

Doing Business in Mexico



Introduction

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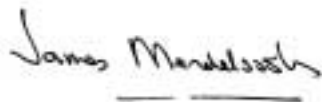
With an economy that is enjoying growing levels of foreign investment, especially in its maquiladora and production facilities, and a growing market of 100 million people, Mexico is an exciting place for the investor.

MSI Mexico Group has prepared this Executive Summary to provide the international investor / entrepreneur with valuable information before entering into Mexican territory. This informative guide provides an initial assessment of what an investor needs to consider when looking to invest in Mexico.

This guide is one of a series of Executive Summaries prepared for clients and fellow MSI members by the independent Mexican member firms that belong to MSI Legal and Accounting Network Worldwide. Further information can be obtained from any member firm in Mexico – please see pages 22-24 for contact details.

Whilst this guide has been prepared by MSI Mexico Group based on the latest Mexican laws and regulations, this information may not be comprehensive and readers should not act upon it without seeking professional advice from the member firms belonging to MSI Mexico Group.

Should you require further advice, professional services can be provided by any of the member firms belonging to MSI Mexico Group.



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General index

General Profile	5
Name	5
Geography	5
Population and Language	5
Government	6
Currency	6
Economy	6
Banking and Financial System	8
Living in Mexico	8
Visas	8
Time and working hours	8
Public Holidays	9
Investing in Mexico	10
Corporations, Companies, Enterprises	10
Restrictions on Foreign Investment	11
Trusts	12
Incorporation	12
Management	13
Year to year periods	13
Statutory Examiner	13
Fiscal Domicile and Federal Tax Number	14
Labour Regulations	14
Labour Relations	14
Salaries and Minimum Wage	14
Working Week	14
Employee benefits	14
Unions and Syndicates	15
Employee Profit Sharing	15
Social Security	15
Taxes, Tariffs and Tax Administration	16
Income Tax	16
Tax Losses	18
Dividends	18
Tax Consolidation	18

General index continued

Maquiladora	18
Foreign Residents	19
Tax Treaties	19
Assets Tax	19
Value Added Tax	20
Federal Tax Incentives	20
Employee Profit Sharing	20
Tax Compliance and Administration	20
Tax Returns	20
Reviews by the Tax Authorities	21
Tax Refunds	21
Expenses and Invoices	21
Other Taxes	21
Individuals	22
Foreign Residents	22
Auditing and Accounting	23
Auditing	23
Transfer Pricing	24
Other Tax Audits	24
Accounting	24
Mexican Generally Accepted Accounting Principles	25
Foreign Currency	25
Inflationary Effects	25
Comparability of financial information	25
Inventories Fixed Assets and Depreciation	25
Deferred Taxes	26
Seniority Premiums	26
MSI Mexico Group	27
Guadalajara	27
Mexico City	27
Mexico State & Puebla	28
Monterrey & Matamoros	28
Tijuana	29
MSI Worldwide Headquarters	29

1 General Profile on Mexico

1.1 Name

The official name is United Mexican States; however it is better known as Mexico.

1.2 Geography

Mexico is bordered by the United States to the north, and Belize and Guatemala to the south. Its total land mass size is 1,972,550 sq km or 761,602 sq mi. Baja California in the west is a 1,287 km peninsula and forms the Gulf of California. On the east side we find the Gulf of Mexico and the Bay of Campeche, which is formed by Mexico's other peninsula, the Yucatan peninsula. The center of Mexico is a great, high plateau, open to the north, with mountain chains on both, the east and west sides, and with ocean fronted lowlands lying outside of them.

Mexico is politically divided into 32 states, with its capital in Mexico City.

1.3 Population and Language

The estimated population in 2002 was 103,400,000 people, with an estimated annual growth rate of 1.7%. Nearly 73% of the population lives in urban areas, the larger ones being:

- Mexico City (Metro Area) 19,750,000
- Guadalajara 2,178,000
- Monterrey 1,702,000
- Puebla 1,222,000

The official language is Spanish. However Indian languages and dialects are still being spoken such as: nahuatl, mayan, mixteco, zapoteco, totonaco, among others.

1.4 Government

The government of Mexico is a Democratic Federal Republic with a presidential system. The government is divided into three independent powers: Executive, Legislative, and Judicial. In Mexico voting is compulsory and universal for those citizens of over 18 years of age.

The executive power is exercised by the president and his/her secretaries and ministers for a six-year term.

