



Investment in Mexico 2020

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Tax incentives

Tax incentives

Entities dealing exclusively in primary activities are exempt from income tax when their gross revenues do not exceed 20 times the annual minimum wage for each partner (approximately USD 32,250) and the aggregate does not exceed 200 times the annual minimum wage (approximately USD 322,510). Additionally, when their income exceeds the above threshold but does not exceed 423 times the annual minimum wage (approximately USD 682,110), a tax credit of 30 percent is granted to the tax payable as calculated in accordance with the corresponding provisions.

Additionally, the Mexican Tax Legislation provides for other tax incentives, which are listed as follows:

- 1) Deductibility of contributions to personal funds for Mexican resident individuals
- 2) Deductibility of personal income tax withheld by employers hiring people with disabilities or senior citizens
- 3) Capital gains deferral upon contribution of real estate to Mexican Real Estate Investment Trusts, REITS, (FIBRAS)
- 4) Manufacturing, Maquiladora and Export Service Decree (IMMEX).
- 5) Tax credit equivalent to contributions made to cinematographic and theatrical projects
- 6) Tax deduction upon acquisition of land (as opposed to the Cost of Goods Sold, COGS) acquired by taxpayers engaged in the construction and sale of real estate
- 7) Preferential tax regime for venture capital investments through Mexican trusts
- 8) Preferential tax regime for tax profits derived through production cooperatives entities
- 9) Tax credit of 30 percent for research and development expenses
- 10) Renewable Energy:
 - Full depreciation of machinery and equipment utilized on the creation of renewable energy and electricity
 - Related to the disruptive effect on after-tax profit account (CUFIN as per its acronym in Spanish) there are specific rules on computing CUFIN derived for such activities (CUFIN E)
- 11) Tax transparency for legal figures used by foreign private equity funds to invest in Mexican companies
- 12) Tax incentives for Value Added Tax (VAT) and income tax purposes, applicable to activities performed in Mexican northern border regions (within 43 municipalities) and applicable from January 1st, 2019 to December 31st, 2020
- Income tax: tax credit equivalent to one third of the income tax to be paid in the year or in monthly advanced payments. The tax credit shall be applied based on the proportion the income derived from the Mexican northern border region represents to the total income derived by the taxpayer during the same tax period. There are additional rules issued by the Mexican tax authorities, and there are no rules regarding the effects on the after-tax profit account (CUFIN)
- Value Added Tax: 50 percent credit upon the general 16 percent VAT rate upon the transfer of goods, rendering of independent services and temporary use or enjoyment of goods, by branches or offices located within the Mexican northern border regions. The VAT activities mentioned above shall be carried out within the Mexican northern border. Formal requirements shall be complied with to apply the VAT incentive. Please note that the VAT incentive shall not apply to the importation of goods or services, the sale of immovable property and intangible assets, digital commerce transactions, among others
- 13) Per a presidential decree, Mexican tax residents acting as withholding agents on interest payments to foreign residents derived from corporate bonds issued by publicly quoted Mexican resident companies may take a tax credit equivalent to 100 percent of the potential withholding, provided certain requirements are met
- 14) Per a presidential decree a tax incentive is established for the fiscal years of 2019, 2020 and 2021 for Mexican resident individuals and foreign residents, which involves being taxed at the 10 percent withholding rate upon the gains derived from the transfer of shares issued by Mexican companies through the Mexican Stock Exchange, even if those shares were not acquired through the Mexican Stock Exchange. In order to be entitled to apply for the tax incentive, specific requirements shall be met
- 15) 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
- 16) Deduction of toll roads for those which render public and private transport of people or goods
- 17) Incentive for equipment of power supply for electrical vehicles
- 18) Incentive for research and development of technology
- 19) Incentive for high performance sports

Business taxation

Overview

Residence

Legal entities are deemed Mexican tax residents when their main business administration or place of effective management is established in Mexico. Under Mexican tax legislation, such situations arise when the persons making or executing the decisions, dealing with the control, direction, operation or management of the legal entity, and the activities of those are in Mexico.

Fiscal period

The fiscal period must be 12 months for legal entities and individuals, coinciding with the calendar year, except for the initial year and liquidation years (irregular period).

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 are computed on the updated taxes while penalties are computed on admitted amounts only.

Offsetting and claims

Balances in favor may be offset or claimed by taxpayers and will also be updated with inflation indexes. Favorable balances derived from federal taxes may be offset or claimed through tax refunds.

