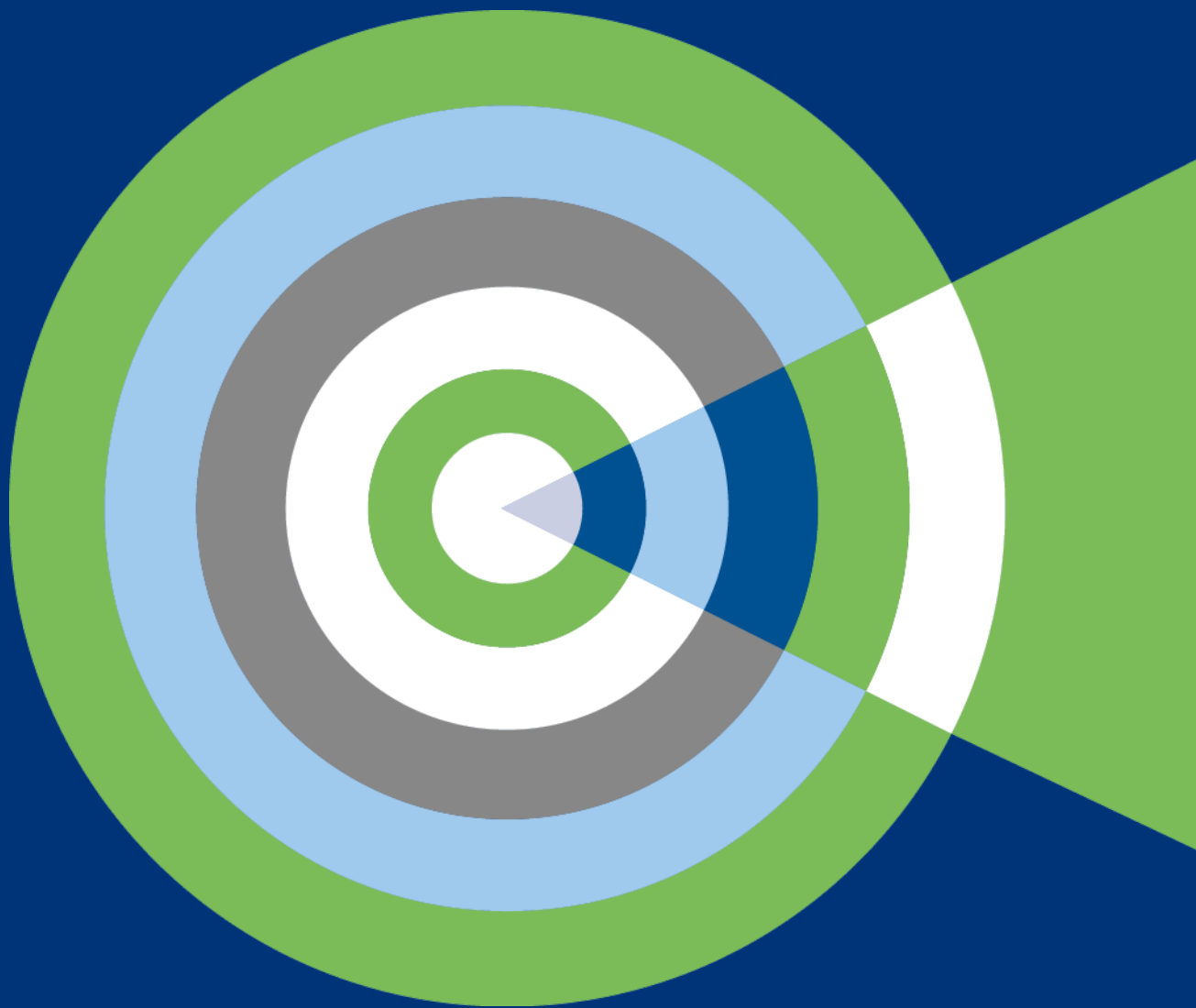


DOING BUSINESS

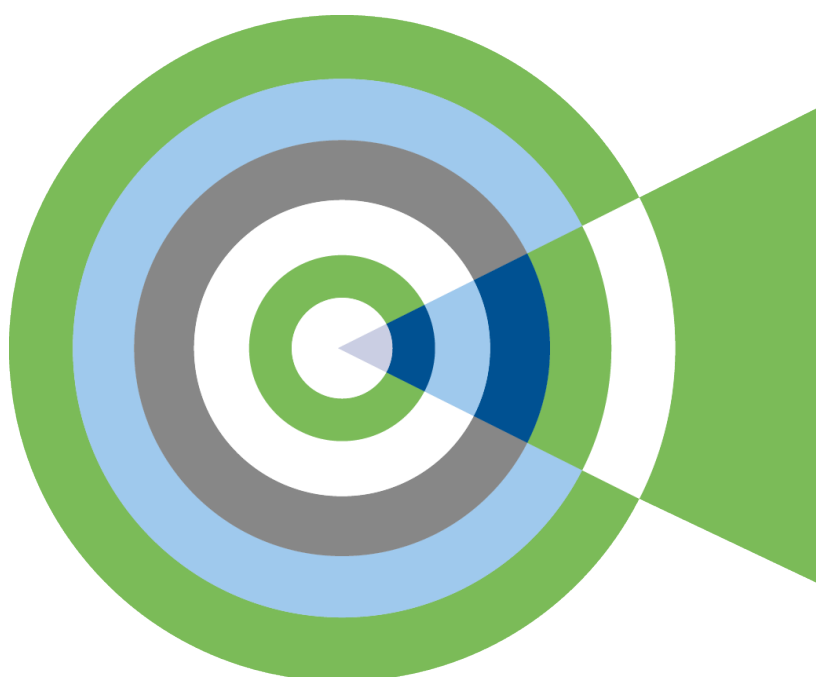
IN MEXICO



The network
for doing
business

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1 – INTRODUCTION

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in around 100 countries throughout the world.

Business partners work together through the network to conduct transnational operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Mexico has been provided by the office of UHY representatives:

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A detailed firm profile for UHY's representation in Mexico can be found in section 8.

Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current in June 2024.

We look forward to helping you do business in Mexico.

UHY Glassman Esquivel y Cia, S.C. (The Firm) is a member of Urbach Hacker Young International Limited, a UK company, and forms part of the international UHY network of legally independent accounting and consulting firms. UHY is the brand name for UHY international network. The services described herein are provided by the Firm and not by UHY or any other member firm of UHY. Neither UHY nor any member of UHY has any liability for services provided by other members.