Legislative power is held by the Congress, with its two houses: the upper house of 64 senators and the lower house of 500 congressmen and congresswomen.

Judicial power is exercised by the Supreme Court. Other courts in the system are the regional and district courts.

Finally, each federated entity or state, is governed in the same way, divided into three independent powers, Executive, Legislative and Judicial. The only difference lies within the executive power that is exercised by a State Governor.

1.5 Currency

The national currency is the Peso (From hereinafter "MxP"). The MxP is made up of 100 cents. And at the year end of 2004, the exchange rate against the US Dollar was USD11.2183: MxP1.

1.6 Economy

Mexico has a mixed economy, with private enterprise as the dominant factor in manufacturing, mining, commerce, communications, entertainment, and the service industries, including construction; likewise, with the government, its agencies and government owned or controlled companies dominant in the areas of public utilities including electricity and petroleum.

The National Gross Domestic Product has been:

	2000	%	2001	%	2002	%
Total	549,137.28	100%	582,859.06	100%	615,282.88	100%
Commerce, restaurants, and hotels	106,569.36	19%	110,504.70	19%	116,322.58	19%
Construction Industry	25,790.64	5%	26,263.07	5%	27,529.29	4%
Electricity, gas and water	5,494.13	1%	6,252.56	1%	7,634.17	1%
Financial Services, insurance, housing, and services for enterprises	54,441.47	10%	55,134.28	9%	60,802.87	10%
Fishing, farming and agricultural products	20,201.05	4%	21,877.04	4%	22,587.93	4%
Manufacturing Industry	101,359.76	18%	103,713.36	18%	106,043.81	17%
Mining	7,017.78	1%	7,214.39	1%	7,550.08	1%
Other Services	172,579.13	31%	192,338.98	33%	203,999.28	33%
Transport, warehousing, and communications	55,683.96	10%	59,560.68	10%	62,812.87	10%
Per Capita					5,973.62	

Mexico adopted a number of measures that have successfully reduced the high rate of inflation, and have stabilized it, as follows:

Year	Inflation index
1994	7%
1995	52%
1996	28%
1997	16%
1998	19%
1999	12%
2000	9%
2001	4%
2002	6%
2003	4%
2004	5%

1.7 Banking and Financial System

The Central Mexican Bank is the authority that regulates and controls the financial system in Mexico. The Central Bank is also the issuer of policies that control inflation and provide the country with stability.

The banking system in Mexico relies upon:

- The Central Bank
- Private and Commercial Banks
- Public and Development Banks
- Auxiliary Credit Organizations
- Credit Unions
- Financial Leasers
- General Deposit Warehouses

1.8 Living in Mexico

Visas

In order to visit Mexico as a tourist, visitor or an investor, it is necessary to obtain a visa from either the Mexican embassies or the Mexican consular offices abroad.

The State Department may issue the following visas accordingly:

- Immigrant: This status is achieved at the time of “permanent establishment” in Mexico, for five consecutive years.
- Non-immigrant: These visas, issued usually for tourists, allow an individual to remain in Mexico for a period no longer than 6 months, and prohibit individuals from working for compensation.
- Visitors: These visas allow an individual to work in Mexico for a certain period of time or for a specific project, legally earning the right to compensation.
- Others: These visas are for honored guests, students, political exiles, among others.

Time and working hours

Most of the country is on “central time” or the equivalent to U.S. Central Standard Time (U.S. Eastern Standard Time minus one hour or Greenwich Mean Time minus six hours). The far northwest of Mexico is on “northwestern time” or the equivalent to U.S. Mountain Time (GMT minus seven hours) and the peninsula of Baja California is on “Baja California time” or the equivalent to U.S. Pacific Time (GMT minus 8 hours), one and two hours later, respectively.

As of April 7, 1996 Mexico instituted daylight savings time. The time frame for the savings time is from April to October; the clock is advanced one hour throughout the country.

The by-law working week consists of 48 working hours, usually from Monday through Friday. Business offices normally open at 8:30 a.m. or 9:00 a.m. for an eight-hour working day, with one or two hours for lunch. The two-hour lunch period is almost universal outside of Mexico City.

Some banks are open from 9:00 a.m. to 4:00 p.m. and others up to 6:00 p.m. The official working hours for government offices are 8:00 a.m. to 2:30 p.m. but have been extended to 7:00 p.m. in many departments. All these hours are for a five-day week.

Factories usually open at 7:00 a.m. or 8:00 a.m. and work eight-hour shifts, with a half-day's work on Saturday, although a five-day week is in use in some cases.

