



DOING BUSINESS IN
MEXICO



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MEXICAN TAX LAW AND REGULATIONS

The Mexican Constitution divides the power to tax among the Federal government, the various states, and the municipalities. In Mexico, Congress maintains the legal authority to enact Federal tax legislation. Federal taxes are codified and include the Mexican Income Tax Law (Ley del Impuesto Sobre la Renta), the Mexican Value Added Tax Law (Ley del Impuesto al Valor Agregado), and the Excise Tax Law (Ley del impuesto Especial sobre Producción y Servicios). The Federal Tax Code (Código Fiscal de la Federación) provides generally applicable tax law provisions. The President maintains the authority to issue regulations and to execute tax treaties to avoid double taxation with other countries. Treaties, however, do not enter into force unless they are ratified by the Mexican Congress.

Tax provisions must satisfy the Mexican Constitution's guarantees of human rights, fundamental individual rights, and entitlements. This principle protects taxpayers. If a law or regulation violates the Constitution, a taxpayer may seek legal recourse to obtain a "writ of Amparo."

Certain taxes are assessed at the local level, such as payroll taxes, real estate acquisition taxes, and hotel taxes. Tax rates or tariffs may vary depending on each State.

Tax Laws, Regulations, and Administrative Rules are implemented by the Tax Administration Service (Servicio de Administración Tributaria or SAT), which maintains the authority to issue Tax Administrative Rules and binding and non-binding rules.

Mexico's legal system is based on the civil law tradition. In contrast, the United States largely follows the common law tradition.

Among the primary differences between the two systems, judicial precedents are far less important in Mexico. The decisions of higher courts may provide a remedy or legal defense that constitutes binding legal precedent (jurisprudencia) only after a series of five consecutive decisions on the same issue. Tax Courts and Courts of Justice are required to apply jurisprudencia in a legal case.

An entity's status as an S.A. de C.V., S. de R.L. de C.V., or S.A.P.I. is largely irrelevant for Mexican tax purposes, as Mexican tax law does not afford special tax treatment in relation to such status. However, for US tax purposes, status as an S. de R.L. de C.V. may provide certain tax benefits for U.S. investors.



Practice Pointer: Mexican tax reform may impact the treatment of foreign fiscally transparent vehicles, including many structures that are common in the private equity space.

For tax planning purposes, the Mexican Income Tax and the Value Added Tax (Federal taxes) are typically the most prominent taxes, depending upon the taxpayer's activities in Mexico. Other taxes include payroll taxes, social security, and housing contributions. For transactions involving the acquisition of real property, acquisition taxes (impuestos sobre adquisición de inmuebles) are also a consideration.

CORPORATE TAXATION

Mexican Income Tax

Mexican companies are **required** to accrue their worldwide income, subject to a **30% corporate income tax**

Mexican tax residents are taxed on their worldwide income. A non-resident with a permanent establishment in Mexico is subject to tax on income attributable to the permanent establishment. A non-resident with no permanent establishment in Mexico is taxed on Mexican-source income only (Article 1 of the IT Law). Current tax rates are 30% for corporations and up to 35% for individuals, with an additional withholding tax at a rate of 10% on dividends distributed to individuals or foreign residents.

Practice Pointer: Permanent establishment status remains one of the most significant cross-border tax considerations for U.S. entities.

Calculation of Taxable Income

Taxable income is determined as follows (Article 10 of the IT Law):

Gross Income (Ingresos Acumulables)	
Less:	Authorized costs and business expenses (deducciones autorizadas)
Equals:	Net profits (utilidad fiscal)
Less:	Employee profit sharing paid as from 2006 (participación de los trabajadores en las utilidades, PTU)
Less:	Carried-forward losses (pérdidas fiscales)
Equals:	Taxable profits (resultado fiscal)
Equals:	Taxable profits (resultado fiscal)

The Mexican Income Tax Law provides that taxable profits are determined using the following method: net profits are equal to gross income (including gains) less costs and qualifying business expenses. Employee profit-sharing and losses incurred in previous years are subtracted from the net profits of the relevant period. Losses may be carried forward for a 10-year period. Entities are required to adjust for inflation at the end of the tax year.

Generally, income tax is levied on an accrual basis and related expenses are deductible in the fiscal year in which they are incurred, regardless of the date of receipt and payment.