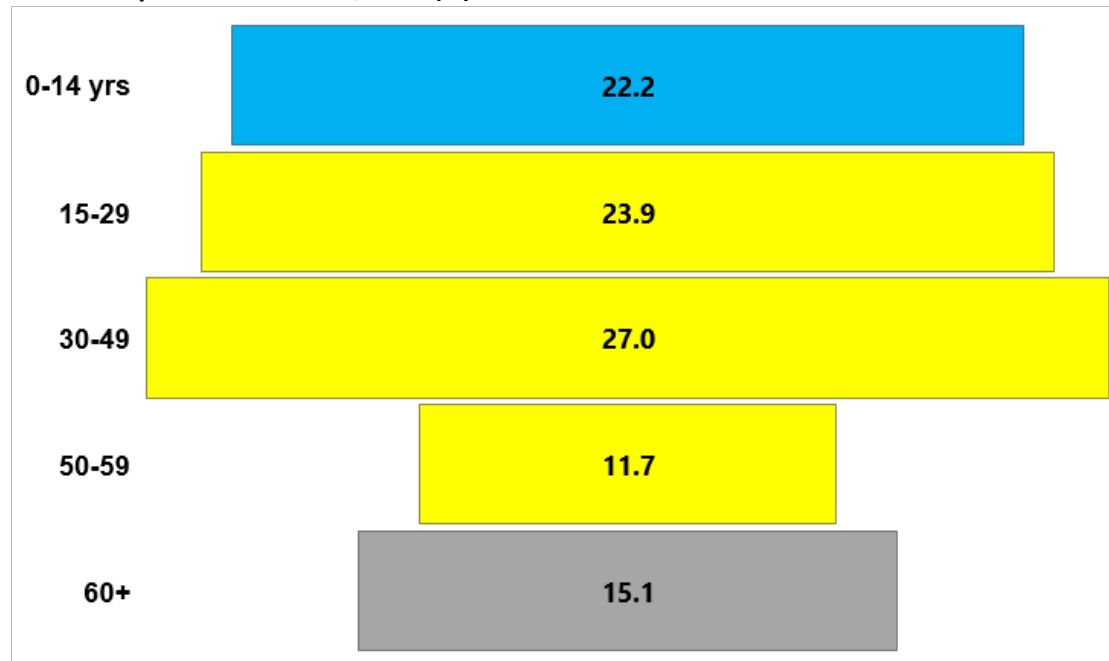
2 – BUSINESS ENVIRONMENT

The official name of the country is United Mexican States. It is the 14th largest country in the world with an area of 1,964,375 square kilometres (755,106 square miles), an area about the size of Western Europe. It borders to the north with the USA (3,141 kms.) and to the south with Guatemala (962 kms.) and Belize (250 kms.). Its exclusive economic zone of territorial sea covers 3,149,920 square kilometres

According to the latest estimates, in 2023 Mexico's population was 129.62 million inhabitants, with a 1.2% annual growth rate in the past ten years. It is the 10th most populated country in the world, with almost half of its population under 30 years-old (46.1%) and 79% living in urban areas. The average median age has risen from 26 years in 2010 to 29 years in 2020. According to official projections, Mexico's population will peak at approximately 164.0 million by 2050.

CHART 1

Mexico: Population Structure, 2023 (%)



The country's currency is the Mexican Peso (MXN) and the official language is Spanish.

POLITICAL AND LEGAL SYSTEM

Mexico is a Federal Republic and its political system stems from the 1917 Political Constitution. It is divided into 32 States, including Mexico City the country's political capital (due to a constitutional reform, as of 2017 the former Distrito Federal where Mexico City is located officially became the Ciudad de Mexico State, or CDMX).

The political structure is divided into an executive branch, a bicameral legislative branch and a judicial branch. Constitutional changes require the approval by a qualified majority (two-thirds plus one) in both Houses of Congress and by a simple majority of State legislatures (i.e. at least 17).

EXECUTIVE

The Executive is headed by the president, who is solely responsible for the appointment of its secretaries (equivalent to ministers), except for the Secretary of Finance and the Attorney General who require confirmation by the Senate.

The central public administration is formed by the Office of the President, 18 Secretaries and the Attorney General's office. Public enterprises, such as PEMEX (oil company) and CFE (electricity company) are formally under the supervision of a corresponding Secretary (Secretary of Energy), although the President appoints their CEOs with approval of Congress.

Presidential elections are held every six years and there is no possibility for presidential re-election. President Andrés Manuel López Obrador from the Morena Party (Movimiento de Regeneración Nacional) took office in December 2018 and will be in office until September 2024.

LEGISLATURE

The Legislative branch or National Congress is divided into the Senate (upper house) and the Chamber of Deputies (lower house). The Senate has 128 seats with terms lasting for six years, while the lower house is made up of 500 representatives with a three-year term, with 300 members elected by direct ballot and 200 by proportional representation. As of 2021, Deputies are able to run for re-election and as of 2024 Senators will also be eligible for re-election.

