transfer to third parties, nationals or foreign.

From June 21st, 2013 certain provisions of the Regulations of the Law came into force regarding the obligations of the Data Controllers to establish and maintain administrative and physical safety measures, and when applicable technical safety measures for the protection of personal data, regardless of the treatment system.

In addition, in order to establish and maintain security of personal data, Data Controllers should consider among others, the following:

- Develop and inventory of personal data;
- Determine the roles and responsibilities of person processing personal data.
- Conduct reviews or audits
- Make a record of the mass storage of personal data.

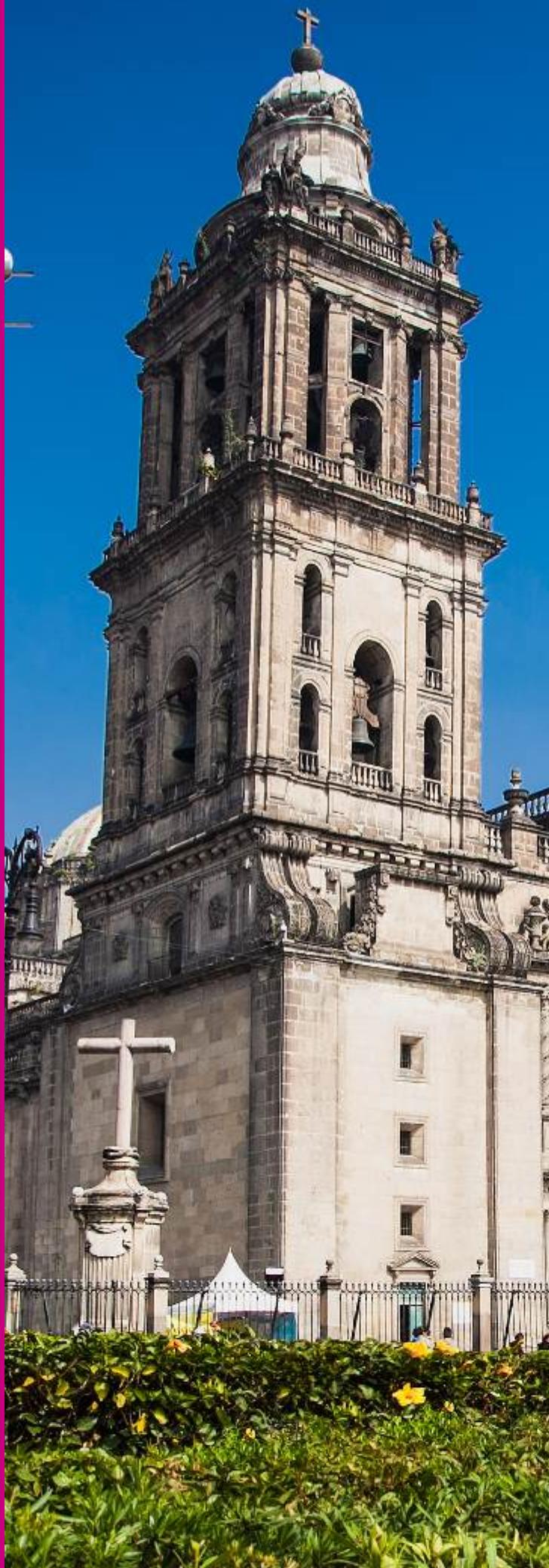
Sanctions

The entities or individuals that do not comply with the provisions stated in the Law, may be subjected to a fine which might be up to MX\$40,000,000.00 and prison sanctions up to five years of prison.





10. Financial Society of Multiple Objects



A Financial Society of Multiple Object (herein SOFOM) is a S.A. that includes within its by-laws a particularly corporate purpose, which shall consist in providing on a regular and professional basis all kind of services regarding: i) financial leasing, ii) credit lending and/or iii) financial factoring.

The aforementioned corporate purpose must be included in the by-Laws from the incorporation of the company or, on a later moment, through an amendment authorized by the Extraordinary Shareholders' Meeting of the company.

