



DOING BUSSINESS IN
MEXICO
TAXES APPROACH

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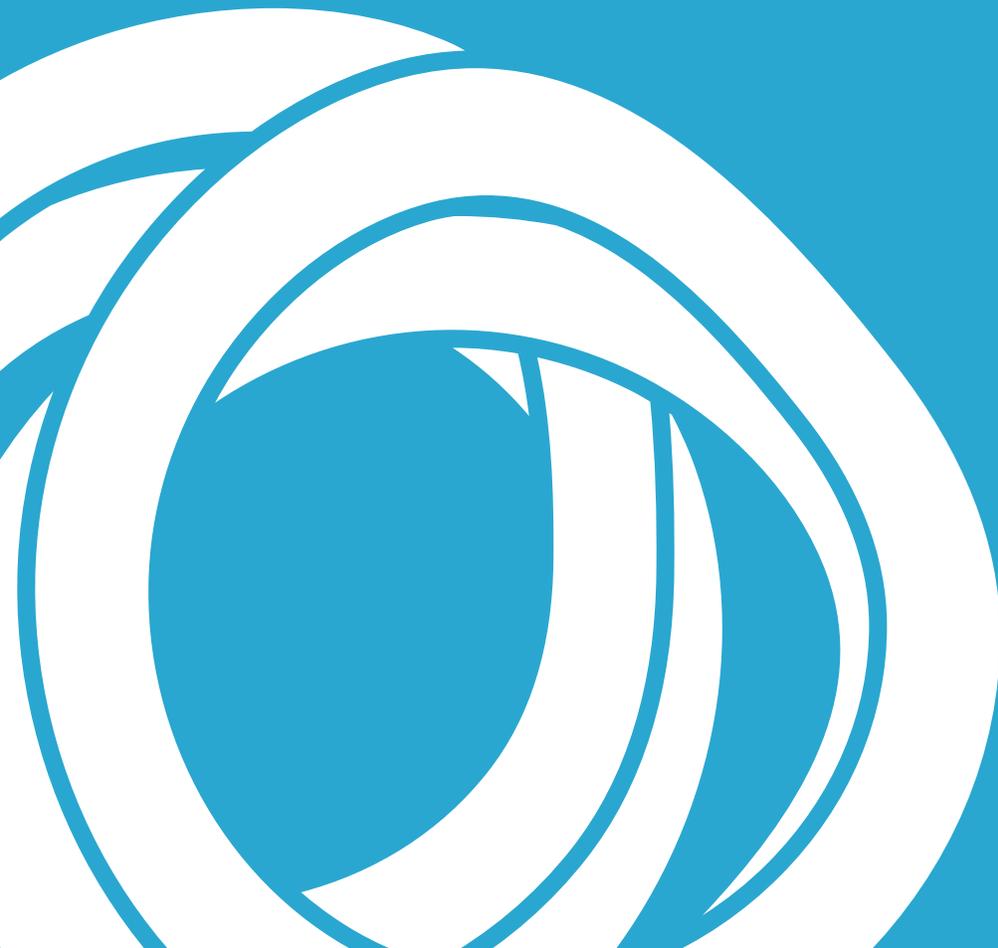
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INTRODUCTION

THE MEXICAN TAX SYSTEM HAS BEEN SUBJECT TO COMPREHENSIVE TAX REFORM LEGISLATION. THIS LEGISLATION, ENACTED PRINCIPALLY IN 1986, 1988 AND 1994, HAS DRAMATICALLY CHANGED THE TAX LAWS IN AN ATTEMPT TO MAKE THE SYSTEM COMPETITIVE WITH THE TAX SYSTEMS OF MEXICO'S MOST IMPORTANT TRADING AND INVESTMENT PARTNERS AS WELL AS WITH THE SYSTEMS OF COUNTRIES COMPETING WITH MEXICO FOR FOREIGN INVESTMENT.