Since the 2021 mid-term election, several members of both the Senate and the Chamber of Deputies, have changed party and/or declared themselves independent. Therefore, the National Congress' current composition is as follows:

- Senate (2018–2024)
 - Movimiento de Regeneración Nacional (Morena): 58 seats
 - Partido Acción Nacional (PAN): 25 seats
 - Partido Revolucionario Institucional (PRI): 14 seats
 - Partido de la Revolución Democrática (PRD): 3 seats
 - Partido Encuentro Social (PES): 4 seats
 - Partido Verde Ecologista de México (PVEM): 8 seats
 - Movimiento Ciudadano: 9 seats
 - Other smaller parties and independent: 7 seats
- Lower House (2021–2024)
 - Movimiento de Regeneración Nacional (Morena): 197 seats
 - Partido Acción Nacional (PAN): 112 seats
 - Partido Revolucionario Institucional (PRI): 71 seats
 - Partido de la Revolución Democrática (PRD): 13 seats
 - Partido Verde Ecologista de México (PVEM): 44 seats
 - Movimiento Ciudadano (MC): 23 seats
 - Partido del Trabajo (PT): 40 seats

From 1997 to 2018 no single party had an absolute majority in either House. However, since the 2018 elections, Morena (President's López Obrador party) has held a simple majority in the Lower House; however, for any constitutional change it still needs to negotiate with other parties to reach the required qualified majority.

The annual approval of the federal budget is regulated by the Federal Budget and Fiscal Responsibility Law which mandates for a balanced budget (some exceptions are allowed). The budget process requires that the revenue side (Revenues Law) has first to be approved by both Houses, followed by the expenditure side which is the sole responsibility of the Lower House.

JUDICIARY

Mexico's legal system has its roots in the Napoleonic Code and it is divided into federal and state systems, each with its own Codes and procedures. Therefore, some legislation applies to all States (Federal laws), while some matters are exclusive to the States (Local laws).

The Supreme Court of Justice is the highest authority and concentrates mostly (though not exclusively) in constitutional matters. It is formed by 11 ministers with spaced-out terms. They are nominated by the Executive and need to be ratified by the Senate.

POLITICAL PARTIES AND NATIONAL ELECTIONS

There currently are seven registered national political parties, even though the four largest hold most of the elected posts both at the federal and state levels. For the 2021 mid-term elections six new parties applied for registration but none reached the required minimum number of votes by law.

The four main parties are:

- Movimiento de Regeneración Nacional (Morena)
 - A populist-left party breakaway from the PRD which took part in its first election in 2015, and got a landslide victory (53% of the vote) for the presidency in 2018. It also won its first 21 state governorships (out of 32).
- Partido Revolucionario Institucional (PRI)
 - Moderate left-of-centre party which held the presidency for 72 years until 2000, returned to the presidency in December 2012 but lost it again in December 2018. At present, it holds 2 state governorships.
- Partido Acción Nacional (PAN)
 - Right-of-centre party which held the presidency from December 2000 until November 2012 and has 5 state governorships.
- Partido Movimiento Ciudadano (MC)
 - Relatively small centre party but which holds two governorships including the second and third most economically important States (Nuevo León and Jalisco).
- Partido de la Revolución Democrática (PRD)
 - A leftist party holding 1 governorship.
- Partido Verde Ecologista de México (PVEM)
 - A “green” party holding 1 governorship.

Since the June 2015 federal elections, there have been several alliances between different parties and, for the first time, Mexican electoral law allowed the running of independent candidates for Congress and State Governorships.