Taxpayers may only offset their amounts of favorable balances against those they are obliged to pay for their own debt, provided that both balances arise from the same tax, including its interest and penalties. This will not be applicable in the case of taxes that are levied upon importation or those that have a specific purpose.

Loans and equity contributions

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

Income tax general computation

The following groups of taxpayers are subject to income tax: (i) Mexican residents on their worldwide income; (ii) Mexican Permanent Establishments (PEs) of foreign residents on income attributable to those PEs; and (iii) foreign residents without having a Mexican PE on income arising from Mexican sources. The corporate income tax rate is 30 percent.

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.

Deductions

Taxpayers may claim, among others, the following deductions: (i) returns of merchandise, discounts or refunds; (ii) cost of goods sold (COGS); (iii) net expenses; (iv) investments in fixed assets; (v) bad debts provided certain requirements established in the MITL are met, and (vi) annual inflationary adjustment.

It is important to note that some requirements must be met for a taxpayer to deduct the above items, among others: (i) deductions must be strictly necessary for carrying out the taxpayer's trade or business; (ii) digital invoices must be issued and comply with tax requirements; (iii) payments must be made through banks or financial institutions (wire transfer) or with a nominative check; (iv) deductions must be recorded in the accounting records, and (v) corresponding value added tax must be evidenced and collected.

Payments to related parties

From 2020, payments made to related parties or through a structured agreement will not be deductible when the income is subject to preferential tax regimes (REFIPRES), leaving aside the possibility of deducting the payment even if it is made at arm's length value.

Based on the above, any payment made to a resident in a country where the applicable tax rate for that income is below 22.5 percent is non-deductible in Mexico; for example, payments to the United States that qualify at the reduced rate of Foreign-Derived Intangible Income (FDII) of 13.125 percent. There may be similar cases in payments to other countries.

There is an exemption if the receiver of the income has personnel and actives used in a business activity.

Inflationary accounting for tax purposes

The MITL recognizes the effects of inflation in determining taxable income. Taxpayers must determine an inflationary adjustment on liabilities and monetary assets and may restate the tax depreciation deduction and net operating losses. 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 percent of its profits from the second year of operation. The profit-sharing should be paid to the employees during the month of May of the following year.



Transfer pricing

Under Mexican domestic tax legislation, all taxpayers are required to price their transactions with related parties at arm's length and prepare supporting documentation of the arm's-length nature of all cross-border and domestic intercompany transactions. The analysis must be conducted on a transaction-by-transaction type basis.

There are specific formal requirements that must be met by the transfer pricing documentation, such as including the transfer pricing method used and the supporting documentation of the application of the transfer pricing method for testing each intercompany transaction.

In general, Mexico follows The Organization for Economic Co-operation and Development (OECD) transfer pricing guidelines although there are deviations in some specific topics. For example, all the transfer pricing methods included in Mexico's legislation are contained in the OECD transfer pricing guidelines and are acceptable by the authorities although there are some differences with regards to the applicability of some of them.

Taxpayers undertaking related party transactions with foreign related parties are required to file an informative return to the tax authorities regarding transactions carried out with said foreign related parties during the previous fiscal 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 the 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. 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 must be submitted by the due date of the statutory tax audit report (*dictamen fiscal*) or along with the annual income tax return if the taxpayer does not file a statutory tax audit report.

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 arm's length nature of the intercompany transaction is not supported, or the informative return is not filed, payments made to foreign based related parties may be considered non-deductible.

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

The current Income Tax Law also addresses plans such as the non-deductibility of certain intercompany payments.

In the context of the Base Erosion and Profit Shifting (BEPS), the requirements of the MITL expands the transfer pricing disclosure requirements. In particular, the following taxpayers must be aware that additional disclosure requirements are applicable:



- Taxpayers whose revenues for fiscal year 2019 were equal to or greater than MXN 791,501,760
- 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

In general the requirements of the master file and local file deviates from those included in the OECD Action 13. However, with regard to the master file, if the document is prepared by a foreign parent company in accordance with the OECD requirements, it is considered to be compliant for Mexican purposes. In addition, the master file might be prepared and/or submitted either in Spanish or English.

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 with 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 not subsidiaries of a foreign resident
- Are required to 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 obtained in the previous fiscal year consolidated revenues equal to or greater than MXN 12,000 million
- 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.



Finally, there are new requirements that (1) limit the possibility of conducting transfer pricing adjustments if the taxpayer is already within the arm's length range and (2) forces any adjustment to be conducted to the median of the interquartile range. Finally, on this regard it is worth mentioning that any transfer pricing adjustment conducted for reducing the tax base of the Mexican taxpayer must comply with very detailed requirements so that they are accepted and there are time limitations to conduct them.