1. MAIN TAXES IN MEXICO



MAIN TAXES IN MEXICO

THE PRINCIPAL TAXES PAYABLE BY INDIVIDUALS AND BY CORPORATIONS OPERATING IN MEXICO AND, IN CERTAIN CASES, BY FOREIGN COMPANIES, ARE THOSE LEVIED BY THE FEDERAL GOVERNMENT.

STATE AND MUNICIPAL GOVERNMENTS HAVE MORE LIMITED TAXING POWERS AND UNTIL NOW HAVE NEVER LEVIED GENERAL CORPORATE INCOME TAXES; SOME STATES TAX EMPLOYERS ON SALARIES AND PROFESSIONAL FEES PAID BY THEM. THE PRINCIPAL TAXES ARE AS FOLLOWS:

FEDERAL TAXES

- 1 Flat Tax
- 2 Value-added tax
- 3 Income Tax
- 4 Payroll taxes, social security premiums, mandatory retirement savings system, and contributions to the National Workers' Housing Fund.

LOCAL TAXES

- 1 On real property
- 2 On salaries
- 3 On acquisitions of real property

THERE ARE SOME SPECIAL FEDERAL TAXES ON A FEW SPECIFIC PRODUCTS AND SERVICES, SUCH AS ALCOHOLIC BEVERAGES, CIGARETTES, GASOLINE, TELEPHONE SERVICE, AUTOMOBILES, ETC.



2. TAXES IN MEXICO



TAXES IN MEXICO



INCOME FROM PERSONAL SERVICES (EARNED INCOME) INCLUDES SALARIES, COMMISSIONS AND ALLOWANCES OF ALL TYPES, INCLUDING THOSE FOR HOUSING, LIVING EXPENSES, EDUCATION, FOREIGN-SERVICE, TAX REIMBURSEMENTS, AND AMOUNTS RECEIVED AS EMPLOYEE PROFIT SHARING.

CERTAIN BENEFITS MAY BE CONSIDERED AS TAXABLE INCOME OF THE INDIVIDUAL EVEN IF THEY ARE NOT A DEDUCTIBLE EXPENSE FOR THE EMPLOYER.

LIVING EXPENSES CAN BE ABSORBED FREE OF TAX TO THE EMPLOYEE ONLY IN THE CASE OF SHORT-TERM VISITS AND IF SUPPORTED BY RECEIPTS FROM THIRD PARTIES. A PER DIEM RATE IS TREATED AS A TAXABLE ALLOWANCE. REIMBURSEMENTS OF EXPENSES OF A SPOUSE OR DEPENDANTS USUALLY REPRESENT TAXABLE INCOME TO THE EMPLOYEE.

BUSINESS TRAVEL EXPENSES, OTHER THAN THOSE SUPPORTED BY RECEIPTS FROM THIRD PARTIES AND LIMITED TO MAXIMUM DEDUCTIBLE AMOUNTS, MUST, IN GENERAL, BE ADDED TO SALARIES FOR INCOME TAX PURPOSES.

EMPLOYMENT INCOME

Income from personal services (earned income) includes salaries, commissions and allowances of all types, including those for housing, living expenses, education, foreign-service, tax reimbursements, and amounts received as employee profit sharing.

Certain benefits may be considered as taxable income of the individual even if they are not a deductible expense for the employer.

Living expenses can be absorbed free of tax to the employee only in the case of short-term visits and if supported by receipts from third parties. A per diem rate is treated as a taxable allowance. Reimbursements of expenses of a spouse or dependants usually represent taxable income to the employee.

Business travel expenses, other than those supported by receipts from third parties and limited to maximum deductible amounts, must, in general, be added to salaries for income tax purposes.

INVESTMENT INCOME

Residents are required to include investment income in their annual returns, except for: (a) interest from the Mexican banking system and government obligations, which is either subject to a final withholding tax of 20% on gross interest (or a portion thereof) or is exempt; (b) dividend income from Mexican corpo-

rations or investment funds; and (c) capital gains on transactions carried out through the Mexican stock exchange, which are exempt.