Public Holidays

Official or statutory non-working holidays are: January 1, February 5, March 21, May 1, September 16, November 20, December 25.

There are certain popular holidays that are not recognized by the authorities, but as a popular belief usually given to the employees, such as: January 6 (Three Kings Day), March 24 and 25 (Holy week.), May 5 (Battle of Puebla), May 10 (Mothers Day), October 12 (Columbus day), November 1 and 2 (Day of the dead and of the saints respectively), and December 12 (Day of the Virgin of Guadalupe).

2 Investing in Mexico

Foreign investment is always welcome in Mexico, especially if it promotes exports, creates jobs, increases the technology level, instructs and trains individuals, helps stabilize the MxP value and the current balance, among other things. Additionally, the Government grants certain investment incentives on a yearly basis in the form of lowered taxes or tax exceptions.

2.1 Corporations, Companies, Enterprises, etc.

Mexican legislation allows an individual to own and manage a company in Mexico. He or she must be registered before the tax authorities, and fulfill the necessary tax obligations. The individual must choose to pay taxes through the general process, or a simpler one.

The basic by-law business entities in Mexico are:

Mexican Legal Business Entities	Acronym	Equivalent to:	Comments
a) Sociedad Anónima b) Sociedad Anónima de Capital Variable	a) SA b) SA de CV	a) Stock Corporation b) Stock Corporation of variable Capital stock	These are the most common entities used by foreign and domestic investors
Sociedad de Responsabilidad Limitada	S de RL	Limited Liability Corporation or Partnership	Used occasionally, by foreign investors for tax purposes. May also be used with variable stock.
Sociedad en Nombre Colectivo	S de NC	General Partnership	Not commonly used.
Sociedad en Comandita	S en C	Partnerships with limited and unlimited partners	
Sociedad Civil	SC	Civil, or individual partnerships	These must be of noncommercial natures, usually used by administrative services and professional firms as lawyers or accountants.
Asociación en Participación	A en P	Joint Venture Agreement	
Sucursal de Sociedad Extranjera		Branch of a foreign entity or company	
Asociación Civil	AC	Civil Association	Non taxed companies, used for charitable and other non-profit organizations.

Not applied to every type of activities.

Considering the above, there are a few rules that apply to the entities:

- i. Owners Liabilities: The investors are liable for the limit of the integration of the stock legally subscribed, with the exception of the S de NC, and the SC which is unlimited to the investors' actions.
- ii. Expression of the Capital: All the values referred to a stock must be in MxP.
- iii. Minimum Capital Stock: In most cases the minimum capital stock invested must be of 50,000 MxP, roughly USD 4,500.
- iv. Maximum Capital Stock: There is no limit.
- v. Number of stockholders: In all cases the minimum number of stockholders must be two (2), with no maximum limit.
- vi. Integration and subscription: The capital stock must be subscribed and paid upon starting company operations.

Notwithstanding, a foreign company or an individual may do business in Mexico through:

- i. A legal representative or agent,
- ii. A branch or a company form abroad, or
- iii. An affiliate incorporated in Mexico.

2.1.a Restrictions on Foreign Investment

The Foreign Investment Law defines foreign investment as:

- i. Foreign individuals
- ii. Foreign legal entities
- iii. Foreign economic units without legal capability
- iv. Mexican business entities, in which a foreigner has the capability of controlling it.

And as such, the activities are defined as:

- i. Activities reserved for the government, such as: Petroleum exploration, energy and light generation, among others.
- ii. Activities reserved for Mexicans and for Mexican corporations

-
- iii. Activities in which the foreigner may own a minority under governmental permit. However it is easier to obtain the proper authorizations if certain requirements are met:
 - a. If the investment of assets in a pre-operating period does not exceed USD 100 million.
 - b. The project is not in México, Guadalajara or Monterrey.
 - c. If the project creates permanent job posts, training programs and personnel development.
 - iv. Activities in which a foreigner may own 100% of a Mexican business entity, with no prior authorization by the government such as:
 - a. Secondary petroquimics
 - b. Telecommunications installations
 - c. Agriculture
 - d. Construction
 - e. Energy systems operations
 - f. Maquiladoras or In-bond industry

Trusts

Proper authorization is needed for foreign investment of over 49% of the rights. They are very popular; due to the fact that in zones or areas where foreigners may not acquire property, by incorporating one they may be approved to do so.