The SOFOM can be regarded as a "Regulated" or "Non-Regulated" entity, but even the Non-Regulated ones must comply with several regulatory obligations in addition to the compliance of an ordinary Mexican company; some of these additional obligations of the SOFOM are:

- Notice of incorporation before the National Commission for the Defense of Financial Institutions' Users (CONDUSEF for its acronym in Spanish).
- Annual payment by concept of inspection and surveillance of the National Banking and Securities Commission (CNBV for its acronym in Spanish), for an approximated amount of \$30,000.00 Mexican pesos.
- Record before the Financial Services Providers' Register (SIPRES for its acronym in Spanish).
- Record before some of the CONDUSEF's registers for recording the standard-form agreements, commissions, among others, before it starts operations.
- Adopt several internal measures in order to prevent money laundering and illicit financial operations.

It is important to point out that at the end of last year the Mexican Congress approved several amendments to different laws that regulate SOFOM, and imposed certain requirements for their incorporation and operation. Those reforms were published in the official gazette on January 10th, 2014.

Among the most relevant changes, in order to incorporate or convert an existing entity into a SOFOM it will be mandatory to have a positive opinion from the CONDUSEF and, only for Non-Regulated SOFOM, it will also be required to obtain a positive ruling from the CNBV; these two steps are new requirements that shall be completed before any Mexican entity can legally operate as a SOFOM.

10. Legal Framework for Corporate Criminal Liability & Anti-Bribery and Corruption Regulation

Corporate Criminal Liability

On March 5 2014 was published the new National Code of Criminal Procedures (“CNPP” for its Spanish acronym) which gradually entered into force at a federal level until June 18 2016, when it entered fully in force.

The CNPP establishes that all legal entities will be criminally responsible for the crimes committed on their name, on its account, for its own benefit or with the resources that they provide.

It is also important to consider that the criminal responsibility of legal entities is not extinguished by transformation, merger or spin-off. In those cases, the penalty will be transferred and measured taking into consideration the relation kept with the individuals involved in the crime committed.

Likewise, the criminal responsibility is not extinguished by apparent dissolution when continues with its economic activity and maintains the substantial identity of its clients, providers, employees or the most relevant aspects from them.

Legal entities may be criminally responsible for the commission of crimes provided in a catalog established in the criminal legislation of the Federation and of the Federative States. Thus, the Federal Criminal Code (“CPF” for its Spanish acronym) establish that a legal entity may be criminally liable if it intervene in the execution of the following crimes:

- Terrorism
- Illicit use of flight facilities
- Crimes against health
- Minor corruption
- Traffic of influences
- Briberies
- Coins counterfeit or alterations
- Against consumption and national assets
- Minors trafficking
- Trade of stolen goods
- Grand theft auto
- Fraud
- Concealment
- Operations with resources of illicit precedence
- Against the environment
- Copyrights violations

Sanctions

Legal entities who are criminally liable, may be subjected to the following penalties:

- Economic fines.
- Securement of instruments, objects and goods of the crime.
- Publication of the sentence.
- Dissolution.
- Suspension of activities for up to six years.
- Closures of business for up to six years.
- Suspension of the business of the legal person for a term up to one year.
- Prohibition to perform the activities which led to the crime being committed, facilitated or concealed it for up to ten years.
- The temporary disqualification consistent in the suspension of rights to participate directly or indirectly in engagement procedures with the government or enter into agreements regulated by the Public Projects Law for up to six years.
- Public admonishment.

According to the CPF the penalties may be reduced up to one quarter if prior to the crime that they are charged with, the legal entity proofs that it had a permanent body of control responsible of verifying the compliance with the applicable legal provisions to follow up the internal policies of crime prevention and, that said body diminished the damage provoked by the crime before or after the accusations.