CAPITAL GAINS

Gains on the disposition of real property or shares of capital stock receive favorable income tax treatment in that historical costs may be increased by factors (based on the number of years the asset had been held) to adjust them for inflation, and in the case of shares of capital stock also by amounts intended to partially cover net retained earnings, whether capitalized or not. The resulting net gain for tax purposes is taxed under a formula favorable to the taxpayer, again depending on the number of years the asset was held before sale. Gains on sales of securities through the Mexican stock exchange, when the securities are classified as available to the general public, are exempt from tax.

Gains from the sale of the taxpayer's principal residence are exempt, provided the taxpayer occupied it as such during the two years before the sale.

Residents of Mexico are taxed on their worldwide capital gains, whereas non-residents are only subject to Mexican tax on gains arising from sales of real property located in Mexico or non-exempt sales of shares of Mexican companies, regardless of where the sale takes place.

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3. DEDUCTIONS AND OTHER TAXES



BUSINESS DEDUCTIONS



EMPLOYEES ARE ALLOWED NO BUSINESS-RELATED DEDUCTIONS, ALTHOUGH REIMBURSEMENTS OF PROPERLY SUPPORTED MOVING AND TRAVEL EXPENSES THAT ARE DEDUCTIBLE TO AN EMPLOYER DO NOT REPRESENT TAXABLE INCOME TO THE EMPLOYEE. NON-BUSINESS EXPENSES.

A RESIDENT IS ALLOWED TO DEDUCT UN-REIMBURSED MEDICAL, DENTAL OR FUNERAL EXPENSES FOR HIMSELF AND DEPENDANTS, AS WELL AS CERTAIN CHARITABLE DONATIONS.

THERE ARE NO STANDARD DEDUCTIONS, EXCEPT THAT AN INDIVIDUAL MAY DEDUCT 50% OF RESIDENTIAL RENTAL INCOME INSTEAD OF ACTUAL EXPENSES AND DEPRECIATION OF THE PROPERTY.

PERSONAL ALLOWANCES

Residents are also allowed to deduct an amount equal to 30 days minimum wage if they receive an annual bonus from their employer.

TAX RATES

Taxable income is taxed in accordance with a progressive table of rates from 3% to a maximum marginal rate of 35%, reproduced in Exhibit 3. It should be noted that this top marginal rate is reached very rapidly.

TAX CREDITS

A resident may obtain a credit to reduce his Mexican tax, payable for any foreign income tax paid on foreign source taxable income, and subject to certain limitations.

A non-refundable low-income credit (subsidy) designed to reduce the tax burden of taxpayers with lower income is granted. This credit is phased out if the taxpayer receives tax-exempt benefits from the employer. For lower levels of income, it may reduce the taxpayer's burden by up to 50% of the tax.

In addition to the low-income credit, there is a refundable credit, which is capped at NPs520.56 for salaries above four times the minimum wage. This credit substitutes the 10% of minimum wage credit applicable up to October 1.

SOCIAL SECURITY TAXES

Contributions to the Mexican Social Security Institute are withheld from employees at the rate of 5.15% of covered salaries up to a maximum of 25 times the minimum wage in the Federal District (10 in the case of

old age, death and disability insurance), resulting in a maximum employee contribution of around \$1,650 dollars per annum.

LOCAL TAXES ON INCOME

A few Mexican states levy a relatively low rate of tax on salaries (but not on income in general), which in most cases is payable by the employer (e.g., the Federal District imposes a 2% payroll tax, payable by the employer).

TAX RETURNS

All resident individuals receiving income during the calendar year are required to file an annual tax return no later than April 30 of the following year in certain instances, such as individuals earning Mexican bank interest only—regardless of the amount thereof. In the case of salaries, the employer is required to compute the annual tax on behalf of the employee unless the employee notifies the employer he will file an annual return.