2.2 Incorporation

The incorporation of business entities is usually performed by a Public Notary or a Public Broker. However only a Public Notary may incorporate civil entities such as the SC and the AC, and they are the only ones with enough powers as to legalize a power of attorney.

It is not difficult to incorporate an entity in Mexico, however, sometimes it is a lengthy process, which involves in that order:

- i. Obtaining a permit from the Foreign Relations Ministry.
- ii. Elevating the incorporation to the public instrument before a Public Notary or Public Broker. As well as registering the company, before:
 - a. The Public Property and Commerce Registry, and
 - b. The Foreign Investment Registry.
- iii. Registering the Company, before the Ministry of Finance.
- iv. Obtaining the proper permits for the performance of operations before local and state authorities.

The articles of incorporation will rule and guide the corporations throughout their lifespans, and will always have to be registered by a Public Notary or a Public Broker before the Public Property and Commerce Registry, even when modified. These articles may never be in contradiction of the law, or “good customs.”

2.3 Management

The stockholders general assembly is the supreme ruling body of any business entity. The assembly must convene at least once a year in the legal and fiscal domicile of the company, before the end of April.

A board of directors or a sole manager must be in charge of the company. Both are appointed by the stockholders general assembly. In the case of Public Companies, it usually is a board of directors instead of a sole manager.

The managers, directors, and legal representatives, answer in solidarity regarding the company before the stockholders general assembly and to third parties for resulting damages, directly or indirectly for the violation of the law, its statutes or regulations and for the abuse of power, fraud or serious negligence. Likewise, the managers, directors, and legal representatives may or may not be stockholders.

There is no need for a worker’s or employee’s representative to be on the board of directors.

2.4 Year to Year Periods

All companies have the requirement to complete their operating and fiscal period on a yearly basis, from January 1 through December 31, except in the cases of the first year of operation, mergers, spin-offs, bankruptcy, among others.

All fiscal years must coincide with the calendar year.

2.5 Statutory Examiner

The stockholders assembly must appoint at least one Statutory Examiner. If a stockholder owns at least 25% of the shares, he or she may appoint a Statutory Examiner. The Examiner must never be a related party of any member of the board or of an employee of the company.

Usually the examiner is an auditor, due to the obligations of vigilance and those that lie within, such as reviewing the accounting books of the company, and present before the stockholders assembly an annual assessment. The examiner has the authority to convene a stockholders general assembly if he or she deems it necessary.

2.6 Fiscal Domicile and Federal Tax Number

All business entities must establish a fiscal domicile as the one registered before the Ministry of Finance, whereupon all accounting records, and official business is conducted.

A federal tax number must be obtained as a means of identifying the company before any governmental agency. The number is issued by the Ministry of Finance.

2.7 Labour Regulations

Labour Relations

The Federal Workers Law has been in force since 1970 and all employers and employees are bound to it. The labour relationship between the employer and the employee can be established by individual or collective status.

The aforementioned law establishes all the requirements and procedures, such as working periods, holidays, vacations, unions, among other things.

Salaries and Minimum Wage

The working process in Mexico is highly competitive, due to its low wages and salaries.

The minimum wage for the Mexico City Area is 46.80 MxP per day, or roughly USD 4.18 US daily.

Working Week

The working week in Mexico is 48 hours divided into 6 days. Saturday is usually half a day. Night shifts are only subject to 42 hours per week, and mixed shifts are subject to 45 hours per week. The service industry does not work on Saturdays.

By Law, double pay is liable for the first nine extra hours, and triple thereafter. A 25% increase is applicable for working Sundays, and vacation premiums apply.

Employee Benefits

Employees are liable for a 7 day vacation period after a one year working period. After that 1 day is added per one year worked until 5 years worked. And after 5 years, every period is granted by 2 more vacation days.

Employees are entitled to half a month's pay as a year-end "bonus", due in December 20.

Retirement premium amounts to 12 days pay for every fiscal year worked.

When an individual is discharged, they are entitled to three months pay, plus 12 days for every fiscal year worked.

Unions and Syndicates

Workers can form a syndicate with 20 or more workers with the purpose of defending mutual interests. In many industries collective agreements are modified every one or two years; however, wages are modified every year.

Employee Profit Sharing

Employees are entitled to 10% of the profits, based on reconciliation similar to that of the Income Tax. The result is divided using a “pro rata” system, and every employee is eligible except the managing director.

The employees' share of profits is due on May 31 of the subsequent fiscal year.