Thin capitalization rules

Interest paid to related parties residing abroad arising from debts which exceed a 3:1 debt-equity ratio shall not be deductible. Debts contracted for constructing, operating or maintaining infrastructure of strategic areas for the country shall not be considered in computing the debt-equity ratio.

Starting 2020, the deduction of net interest (interest accrued in charge less interest accrued in favor) cannot exceed 30 percent of the adjusted fiscal profit. If the interest expense cannot be deducted in a given year, it can be deducted in the following ten years. As point of departure, the calculation of this 30 percent is applicable individually, but there is an option to apply it at the group level, according to the rules that will be issued in 2020.

The adjusted fiscal profit will be the fiscal profit plus accrued interest expenses and the deduction of investments, a kind of fiscal EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization). It is important to mention that in the case the tax result at the end of the year derives in a tax loss, the net interest expense will not be deductible and subject to the carryforward.

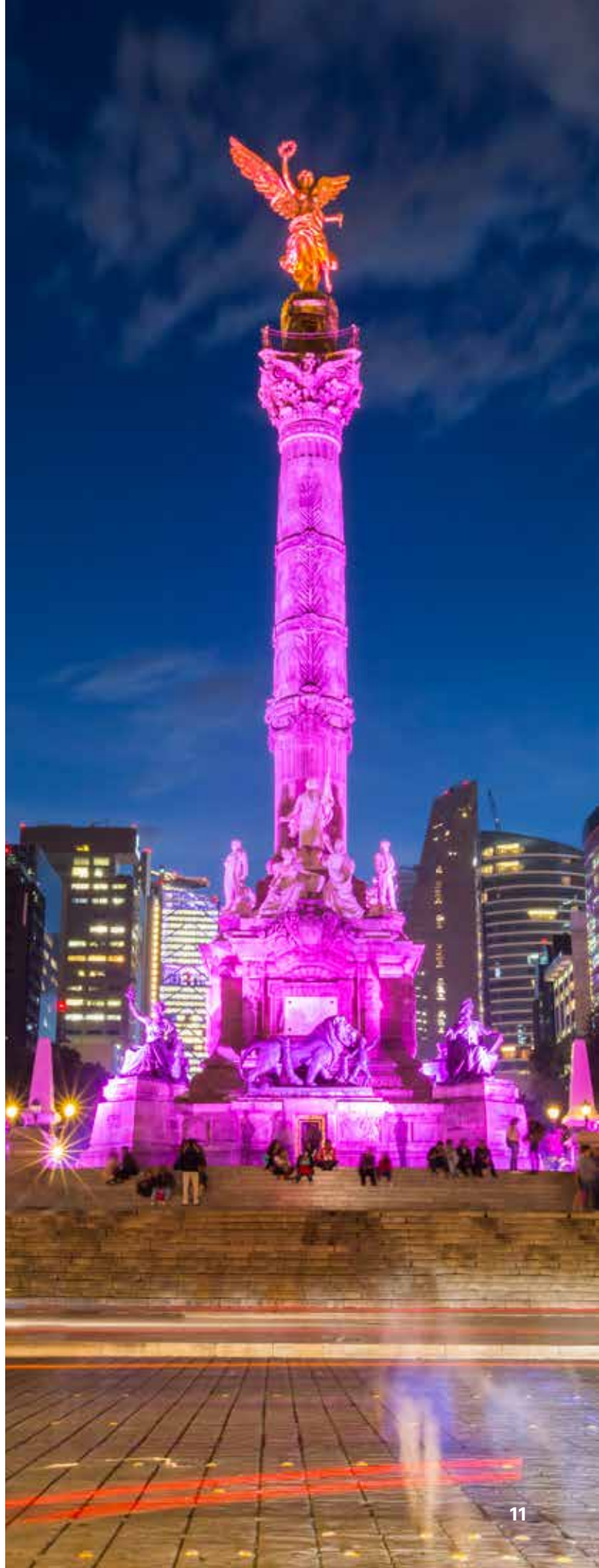
There is an exception for the first MXN 20,000,000; however, this amount is at the group level.

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. There are specific restrictions on the use of NOLs in case of mergers and spin-offs.

Foreign tax credit regime

Mexican residents are entitled to an ordinary foreign tax credit with a per-country limitation provided that the foreign income is subject to Mexican income tax. The foreign tax credit limitation for business activities is 30 percent of the tax profit from foreign sources determined in accordance with the MITL.