PAYMENT OF TAX

Any unpaid balance of tax is payable upon filling the return. The full tax on salary income and certain interest income is withheld at source.

However, in the case of salaries received by resident individuals from non-resident employers, the law requires such individuals to file monthly advance tax returns to pay an amount equal to the tax withholdings applicable to these wages. The monthly returns are due by the 17th day of the following month.

4. EMPLOYEE PROFIT SHARING



EMPLOYEE PROFIT SHARING



ALL BUSINESSES IN MEXICO WITH EMPLOYEES, WHETHER ORGANIZED AS SOLE PROPRIETORSHIPS, PARTNERSHIPS OR CORPORATIONS, ARE REQUIRED TO DISTRIBUTE A PORTION OF ANNUAL PROFITS AMONG ALL EMPLOYEES, EXCEPT DIRECTORS AND THE GENERAL MANAGER. THE EMPLOYEE'S RIGHT TO SHARE IN THE PROFITS OF A CONCERN DOES NOT GIVE THEM THE RIGHT TO INTERVENE IN ITS MANAGEMENT.

PERSONAL ALLOWANCES

Employees are entitled to receive as their share of their employer's annual profits an amount equal to 10% of taxable income, as determined in accordance with the Income Tax Law, with certain modifications to eliminate the income tax adjustments related to below, in which the labor law establishes a limitation equal to one month's salary.

In the case of entities whose income is derived exclusively from personal services, such as professional partnerships, the amount of profit sharing payments made to each employee need not exceed one month's salary. The same limitation applies in the case of employees whose duties relate to collecting loans and interest thereon or who manage rental property.

METHOD OF DISTRIBUTION

Distribution of the employee's share in the profits must be made within five months after the end of the fiscal year.

The employer is required to make a copy of the company's return available to his employees so that they may exercise their right to object to their employer's income tax return. Any objection by employees to the tax return is communicated to the Revenue Authorities who issue the final decision, which cannot be contested by the employees. The labor law provides that non-compliance with the provision of the law establishing profit sharing is grounds for a valid strike.

The portion of the company's profit that is distributed among its employees is divided into two equal parts. The first is distributed among the employees in accordance with the number of days worked by each during the year, and the second in proportion to the salaries earned by each, except that the maximum compensation for computing the profit sharing of each white collar or supervisory employee is 120% of the salary of the highest paid blue-collar employee.



PERSONS SUBJECT TO OR EXEMPT FROM DISTRIBUTING PROFITS

ALL INDIVIDUALS, COMPANIES OR ECONOMIC UNITS WITHOUT LEGAL PERSONALITY THAT HAVE EMPLOYEES ARE REQUIRED TO DISTRIBUTE A PORTION OF THEIR PROFITS TO THEM. NON-PROFIT ORGANIZATIONS PAY PROFIT SHARING IN ACCORDANCE WITH SPECIAL RULES CONTAINED IN THE FEDERAL LABOR LAW. TAXPAYERS WHO ARE ENTITLED TO STATUTORY REDUCTIONS OF THEIR INCOME TAX WILL USE AS THE BASE FOR PROFIT SHARING THEIR TAX PROFIT COMPUTED AS IN THE CASE OF A TAXPAYER WHO IS NOT ENTITLED TO THESE REDUCTIONS. PROFIT SHARING IS NOT APPLICABLE TO THE FOLLOWING:

- 1 NEWLY ESTABLISHED BUSINESSES, DURING THE FIRST YEAR.
- 2 NEWLY ESTABLISHED BUSINESSES THAT MANUFACTURE A NEW PRODUCT, DURING THE FIRST TWO YEARS.
- 3 MINING AND SIMILAR BUSINESSES, DURING THE EXPLORATION PERIOD.
- 4 PUBLIC AND PRIVATE WELFARE INSTITUTIONS RECOGNIZED BY LAW.
- 5 ENTERPRISES WHOSE CAPITAL AND GROSS INCOME ARE LESS THAN A CERTAIN MINIMUM ESTABLISHED BY THE LABOR DEPARTMENT.