Social Security

Employees benefit from a Social Security System contributed to by the employer and the employee at an estimated rate of 16% and 4% respectively, based on the employee's salary. As such employees have access to:

As such the employees have access to:

- i. General medical services
- ii. Retirement funds
- iii. Housing loans

3 Taxes, Tariffs and Tax Administration

All residents are subject to federal taxes, such as: Income Tax , Assets Tax, Value Added Tax, among others.

For tax purposes those considered as residents are:

- i. Business entities incorporated in accordance with Mexican legislation, as well as those with permanent establishment or a fixed base in Mexico.
- ii. Individuals who:
 - a. Have their home address in Mexico.
 - b. Have their home address abroad, but with more than 50% of the income on a worldwide basis coming from Mexico.
 - c. Render professional services in México.
 - d. Have Mexico as their vital source of interests.
 - e. Have a permanent establishment in Mexico (More than 183 days a year.)

3.1 Income Tax

A corporate income tax rate of 30% is applied to the net result of reconciliation between financial and tax information. The net result culminates as the Net Tax profit or loss.

Tax Reconciliation	
	Net accounting income before taxes
Add	Non Deductible expenses Other Taxable Income
Subtract	Other Taxable Deductions Non Taxable Income
Equal to	Net Tax Profit
Multiplied by	30%
Equal to	Payable Income Tax

From hereinafter referred to as "IT," "AT," and "VAT" respectively.

For 2006, the Income Tax rate will be 29% and for 2007 the Income Tax rate will be 28%.

As non-deductible items, there are:

- i. Gifts
- ii. Representation expenses
- iii. Rental of ships and vacation homes
- iv. Taxes that are on behalf of third parties
- v. Share payments of a company's profit
- vi. Premiums paid on repurchase of company shares (Buy-back)
- vii. Losses from mergers or capital reductions
- viii. Penalties or severance payments
- ix. Interest payable on capital shares
- x. Payments made to a company abroad on a prorated method (Except for branches.)
- xi. Amortization of goodwill items

The following items are also tax deductible (limited base):

- i. Travel expenses
- ii. Car rental
- iii. Airplane rental

As reconciliation entries, a special computation is performed on the following items based on the effects of inflation such as:

- i. Interest and net monetary position (Interest paid are subject to the "Thin capitalization clause", limited when the debt exceeds three times the stockholders equity.)
- ii. Depreciation
- iii. Amortization

The following are considered as taxable deductions:

- i. Cost of sales
- ii. Sale returns and discounts
- iii. Operating expenses
- iv. Bad debt
- v. Retirement funds, and seniority premiums
- vi. Board members fees

As non-taxable income are considered the following:

- i. Inflationary effects of Bulletin B-10 (Explanation in the accounting entry.) over assets and capital stock
- ii. Stock premiums
- iii. Capital stock Increases
- iv. Payments of losses by the stockholders
- v. Dividends received from Mexican business entities

Until December 2004, the deduction was made for the purchases of inventory rather than the cost of sales.

Tax Losses or “NOLs”

Tax Losses may be carried forward for a period of 10 years from their year of claim, and be deducted from the Net Tax Profit.

Dividends

A net profit tax account is mandatory for all companies. Hence, when a dividend is paid through that account no tax is levied.

However if paid through other methods, the dividend must be grossed-up by a factor of 1.4286, and a 30% tax rate applied. The tax on dividends is payable through the company’s tax returns.

Tax Consolidation

The Income Tax Law allows for a group of companies to consolidate for tax purposes, in hope of increasing cash flow.

Maquiladoras

The Maquila, or the in-bond industry, is an authorization of the Ministry of Economy and the Ministry of Finance to engage in an agreement with a foreign company and offer transformation of goods services. This involves importing and exporting almost all of the inventories.

Due to low margins, the Maquila program is very popular with companies abroad. However they are subject to strict Transfer Pricing rules. A “safe harbour” is offered by the tax authorities as a minimum income equal to 6.9% over the maquiladora assets or 6.5% over costs and expenses. An Advanced Pricing Agreement may be performed prior to a fiscal year of operations in lieu of a better opportunity than the safe harbour. Further information on Transfer Pricing may be found in the section on audit.

Foreign Residents

Foreign residents or residents abroad with no permanent establishment in Mexico are subject to IT on income generated in Mexico. By law the party that makes the payment is obliged to withhold the IT on the gross income with no deductions whatsoever.