CORPORATE TAXATION

Accruable Income

Income from the sale of goods and services (other than income from independent personal services derived by companies or organizations, and income from supplying water or collecting waste) is considered accrued on the earliest of the following dates (Article 17 of the IT Law):

1. The date of the invoice covering the income is issued;
2. The date the goods are placed at the disposal of, or the services are performed for, the acquiring party; or
3. The date of the payment or the date of the total or partial amount falls due (even in the case of payments).

Advance Income Tax Payments

Legal entities are required to make advance income tax payments within the first 17 days of every month based on estimated net profits derived from the prior month. The first advance payments cover the first 3 months of the tax year. The advance payment system is intended to collect an amount approximately equal to the total tax liability for the entire tax year (Article 12 of the IT Law).



CORPORATE TAXATION

Deductions

Taxpayers may deduct expenses that are necessary to accomplish their business activities and that are supported by digital tax invoices (CFDI as per its acronym in Spanish), duly registered in the taxpayer's accounting records, as long as the taxpayer maintains proper documentation to support such transactions. Expenses or disbursements must meet certain requirements to qualify as deductible. These conditions must be fulfilled, at the latest, on the date the tax return is filed (Articles 25 and 27 of the IT Law).

Depreciation

Investments in business-related assets must be depreciated under the straight-line method at the rates provided in the IT Law. Such rates range between 0 to 100%, depending on the item to be depreciated.

Prorated Expenses

Generally, prorated expenses incurred abroad by foreign residents are not deductible for income tax purposes (Article 28, section XVIII of the IT Law). However, such expenses are generally deductible if the foreign resident has a permanent establishment in Mexico (Article 26 of the IT Law).

Distribution of Dividends



Legal entities are required to maintain an account representing net profits (cuenta de utilidad fiscal neta or CUFIN) to record historic profits that have already been taxed at the corporate level (Article 77 of the IT Law). CUFIN is comprised of accumulated net profits, adjusted for inflation. CUFIN is increased by dividends and profits from other Mexican entities and by revenues, profits, or dividends subject to preferential tax regimes (tax havens). It is decreased by any dividends or profits paid, and profits are distributed by a decrease of capital stock.

Profits that have already been taxed at the corporate level, however, are not subject to further taxation as dividends. Nonetheless, when profits other than those derived from the CUFIN are distributed, or, when dividends are distributed in excess of the CUFIN balance, the distributing company is required to withhold tax.

Under such circumstances, the distributing entity is required to “gross up” the dividend, multiplying it by a gross-up factor (1.4286 for tax year 2022). The grossed-up figure is subject to the corporate income tax rate (30% for tax year 2022). The corresponding amount is required to be withheld.

An additional 10% is required to be withheld on dividends or profits distributed or paid by legal entities residing in Mexico to individuals residing in Mexico or non-residents, with respect to profits generated as of the tax year 2014.

CORPORATE TAXATION

Capital Contributions

Mexican companies must keep a capital contributions account (“CUCA”) to memorialize and track shareholder contributions.

CUCA represents shareholder contributions and is inflation-adjusted. Capital contributions and premiums obtained by selling shares increase CUCA and capital redemptions reduce it (Article 78 of the IT Law). Additional taxes may apply if there is not enough CUCA.

Employee Profit-Sharing Participation

Employers are required to pay **10% of the company's profits**.
But, the distribution is capped.

The Mexican Federal Constitution guarantees employees the right to participate in a company's profits, taking into consideration the provisions established in the IT law. Profit-sharing provides an incentive for employee productivity.

The Federal Labor Law (hereinafter “FLL”) provides employees the right to participate in a company's profits at a rate established by the National Commission. Under the IT law, the applicable percentage is 10% of the company's taxable income. However, the distribution is capped at an amount equal to 3 months of the employee's annual salary or the average of the profit-sharing distributions received by the taxpayer in the last 3 years, whichever is higher.

Losses

Losses may only be deducted by the taxpayer who incurred them. As such, the right to offset losses may not be transferred, even in the case of a merger. However, an exception applies with respect to a spin-off. Losses from the company undergoing a spin-off may be shared between the resulting companies in proportion to the inventory and the accounts payable connected with the commercial activity of the original company (Article 57 of the IT Law).





CORPORATE TAXATION

Tax Treaties to Avoid Double Taxation

Generally, a country’s right to tax income is a function of residency or source. Whether income is sourced in Mexico primarily depends on the location where the taxable event occurs (for example, whether services are rendered in Mexico) and whether the source is a Mexican or foreign resident.