Foreign transparent vehicles and private equity funds

Some provisions were added to establish new rules for taxing the income obtained by or through foreign tax transparent entities or legal figures.

Transparent entities and legal figures will be treated as opaque. Where their administration or effective place of management is in Mexico, they will be taxed as Mexican tax resident entities. They will be subject to income tax under the corresponding regime of the Income Tax Law (corporations, not-for-profit organizations, foreign residents, and preferential tax regimes) which is applicable to them. This provision does not apply when a tax treaty that Mexico has in force, contains provisions that provide the tax treatment of the transparent entity or legal figure. The regime described will enter into force on January 1st, 2021.

Another provision has been included in the Income Tax Law to regulate treatment to income obtained by Mexican residents or PEs located in Mexico by foreign residents through foreign transparent entities or legal figures. In that scenario Mexican residents and PEs would be subject to taxation from the income received through to the entity or figure. If those vehicles are subjected to income tax under any of the regimes of the Income Tax Law, then such income tax if effectively paid may be credited by the Mexican resident taxpayer.

Notwithstanding the above, legal figures will not be treated as opaque, due to a tax incentive that has been incorporated in the Law, applicable only to private equity investments.

In this regard, investments made through foreign investment vehicles without a legal personality and considered as transparent for tax purposes abroad that invest in Mexican legal entities, should be considered as transparent and tax the income on the hands of the beneficiaries.

The tax incentive only applies to income derived from interest, dividends, capital gains and the use of immovable property.

Moreover, this tax incentive would be applicable as long as the transparent vehicle complies with the following requirements:

- The manager of the foreign vehicle should implement a registry of all the members of the foreign investment vehicle, which has to be submitted before the MTA. Any modification about the members of the foreign vehicle, must be reported to the MTA in the following February of the next calendar year
- The Manager must provide to the MTA the certification of residence of all the members of the foreign vehicle and his/its own certificate

- Pension funds and international organizations must file their constitutive agreement
- The foreign investment vehicle should be constituted in a country that has in force a broad exchange of information agreement with Mexico
- The members of the foreign vehicle, including its manager, should be resident for tax purposes, in a country that has in force a broad exchange of information agreement with Mexico
- The members must be the beneficial owner of the income received, and the income has to be subject to taxation in the jurisdiction where they are resident for tax purposes

If the above obligations are not met, the tax transparency of the vehicle will not be applicable in the proportion of the participation of the member that does not fulfill the above requirements, and the figure will be treated as a corporation for Mexican tax purposes in such percentage.

These regulations will enter into force in 2021.

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. Mexico has income tax treaties in force and has signed the OECD MLI.

Withholding tax

Dividends

Individuals residing in Mexico and non-residents who receive any dividends or profits that are generated from 2014 will be subject to a 10 percent withholding tax, which should be considered as a final payment. Tax treaties to avoid double taxation may 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. When dividends do not come from said account or exceed the balance thereof, the dividend or exceeding amount will be subject to corporate taxation by applying the 30 percent corporate tax rate (effectively, the dividend being grossed up by a factor of 1.4286).



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 Mexican PE. Withholding tax rates applicable to interest paid to a nonresident generally vary, ranging from 4.9 percent to 35 percent.

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 Mexican definition of royalties includes industrial, commercial or scientific equipment (ICS equipment).

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

(i) Railcars: 5 percent; (ii) Technical assistance and other royalties not included below (including the use of Industrial, Commercial or Scientific (ICS) equipment): 25 percent; (iii) For the temporary use or enjoyment of patents or certificates of invention or improvement, trademarks or brand names and for advertising: 35 percent.

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.

Income tax will be calculated by applying the 25 percent 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 15 days following the obtainment of the income.

Tax haven considerations

Payments made to a related party located in a tax haven will be subject to a 40 percent withholding tax rate to the above described payments. If the foreign related party is resident of a country with which Mexico has in force a tax treaty to avoid double taxation, normal withholding tax rates should apply.



Digital Tax

Digital services meaning

It includes downloading or accessing images, movies, text, information, video, audio, music, games, including gambling, as well as other multimedia content, multiplayer environments, obtaining mobile tones, viewing news online, traffic information, weather forecasts and statistics. Shall not apply to downloading or accessing books, newspapers and electronic journals.