The most common payments abroad are:

- i. For royalties, compensations and technical assistance the IT withholding rate ranges from 10% for those countries with a tax treaty to 25% for the ones who do not have a tax treaty with Mexico.
- ii. Likewise for interest, the IT withholding rate ranges from 4.9% for those countries with a tax treaty to 40% for the ones that do not have a tax treaty with Mexico.
- iii. For payments made to “Tax Heavens” or preferred tax regime jurisdictions the IT withholding rate is 40%.

Tax Treaties

México has the following treaties in force:

- | | | |
|------------------|---------------|------------------|
| ● Australia | ● Germany | ● Poland |
| ● Belgium | ● Ireland | ● Portugal |
| ● Canada | ● Israel | ● Romania |
| ● Chile | ● Italy | ● Singapore |
| ● Czech Republic | ● Japan | ● Spain |
| ● Denmark | ● South Korea | ● Sweden |
| ● Ecuador | ● Luxembourg | ● Switzerland |
| ● Finland | ● Netherlands | ● United Kingdom |
| ● France | ● Norway | ● United States |

3.2 Assets Tax

As a lieu tax for the Income Tax, the Assets Tax or “AT” is mandatory for most companies after a four year period of incorporation. The AT is only liable thereafter if it is higher than the Income Tax. A 1.8% AT rate is applied on the average of fixed and financial assets, with a few liabilities deducted.

3.3 Value Added Tax

A Value Added Tax or “VAT” rate of 15% (10% in border zones) is applicable in the final price of:

- i. Sale or disposal of goods and merchandise
- ii. Leasing of goods and services
- iii. Rendering services, and
- iv. Imports of goods and services.

Some articles such as food (but not in restaurants.), medicine, and exports are subject to a 0% (Zero) VAT rate.

The VAT to pay is the result of the VAT issued by the company through their invoices, and the VAT paid by the company. All VAT is payable on a cash-flow basis; only what is paid is liable.

Maquiladoras and companies in the PITEX program are not subject to VAT on imports, only if those are being exported again.

3.4 Federal Tax Incentives

The Federal Government decrees on a yearly basis the incentives to be applied, such as:

- i. Accelerated depreciation over certain assets
- ii. Maquiladoras, and PITEX programs are not subject to duties and VAT
- iii. Investments made over technical research and development, equal to 20% in excess of the prior year’s amount
- iv. Certain industries that need diesel may take a credit on Special Production Tax
- v. 100% deductible ecological technology devices for the production of clean energy.

3.5 Employee Profit Sharing or Compulsory Profit Sharing

(Explained in the Labour Regulations Entry)

3.6 Compliance and Tax Administration

Tax returns

Annual tax returns are due by the end of March. Informative annual tax returns are liable before the end of February. Tax pre-payments are made on the 17th of the month after the period ends.

Today most tax returns are filed over the Internet.

Reviews by the Tax Authorities

The tax authorities have the right to review the accounting and tax payments of any business entity. However, if the entity is audited for tax purposes, the review is limited if the external auditor provides the sufficient and required information.

The right of the tax authorities to review an item expires after 5 years of filing that corresponding return.

Tax Reimbursements or Refunds

The Federal Tax Code and the applicable rules provide that if there is Federal tax overpayment or favorable balances, the tax payer has the right either to compensate against another Federal tax to pay, or receive a refund of the balance.

Expenses and invoices

The tax authorities have strict rules regarding invoices on expenses and invoices issued. In order for an expense to be deductible, or to credit the VAT, the requirements have to be met.

The expenses are usually covered through check or bank wire transfer.

3.7 Other Taxes

The Special Production Tax is applied to alcoholic beverages, some cold drinks, tobacco, gasoline and some petroleum products, and communications and related services.

In most states 2% state tax is applied to payrolls, as well as a tax on real state ownership. Furthermore a tax on the transfer of real estate applies at the time of acquisition at an average of 3% of the value.

Although Mexico is one of the most open economies in the world, import duties still apply, based on the country of origin and the product to be imported.

Social Security contributions and quotes are explained in the Labour Regulations entry.

3.8 Individuals

Individuals that are resident for tax purposes are subject to IT on a worldwide base income. The annual IT is determined through a tax bracket with a 30% maximum tax rate.

The only deductions applicable are:

- i. Medical and dental fees, as well as hospital expenses paid in Mexico
- ii. Health insurance
- iii. Real interest on home loans
- iv. Donations approved by the tax authorities
- v. Funeral expenses
- vi. School bus travel for children when mandatory

When the main source of income is wages or salary, the Company is responsible for withholding the IT on a monthly basis. However an annual tax return must be filed in the month of February, over the Internet.