Anti-Bribery and Corruption Regulation

The legal framework in anti-bribery and corruption matters is the result of a comprehensive constitutional reform that came into force on 2015. This reform creates an Anti-Bribery National System that is primarily composed of several committees, laws and secondary reforms, each one with specific functions, being the most important the enforcement of criminal or administrative responsibilities to those who commit acts of corruption.

The anti-bribery regulation is composed by four new laws and reforms to other three existing laws. Although those laws and reforms apply mainly to the public entities and public servants, the General Law of Administrative Responsibilities ("LGRA" for its Spanish acronym) does provide sanctions to those private entities or individuals who commit serious offences. The LGRA will enter into force by July 19, 2017.

The acts that may be committed by an individual or a legal entity that qualified as major administrative offenses are amongst others:

- **Bribery.** The offering or delivery of any improper benefit to one or more public officers, either directly or through third parties, so that in return, such public officers perform or refrain from performing an act in respect of their functions.
- **Influence peddling to induce the authority.** The use of influence, economic or political power, real or fictitious, over any public officer, for the purpose of obtaining a benefit or advantage.
- **Use of false information.** The submission of false documentation or altered information, or simulation of the fulfillment of requirements established in the procedures, for the purpose to obtain an authorization, benefit, leverage, among others.
- **Collusion.** Performing with one or more individuals or legal entities, in terms of public procurement, actions that imply or aim or have the effect of obtaining a benefit or advantage in public procurement. Collusion will also be considered when individuals enter into an agreement into contracts, agreements, arrangements, or combinations between competitors, with the objet or effect of obtaining an improper advantage or cause harm to the public entities.

Sanctions

The main consequences of an infringement of the LGRA or its regulation are administrative penalties. This Law differentiates the sanctions to be imposed to individuals from those applicable to legal entities.

Among the administrative penalties that will be imposed to Individuals are fine for up to two times the benefits obtained or in case of not obtaining them, the equivalent to the amount up to 150,000 times the daily value of the Measurement and Update Unit (\$10'956,000.00 MXN approximately), temporary disqualification to participate in acquisitions, lease and public services or government constructions for a period of no less than three months and no more than eight years; and compensation for the damage claims made to the Federal, Local or Municipal Public Finance or the Property of public entities.

Likewise, the administrative penalties applicable to legal entities are fines up to two times the benefits obtained or in case of not obtaining them, the equivalent to the amount up to 1'500,000 times the daily value of the Measurement and Update Unit (\$109'560,000.00 MXN approximately), temporal disqualification to participate in acquisitions, lease and public services or government constructions for a period of no less than three months and no more than ten years, the suspension of activities for a period no less than three months and no more than three years,

dissolution of the legal entity; and compensation for the damages caused to the Federal, Local or Municipal Public Finance or the property of public entities.

Certain penalties will only be legally enforceable when the legal entity obtains an economic benefit and the involvement of its Board of Directors, partners or Surveillance Body is proved, or when the Company is systematically used in manner that connects it with serious administrative penalties.

KPMG Contacts:

Manuel Rico

Partner, Head of International Tax Services
KPMG in Mexico

Juan Carlos Silva

Partner, International Tax Services, Monterrey
KPMG in Mexico

Jesus Castillo

Partner, Corporate Business Tax Services, Guadalajara
KPMG in Mexico

Mario Hernandez

Partner, Corporate Business Tax Services, Ciudad Juarez
KPMG in Mexico



© 2019 KPMG Cárdenas Dosal, S.C., la firma mexicana miembro de la red de firmas miembro independientes de KPMG afiliadas a KPMG International Cooperative ("KPMG International"), una entidad suiza. Las firmas miembro de la red de firmas independientes de KPMG están afiliadas a KPMG International. KPMG International no provee servicios a clientes. Ninguna firma miembro tiene autoridad para obligar o comprometer a KPMG International ni a ninguna otra firma miembro frente a terceros, ni KPMG International tiene autoridad alguna para obligar o comprometer a ninguna firma miembro. Todos los derechos reservados.