

MEXICAN TAXES OVERVIEW

Tax regime in México is mainly governed with a self declaration and self calculation policy. The principal fiscal obligations of entities and individuals are to calculate their taxes in order to make monthly provisional payments and to prepare an annual declaration for those taxes that require doing so (ISR, IETU, IVA, IEPS, as per the acronym in Spanish), as well as to pay, transfer or withhold the predetermined tax, given the case, for those taxes that requires doing so (IDE, IVA, as per the acronym in Spanish). Taxpayers are also subject of domiciliary visits by the fiscal authority in order to verify the compliance of their fiscal obligations, either as entities or individuals.

Congress provides, through legislation, the rules and procedures necessary for the persons to calculate their taxes. This information is complemented with Miscellaneous Tax Resolutions (Misceláneas Fiscales) emitted by the fiscal authorities, which contain rules and guidelines on the interpretation of specific articles of the tax law; such criteria will be applied by the entity or individual when calculating their taxes.

The principal fiscal authority in México is the Secretariat of Finance and Public Credit (SHCP as per the acronym in Spanish); its function is to propose, direct and control the country's economic and fiscal policies. The executive agency for fiscal matters is the Tax Administration Service (SAT as per the acronym in Spanish), its function is to execute and enforce tax statutes and ordinances.

Taxpayers in México are required to be registered in the Federal Taxpayer Registry (RFC as per the acronym in Spanish), in the SAT offices. The RFC number is used for all tax procedures; furthermore, all taxpayer, including partners and shareholders of legal entities shall be required to obtain their Advanced Electronic Signature (FIEL as per the acronym in Spanish).

The administration of President Felipe Calderón Hinojosa succeeded in passing a Tax Reform on 2007 which has come to effect in 2008. The reform has been largely criticized for doubling the workload on the taxes, instead of increasing the number of taxpayers, although has proven to be very effective in terms of revenue for the Government.

CLASSIFICATION OF TAXPAYERS

The law classifies taxpayers within the following groups:

Entities

Corporations, (Personas Morales) including business associations and administrative entities that run commercial, industrial, agricultural, cattle, fishing, and wildlife activities. They also include branches and permanent establishment of foreign corporations or entities, and some nonprofit organizations and firms offering professional services.

Nonprofit Entities

Nonprofit entities include certain corporations or civil associations, and cooperative corporations.

Mexican and Foreign

Mexican and/ or foreign individuals with respect to their income, regardless of the location of the source of income.

Corporations and individuals residing outside of México

Corporations and individuals residing outside of México with a source of income located within the Mexican territory.

Individuals and corporations who reside abroad without permanent establishment or base in the country may request their registration in the federal registry of taxpayers.

The request must be filed within the following month, after the following situations occur:

- In the case of corporations, when the articles of incorporation are signed;
- For individuals as well as corporations residing abroad, when legal or fact situations occur that create an obligation to file a periodical declaration of activities.

MEXICAN TAX LAW

The Constitution of México establishes the taxation principles that Congress must comply with when legislating any tax law and as well the Fiscal Authorities when exercising its faculties. Each specific tax in Mexico is comprised in its own statute and each statute has its ordinance, both establish the necessary rules and procedures to calculate such tax. The Fiscal Code (Código Fiscal de la Federación) is a general code that contains the general rules, definitions and main topics applicable to every tax law. It also serves a supplementary function for the tax statutes.

There are also the Miscellaneous Tax Resolutions which are internal documents of the Fiscal Authorities, issued and available to the public, that contain rules, criteria and interpretation of specific tax regulation. For a proper tax calculation it is necessary to consider the specific tax statute, ordinance, the Fiscal Code, and the applicable Miscellaneous Tax Resolutions.

CONSTITUTIONAL TAX PRINCIPLES

The most relevant principles are the proportionality and equity principles, because they are the most commonly violated principles by legislation and fiscal authorities, therefore becoming matter for the writ of protection (demanda de amparo) against violators tax laws or acts of authority.

The proportionality principle consists in the adequate distribution of taxes considering the economic capacity of the taxpayer, in order for taxes to be progressive.

The equity principle establishes the right of every taxpayer to be treated on a case per case basis, all of those that incur in the same legal presuppositions and in the same conditions will be treated equally and when there is a special condition or a different situation of the taxpayer, that condition or situation shall be taken into consideration, so that the application of the law is fair.

Constitution also provides the principle of lawful taxation, also known as *nullum tributum sine lege*; it establishes that there can be no taxation without its corresponding statute. Other taxation principles are the generality principle, mandatory principle and the public expenditure vinculation principle.

INCOME TAX (ISR)

This tax is calculated on net taxable income. Monthly provisional payments are to be made during the fiscal year also an annual declaration is required.

Persons subject to the ISR are divided in three categories, the first are residents in national territory, the second category are the non-residents with a permanent establishment, such as branch, in Mexico. The third category are the non-residents with no permanent establishment in Mexico.

For the non-residents the income is taxable only if it was originated in Mexico; that condition is irrelevant to residents in Mexico because their income is taxable regardless of the source of income.

The rate applicable to the withholding of income tax on interest paid by the entities of the financial system is maintained at 0.5% (rate applies on the capital) annual.