Professional fees, and individual business activities are taxed on a similar basis as the salary.

Foreign Residents

Individuals resident abroad, as applied to companies or entities resident abroad, with no permanent establishment in Mexico are subject to IT on income generated in Mexico. By law the party that makes the payment is obliged to withhold the IT on the gross income with no deductions whatsoever. For wages and salaries a tax bracket is applicable as follows:

	Tax Rate
Income up to 125,900 MxP	Exempt
From 125,901 to 1,000,000 MxP	15%
In excess of 1,000,000 MxP	30%

4 Audit and Accounting

4.1 Auditing

Additionally to the previously mentioned statutory audit, the most common audits in Mexico are for financial and tax purposes. The audits may only be performed by certified public accountants, which must be registered by a recognized school of public accountants and before the Ministry of Finance, in the SAT. As performed in most countries, auditing procedures in Mexico are established in the Mexican General Auditing Rules of the Mexican Institute of Public Accountants, and are liable for all audits. Basically, the MGARs review the Mexican Generally Accepted Accounting Principles, also issued by the same institute.

For financial audits, no company is liable, except:

- i. All companies listed on the Mexican Stock Exchange, which are required to submit an annual consolidated financial report, as well as file the audited financial statements with the National Banking and Securities Commission,
- ii. Financial institutions and insurance companies must file audited financial statements with the appropriate regulatory agency; or,
- iii. Whenever a governmental department requires so.

For a tax audit to be performed, the financial audit must also be performed. Generally, the taxes that are reviewed are Income Tax, Assets Tax, and Value Added Tax.

The tax audit is liable for the following companies:

- i. Companies which generated over 27,466.183 MxP in accruable income, or an average value of assets for Assets Tax purposes of more than 54,932,367 MxP.
- ii. Companies with more than 300 employees.
- iii. Companies that are controlled by another audited company or by an individual or group of individuals that have more companies being audited.
- iv. Companies that merged, spun-off, or are in the process of liquidation or selling-out.

Financial and tax audits must be performed generally within the first five months at year-end.

29% in 2006, and 28% in 2007.

From hereinafter referred to as the "MGARs."

Transfer Pricing

All companies that perform transactions with related parties, within Mexico or abroad, are liable for a "Transfer Pricing Study," which must be completed in the same time frame as the tax audits. The Transfer Pricing Study is based on the Organization for Economic and Commercial Development's (OECD) rules, and it ascertains the "arms length" rule in the transactional operations performed with related parties.

Notwithstanding, the transfer pricing study will be an integral part of the same tax audit. If such is not completed, a note in the opinion of the review will be stated. As a safe note, currently the tax authorities are placing great emphasis on Transfer Pricing Policies which are minimized with the issuance of the Transfer Pricing Study.

The Mexican Tax Authorities are also considering the possibility of an Advanced Price Agreement , especially for the Maquila program.

Other Tax Audits

Other audits may be liable for such taxes as for:

- i. Social Security contributions.
- ii. Local and state taxes contributions.

4.2 Accounting

The accounting profession in Mexico is well regarded by the business community and has close ties with the authorities. The title of public accountant is granted by Mexican universities, and subsequently the various schools certify public accountants for auditing.

The Commercial Code, the Income Tax Law, and in general Mexican legislation, provide that all business entities must maintain their accounting records in Spanish, in MxP, in bound books, and must be kept in the fiscal domicile of the company for a period no shorter than 5 years. However the bound books can be substituted by electronic records.

The main and bound books to be kept by law are:

- i. Main ledger or general ledger
- ii. Daily ledger
- iii. Inventories record
- iv. Adjusted trial balance
- v. Stockholders General Assembly Minutes Book
- vi. Board of Directors Minutes Book
- vii. Share and stock record
- viii. Foreign debt, cash, credits record.

From hereinafter referred to as "IMCP", for their name in Spanish: Instituto Mexicano de Contadores Públicos.

From hereinafter referred to as the "MGaaPs."

Referred to as the total income of a company for tax purposes.

Or "APA."

4.3 Mexican Generally Accepted Accounting Principles

The MGAAPs, are in essence similar to the US GAAPs and other international principles, however there are basic applied differences. The MGAAPs are issued by the IMCP which is the highest authority in the subject. Additionally, the National Banking Commission, the National Insurance Commission, and the National Values and Trade Commission, issue certain accounting rules that are enforced on banking, financial, and insurance companies.