5. CORPORATE TAXES



CORPORATE TAXES



35%

MUST BE PAID ANNUALLY TO THE TAX AUTHORITIES ON THE COMPANY'S TAXABLE PROFITS

A MEXICAN COMPANY WILL BE SUBJECT TO THE FOLLOWING TAXES DURING ITS OPERATION:

A CORPORATE TAX ASSESSABLE AT A MAXIMUM RATE OF 35% MUST BE PAID ANNUALLY TO THE TAX AUTHORITIES ON THE COMPANY'S TAXABLE PROFITS. THE PROCEDURE TO CALCULATE SUCH PROFITS IS BY DEDUCTING CERTAIN ALLOWED EXPENSES FROM THE TOTAL ACCRUABLE GROSS INCOME.

Most of the company's income is considered accruable for income tax purposes at the time any of the following situations occur:

- 1 INVOICES ARE ISSUED.
- 2 GOODS ARE DELIVERED TO THE BUYER OR SERVICES ARE RENDERED.
- 3 WHEN TOTAL OR PARTIAL AMOUNTS OF THE TRANSACTION IS COLLECTED OR IS PAYABLE, INCLUDING ADVANCE PAYMENTS.

Basically, the allowed deductions are all costs and/or expenses strictly necessary to carry out the company's business. Except for the first year of operations, all Mexican corporations must file their income taxes through monthly provisional payments. These provisional payments will be credited against the annual income tax return.

FLAT TAX

The Flat Tax base is determined by netting the following inflows and outflows:

Inflows

1. Cash collected from the sale of assets, including inventory and other assets
2. Cash collected from independent services
3. Cash collected from rental property

Outflows

1. Cash payments from purchases of assets
2. Cash payments from services
3. Cash payments from rental property

If the inflows exceed the outflows, the Flat Tax rate of 17.5 percent will be applied to the excess.

Moreover, the Flat Tax base will be determined on a cash-basis method. Salaries, wages and employer

IF THE INFLOWS EXCEED THE OUTFLOWS THE FLAT TAX RATE OF 17.5 PERCENT WILL BE APPLIED TO THE EXCESS.

Social Security contributions are not deductible in determining the Flat Tax base. In addition, no depreciation or amortization is allowed to reduce the Flat Tax base.

Salaries, wages and employer Social Security contributions will be considered as credit for Flat Tax purposes. The credit is determined by multiplying these salaries and wages by the Flat Tax rate (17.5 percent)

Also, if you require additional information regarding the Social Security contributions, following there is the link:

http://www.sat.gob.mx/sitio_internet/asistencia_contribuyente/principiantes/eres_extranjero/78_9768.html

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VALUE ADDED TAX

A company doing business in Mexico will be obligated to pay Value Added Tax (VAT) when it carries out any of the following activities:

1 ALIENATES OR
LEASES GOODS

2 RENDERS
INDEPENDENT
SERVICES

3 IMPORTS GOODS
AND/OR SERVICES.

This tax shall be calculated by applying the general rate of 16% to the price of the goods or services. The VAT is charged to the taxpayer who acquires the goods or receives the services from the company. Therefore, the VAT must be stated separately on the invoice of the goods or services. Basically, the company shall pay to the tax authorities the difference between the VAT it has transferred to its clients or paid on the importation of goods and services from the VAT the company had paid to third parties during the course of business.

THE VALUE ADDED TAX WILL BE
DETERMINED ON A CASH-BASIS.

SOCIAL SECURITY TAXES

Contributions to the Mexican Social Security Institute are withheld from employees at the rate of 5.15% of covered salaries up to a maximum of 25 times the minimum wage in the Federal District (10 in the case of old age, death and disability insurance), resulting in a maximum employee contribution of around \$1,650 dollars per annum.

Also, if you require additional information regarding the Social Security contributions, following there is the link:

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