Under the IT Law, withholding applies to many types of payments made to non-residents including payments from a Mexican source made in cash, in-kind, in services, and by issuance of a credit (Article 153 of the IT Law).

Mexico has executed Tax Treaties with more than 70 countries around the world.

Reduced treaty rates may be applied at the source, and if the taxpayer complies with formal requirements set forth in Mexican domestic law and the applicable treaty, the benefits of a tax treaty will be granted as a tax refund. Generally, the types of payments that may be reduced by a tax treaty are payments for services, royalties, dividends, and loan interest.

Tax Preferential Regime

A tax haven is a jurisdiction that does not apply taxes to certain income or that maintains a corporate income tax rate that is less than 75% of the Mexican income tax rate, which is currently 30% (Article 176 of the IT Law).

Certain payments made to a tax haven jurisdiction are subject to 40% withholding tax (not including dividends). If payments are made between related parties, administrative rules provide that to the extent an exchange of information agreement is executed between a tax haven and Mexico, the domestic rate is applicable (instead of 40%) (Article 171 of the IT Law).



CORPORATE TAXATION

Transfer Pricing

Mexico is a member of the Organization for Economic Co-operation and Development (hereunder “OECD”) and follows the OECD-promulgated guidelines. Indeed, the application of the OECD’s rules has even been recognized in the IT Law, which allows for a variety of accepted methods.

Transactions between related parties are subject to additional regulations (Article 179 of the IT Law).

Practice Pointer: Mexico utilizes the arm’s length standard. Notably, Mexico has reserved the application of the separate-entity approach; therefore, taxpayers utilize the traditional approach with respect to the allocation of income to a permanent establishment.

Currently, most transactions between related parties in Mexico and abroad must be at fair market value, and generally, should be supported with a transfer pricing study.

Mexican Value Added Tax

16% VAT	0% VAT	EXEMPT
Disposition of goods, professional services, granting temporary use of goods, importing goods or services	Export of goods, commission, services, etc.	Certain interest payments, disposition of a home, etc.

The Mexican Value Added Tax (VAT) is an indirect tax that is governed by the Mexican Value Added Tax Law (VAT Law) and by its regulations (VAT Regulations).

Legal entities carrying out the following activities within Mexican territory are generally subject to the VAT: (i) transfer of goods, (ii) professional services, (iii) granting rights to temporarily use goods, and (iv) importing goods or services. Generally, Mexican taxpayers are subject to a VAT on such activities at a tax rate of 16%. Exports and certain other items are taxed at a 0% tax rate. Certain transactions are exempt without credit for previously paid VAT.

To calculate VAT liability, the input VAT (calculated by applying a special formula) may be credited against the output IVA if certain requirements are met. VAT should be paid on a monthly basis. Taxpayers must pay VAT liability incurred in a given month by the 17th day of the following month.

As established in the Mexican Federal Fiscal Code, if a tax return reflects a positive balance, upon its filing a taxpayer may: (i) credit the balance against input VAT in the following months, (ii) request a return of the balance, or (iii) use the balance to offset certain other tax liabilities.

Generally, foreign residents who are subject to VAT may not be able to utilize VAT paid in Mexico as a foreign tax credit in the United States. Foreign taxpayers should engage in foreign tax credit planning prior to engaging in business activities in Mexico.

CORPORATE TAXATION

Excise Tax

Excise tax (IEPS) is imposed on the transfer, import, or provision of certain types of goods and services. IEPS is distinguished from VAT by its application to the production, sale, and import of certain items or activities such as junk food, sweetened beverages, alcohol, and alcoholic beverages, tobacco, fossil fuels, pesticides, and services related to those goods, as well as lotteries, telecommunication, and gambling.

Like VAT, IEPS is an indirect tax that permits sellers, such as retailers and producers, to collect from downstream purchasers the IEPS assessed on their provision of taxable goods or services.

Local Taxes

Payroll Tax

The Payroll Tax is applicable to those who make salary payments to one or more employees in cash or in kind. The applicable tax rate varies depending on the municipality.

Real Estate Acquisition Tax

The real estate acquisition tax is imposed on the ownership of real property. The tax base is the cadastral value of the real property. The applicable tax rate varies depending on the municipality.

Real Property Transfer Tax

The Real Property Transfer tax is imposed on the transfer of real property (or the transfer of real property interests) at the local level by municipalities. Generally, the tax is assessed on the total value of real property.

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