Foreign Currency and Exchange Effects

Since the accounting records must be in MxP at the period end, the MGAAPs stipulate that the foreign exchange items must be converted to MxP based on the statutory exchange rate at that date. The statutory exchange rate is published in the official gazette by Mexico's Central Bank on a daily basis.

Inflationary Effects

The financial statements must be prepared incorporating the inflationary effects to the financial information in accordance with the procedures established in Bulletin B-10 and its adapting documents, which do not have any tax effects.

The third adapting document to Bulletin B-10 requires that not only the amounts in the financial statements be expressed in Mexican pesos at the acquisition rate of the most recent period, but it also indicates that the different accounts or items within the stockholders' equity should reflect the face value calculated with the updating effects; just as the items of the profit and loss statement were updated with the multiplying factors resulting from dividing the INPC from the last month of the period by the INPC of each of the months of the period.

Comparability of the Financial Information

By means of comparing the same information and allowing a correct interpretation, the financial statements must be presented comparing the information of the previous year at acquisition rate as of the year end presented.

Inventories, Fixed Assets and Depreciation

Inventories have the same valuation methods as the international approved ones, such as FIFO, LIFO, average, among others. Fixed assets depreciation is generally calculated through the straight line method.

Deferred taxes

The company has an obligation to determine the deferred income tax, through the application of bulletin D-4 of the MGAAPs. One of the purposes of this bulletin is to acknowledge the income tax and employee profit sharing from the deductible or taxable temporary differences that may come up at the time of its recognition. Hence, the Income Tax and the deferred Income Tax are registered based on the results corresponding with the period of the company.

Seniority Premiums

Seniority premiums are granted after 15 years of service, and are considered as a cost for the years that an employee has rendered services, and are based upon actuarial computation. Such a provision must be created.

5 MSI Mexico Group

Potential investors are advised to consult one of our professional member firms at an early stage as they will be able to ensure that all relevant matters are identified. MSI Mexico Group is committed to providing the highest quality law and accounting services in Mexico. Should you need further assistance, please contact one of the following firms.

Guadalajara

Corona Rivera Velázquez y Cia SC

Marsella No. 75
Col. Americana 44160
Guadalajara Jalisco
México

Contact: Juan Corona Ramírez

Email: corvezsc@infosel.net.mx

Tel: + 52 33 615 42 83

Fax: + 52 33 615 69 54

Services: Accountants, Certified Auditors, Tax Consultants

México City

Rivero & Olivares Contadores Públicos SC

Av. De las Palmas No. 755- 402
Col. Lomas de Chapultepec
México City 11000

Contact: Juan Ignacio Rivero

Email: jirivero@ryo.com.mx

Tel: + 52 55 5284 2400

Fax: +52 55 5284 2411

Web: www.ryo.com.mx

Services: Accountants, Certified Auditors, Tax Consultants

Other: Also servicing Chiapas and Oaxaca

Also referred to as "Purchasing Power Rate."

National Price Index, or Índice Nacional de Precios al Consumidor. From hereinafter referred to as "INPC."

Or Assets Tax, based on the Mexican Tax Legislation.

Rubio Villegas y Asociados SC

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Col. Cuauhtémoc
Mexico City 06500

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Services: Lawyers, Tax consultants

Other: Also servicing Monterrey

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Web: www.icafe.com.mx

Services: Accountants, Certified auditors, Tax consultants

Monterrey & Matamoros**Pérez Gongora y Asociados SC**

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Col. Zona Centro
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Services: Accountants, Certified auditors, Tax consultants, Offshore services

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Services: Accountants, Certified auditors, Tax consultants

About MSI

MSI is a worldwide network of independent professional firms, with over 250 member firms in around 100 countries. It is one of the fastest growing professional service networks and aims to appoint a legal and accounting member firm in every major commercial center across the world.

MSI provides the clients of its member firms with access to lawyers, accountants, tax consultants, certified auditors and specialist service providers in most of the world's jurisdictions, ensuring that clients receive similar high levels of service and value for money from a network of like-minded professional firms that offer local expertise and solutions to cross border business challenges.

The MSI Secretariat

MSI Legal & Accounting Network Worldwide is run by its London based Secretariat. Should you need any further assistance, please contact the Secretariat at the following address:

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MSI is a network of
independent professional firms

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