- Hose of intermediation between third parties that are suppliers of goods or services and the plaintiffs thereof. The provisions of this section shall not apply, in the case of intermediation services that are intended to dispose of used personal property
- Online clubs and dating pages
- Distance teaching or test or exercises

Digital service is provided in national territory when:

- The user's address is in Mexico
- The user's phone number has Mexico's phone code
- Payments are made through a Mexican intermediary
- The user's IP address is assigned to Mexico

Taxes to platforms

1. Value Added Tax. Platforms must pay VAT on the commissions charged to users at the rate of 16 percent
2. Income tax. No income tax to be paid by foreign platforms with no PE

Taxes to be withheld when the platform is an intermediary

VAT

In case of VAT, platform must withhold 50 percent VAT for individuals (general rate is 16 percent) in relation to granting the use of immovable property. The full rate is applicable when the platform does not have a tax identification number.



Income tax

For income tax purposes, in the case the users (for instance in accommodation services for the host) there will be a WT of payments received through the platform and different rates apply depending on the amount of income received by the host.

WT rates are applicable on a monthly basis, exclusively for individuals that are Mexican residents.

WT rates for hospitality services are as follows:

- 2 percent when derives up to USD 250
- 3 percent from USD 251 up to USD 750
- 5 percent from USD 750 up to USD 1,750
- 10 percent from USD 1,751

When the individual resident in Mexico does not provide his TIN, *the withholding tax will be 20 percent.*

Those payments of taxes (VAT and income tax) can be considered for individuals as final payment, if the amount received for the services rendered (for instance accommodation) or goods sold does not exceed annually USD 15,000. If the users derived more than USD 15,000, the WT is considered not final. In the case of income tax, the individual may consider the WT as payment in advance and in the case of the VAT, the WT is creditable.

Formal obligations in VAT and income tax

There are two sets of obligations for digital platforms; the first one is a general applicable to all of platforms; the second one is applicable when the platform offers services as an intermediary.

General obligations:

- 1) Obtain a TIN before Tax Administration Service
- 2) Charge the value added tax of their services
- 3) Provide information about the number of transactions in each month with the users, type of service, number of users; this information must be filed quarterly
- 4) Issue digital invoices for the users of the platform
- 5) Appoint a legal representative located in the Mexican territory (this does not constitute PE, in accordance to VAT Law)
- 6) Obtain an electronic signature before Tax Administration Service



Obligations when the platform is an intermediary

Additionally to the above, when the digital platform is an intermediary, it must comply with the following:

- 1) To be registered before MTA as withholding agent
- 2) Withhold VAT and income tax for the accommodation services rendered only by individuals, and to deposit the amount withheld to Tax Administration Service until the 17th of the following month
- 3) Issue a digital certification to individuals with the amounts withheld on income and value added tax
- 4) As an intermediary of services, provide on a monthly basis information to the MTA that contains:
 - a) Name of the users (individuals or entities)
 - b) TIN of users
 - c) CURP (only individuals)
 - d) Tax address
 - e) Financial institution where the payments are deposited
 - f) Amount of the transactions made using the platform
 - g) Address of the immovable property used for the accommodation services

Value Added Tax (VAT)

Mexican VAT is paid on a cash flow basis. The VAT Law establishes that all individuals and entities are required to pay VAT at a standard rate of 16 percent (0 percent rate applies in some cases) when they carry out the following activities within Mexico: (i) sale of goods; (ii) supply of independent services; (iii) granting of temporary use or enjoyment of (tangible) goods; and (iv) import of goods or services.

VAT is calculated on a monthly basis and is considered as final tax payment. Favorable balances may only be credited against the corresponding tax in the following months or request it through a VAT tax refund. When such VAT tax refund is requested, it must be on the total favorable balance. Favorable balances whose return is requested shall not be credited in subsequent tax returns.

There are important exceptions for which no VAT is payable. The most significant of these are land and 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.

In general, the importation of goods or services is subject to the payment of VAT, with specific exceptions. 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 VAT is payable when the importation becomes definitive, with the exception of temporary imports carried out by companies part of the IMMEX Program, which 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.

Other taxes

Transfer taxes and stamp duties

Mexico does not generally impose transfer taxes or stamp duties, except for those charges described below.

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. 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.

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 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 percent and 5 percent.

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 Mexican PE, the income tax rate is 2 percent. The tax must be withheld and paid by the person making the payments.

Excise tax (on production and services)

In accordance with the Excise Tax Law entities or individuals are required to pay the tax imposed, when performing the following acts or activities: (i) The sale with Mexico or, where appropriate, the importation of goods set out in such Law; (ii) The provision of the services referred to in such Law. The tax rate varies based on the product or good in question.