Net taxable income is subject to a graduated rate of 30% in 2010 to 2012, in 2013 is 29% and 28% in 2014.

In order to claim the exemption under the double taxation treaties, the taxpayer must prove their residency in the corresponding country and must comply as well with the specific regulations of the treaty.

BUSINESS FLAT TAX (IETU)

One of the main aspects of the Fiscal Reform of 2008 was the implementation of the tax law IETU, which is designed as a complement the ISR. The previous attempt of the Government to complement the ISR was the Impuesto al Activo (Assets tax), but failed its purpose and was abrogated because of a large number of taxpayers where demanded its unconstitutionality through the protection remedy and obtained it.

IETU has been largely criticized because it imposes double the work on the taxpayer, who now has to make two monthly tax calculations, the ISR and the IETU, and pay whichever of the tax that its calculations resulted in a higher quantity and, in some cases, both.

To calculate this tax it is necessary to determine the total income of the year, minus deductions and apply the rate of 16.5% in 2008, 17 in 2009, being these two years a period of transition and starting in 2010 a rate of 17.5% will be applied.

Monthly provisional payments must be presented at the same time as the ISR; the same applies for the annual declaration. The monthly payments can be made in authorized banks, without the need of going to SAT offices. If chosen to do so it is necessary to electronically send to SAT a statement that contains the concepts used for the calculation and the number of the bank operation.

Existing tax deductions were eliminated with the implementation of this new tax law, such as inventories, employee salaries, dividends, among others.

VALUE ADDED TAX (IVA)

The statute for this tax establishes four different activities that are subject to IVA, when a person or entity sell or disposes of property, renders independent services, import goods or services or grants the temporary use of property.

This taxpayer has the obligation to transfer this tax to the person that will acquire the goods, use them or receive the services. For instance, this tax is required and collected on the value added to the goods or services in each stage of the production or distribution process and are paid one time by the final consumer on the added value in each level.

Therefore is considered a transferred tax.

The general rate is 16% but there is also a 0% rate in the sale of patents, medicines and some nutritional product. There are also lower rates applied to certain locations in the country. 11% is applicable rate in the areas located 100 km (62.14 miles) south from the border and 50 km (31.07 miles) from the coast going inland.

The IVA is paid through monthly payments to the SAT, and the calculation consists on the total of taxable activities or operations minus the credited taxes.

TAX ON CASH DEPOSITS (IDE)

This tax was designed as a measure against the tax evasion of informal businesses owners. For every cash deposit of more than \$15,000.00 Mexican pesos made on any bank account, in a single transaction or in several transactions in the course of one month, the bank will retain a 3% of the amount that surpasses the \$15,000.00 pesos limit. For example, if a person makes a deposit of \$40,000.00 pesos that bank will retain a 3% rate over the 15,000.00 pesos excess. Amount that exceeds the 15,000.00 pesos will be tax retention of \$300.00 pesos.

Deposits made via electronic transfers, account transfers, negotiable instruments or any other document will not be liable for the tax because it is assumed a control exists and therefore knowledge of the origin of the funds is possible. The tax actually paid is creditable against the income tax.

The cash deposit tax is creditable to the fiscal year ISR, ISR retained by third parties, and other federal contributions. If after the compensation there is a surplus, the taxpayer may file for a refund.

SPECIAL PRODUCT AND SERVICE TAX

This tax is applicable to entities and individuals that sell import certain goods in a definitive manner or render certain services. Some of these products are: alcoholic beverages; alcohol and denatured alcohol; tobacco and cigarettes; gasoline and diesel; mineral water, hydrating or re-hydrating beverages; and certain services as telecommunications.

If the tax is not paid in the term established by law, a penalty will be assessed:

- A. The tax payment must be updated for inflation.
- B. Once established the fiscal authority will calculate the penalty without exceeding 3% interest per month

Therefore, the unpaid tax, plus inflation, plus penalty is paid to the fiscal authority.

RETURN POLICIES

If the taxpayer obtains a favorable balance he has the possibility of choosing the following two options:

Compensation

Consists in subtracting debts that must be paid from the amounts obtained by previous balances in favor. The debts as well as the balance in favor not necessarily should derive from the same type of tax. A favorable balance may be updated in relation to the inflation level at the time.

Also the IVA or value added tax balance when favorable may be compensate against other taxes depending on each tax law requirements.

Refunds

Refunds are obtained by filing a refund application to the fiscal authority. After receiving the application, the fiscal authority has 50 working days to approve or disapprove the application, (40 days if the balance in favor is deposited in the taxpayers banking account). If this term is exceeded, the fiscal authority must pay interest to the taxpayer.

If the tax payer wishes to correct some of the data included in his statements, he may present no more than 3 supplemental statements.

DOUBLE TAXATION TREATIES

Mexico has signed treaties of this nature with 39 countries, with the purpose to avoid the double taxation when the source of income is outside the country of residence of the taxpayer. With the implementation of the new tax IETU it was necessary for

Mexico to assure that this tax would be recognized and credited in such treaties, because as well as the ISR it also levies incomes. To this day 35 countries have confirmed the IETU as a creditable tax against their local income, in compliance with the double taxation treaties signed with Mexico.