Tax on new automobiles

Sales of new automobiles manufactured in Mexico, and 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.

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 has ranges.



Logistical services and customs

Importers' registry

Entities and individuals importing merchandise from abroad and wishing to trade 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.

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.

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.

Manufacturing, Maquiladora and Export Service Decree (IMMEX)

Since November 1st, 2006, the IMMEX program has consolidated both the Maquila Decree and the Temporary Import Program for Exporters (PITEX, as per its acronym in Spanish), 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. Specific incentives are provided under this program, however certain requirements must be met.

Sector Promotion Programs (PROSEC)

This program is a tariff reduction measure that allows foreign or domestic producers to request from tax authorities 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.

VAT and excise tax certification

Since December 11st, 2013, the VAT Law 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"). Several customs, tax and operational benefits are obtained under the VAT and excise tax certification.

Authorized Economic Operator

The function of the Authorized Economic Operator (AEO) 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 desire to participate. Several customs and operational benefits are granted under AEO.

USMCA (formerly NAFTA)

The USMCA was signed the 30th of November of 2018 in Argentina, by the three presidents of the nation members of this agreement which is the result of the renegotiation of the previous trade agreement between these nations (North American Free Trade Agreement - NAFTA). On December 10th, 2019, the Protocol of Amendment to the USMCA was signed by the three countries. The NAFTA will remain valid until the USMCA enters into effect once the three countries comply with its internal requirements to approve (ratify) the new deal. Mexico ratified the Protocol on December 12th, 2019.

Currently, most of the imports under the NAFTA are duty-free. The aim of the USMCA is to reduce technical barriers, such as import permits and other non-tariff barriers, as well as to develop fair and expedite procedures for the resolution of disputes. It 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. Panels were installed as dispute settlement mechanism and quick response panels were introduced to address certain labor issues between parties.

Some of the main considerations would be that the *de minimis* threshold was increased from 7 percent to 10 percent, which would assist in the USMCA origin qualification process. In addition, the official format of the certificate of origin will be no longer needed but the essential information that was on the certificate of origin will still have to be demonstrated. The importers would also be allowed to declare the goods as originating, in addition to the exporters and producers (Mexico will defer this for three and a half years). Origin verification audits will be more extensive for certain goods as textiles.

Some of the most impactful changes were the amendments to the rules of origin in the automotive, chemicals, textiles and television industries. Regarding the automotive sector, the rule of origin was amended so that the Regional Value Content (RVC) of automobiles shall gradually increase to 75 percent from the one that currently applies (62.5 percent); 40 percent of the value of the car shall be produced in countries with an hourly salary of at least USD 16; 70 percent of the aluminum and steel shall be USMCA originating; and the core parts shall also be originating. In addition, the RVC of spare parts was also set to gradually increase.

Several new chapters were considered in the USMCA regarding small and medium enterprises, e-commerce, labor, environment, competitiveness, anticorruption and good regulatory practices, among sectorial annexes, such as chemicals, cosmetics, information and technology, medical devices, pharmaceutical products and energy efficiency.



Individuals

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 his/her permanent home is in Mexico. If such person has his/her permanent home in another country as well, he/she would be considered a Mexican tax resident if he/she has his/her (economic) center of vital interest in Mexico.

Individuals are allowed to claim personal deductions, among others, medical and dental fees, hospital expenses paid in Mexico, funeral expenses, donations approved by the tax authorities, interests paid for main residence during the fiscal year derived from mortgage credits, school bus expenses for children, school fees, supplementary and voluntary contributions to the National Retirement Savings System, subject to requirements.

Resident individuals should file a Mexican annual income tax return no later than April 30th of the following year, except in specific cases.

The income tax is determined by applying progressive rates depending on the income level, with a maximum marginal tax rate of 35 percent for tax year 2018.

Non-resident taxpayers

Foreign individuals 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 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 MXN125,900 Mexican source income wages earned; then an income tax rate of 15 percent applies when income exceeds MXN125,900 and a 30 percent rate applies on the income that exceeds MXN1,000,000 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.

Social security

The Social Security Law is intended to guarantee the right to health, medical assistance and welfare services necessary for the social and collective wellbeing of employees and their families. Employers are obliged to comply with certain social security obligations. Failure to comply with such obligations may result in monetary penalties not only for omission but also for late compliance with such obligations.

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 percent of the total payroll of the company in the relevant State.



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