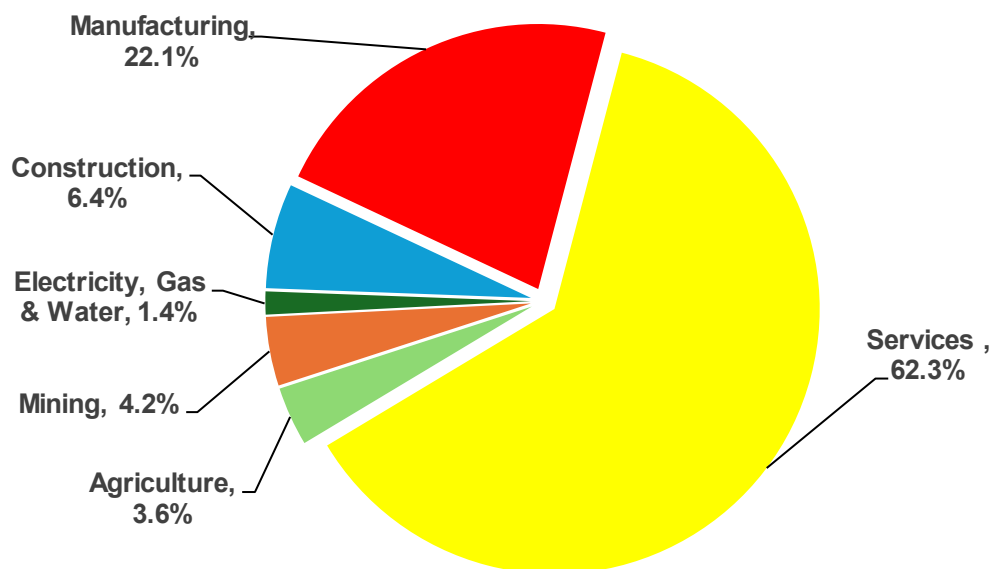
ECONOMIC STRUCTURE

In 2023 Mexico's economy was the 12th largest in the world measured in current dollars and the 12th in constant PPP dollars (Purchasing Power Parity), according to I.M.F figures. Gross domestic product (GDP) amounted to USD 1.811 billion dollars (current) and USD 3,278 billion in PPP terms. Per Capita Income in 2023 reached USD 24,976.0 on a PPP basis.

Services account for nearly two-thirds of the Mexican economy (62.3%), followed by the manufacturing (22.1%) and construction (6.4%) sectors. Chart 2 shows the country's GDP structure in 2023. It is important to note, however, that because of the Covid pandemic in 2020-21, manufacturing and construction sectors were particularly hit by temporary activity lock-downs.

CHART 2

Mexico: Gross Domestic Product Structure, 2023 (%)



Broadly speaking, in regional terms the economies of northern states concentrate on manufacturing, the central region on manufacturing and services, and the southern region on agricultural and services activities. For the past 20 years there has been a wide difference in growth rates among the different regions with the northern and north central regions growing, on average, 4% per annum, while the southern region showing growth rates below 2% p.a. The oil industry is mainly concentrated in the southern region and along the Gulf of Mexico coast. It should be noted that contrary to widespread belief, the oil industry only accounts for less than 5% of Mexico's GDP. Its main importance has traditionally been as an important revenue source for government finances: in 2000-2010 oil revenues accounted, on average, for 33.8% of its total revenues. However, due to declining production and prices together with a fiscal reform in 2014, since 2015 oil revenues have steadily fallen to approximately 19.0% of total government income last year.

Since the mid-1980s, Mexico began an aggressive foreign trade liberalisation policy, both removing non-tariff barriers and substantially reducing import duties. This policy was complemented with a large array of Free Trade/Preferential Trade Agreements. At present, Mexico has 15 such Agreements covering 46 countries, including North America, the European Union, EFTA, Japan and with most of the Latin American countries covering approximately 60% of the world's GDP. In addition, Mexico is also member of the Trans-pacific Partnership (TPP) that aims at creating one of the world's largest trading blocs.

After 25 years in operation, in 2019-2020 the NAFTA agreement was revised and renegotiated by its 3 partners (U.S., Canada and Mexico) leading to a renamed agreement, USMCA, which entered into force in June 2020. The new agreement changed some of the original provisions (like the regional content rule and the controversy solution mechanism), and incorporated several new chapters such as intellectual property, digital trade, customs procedures and certifications and a labour dispute resolution mechanism.

The trade liberalisation policy led Mexico to become the 12th largest exporter of goods and services and the 13th largest in merchandise goods in 2022. Moreover, in 2023 89.2% of Mexican exports were manufactured goods and only 10.8% were commodity-related (mining, oil, and agricultural products), while Latin America's average for commodity-related exports stood at 53.5%. Mexican manufacturing exports are more than two thirds of total Latin American manufacture exports. The main export products are automobile and auto parts which in 2023 made Mexico the 7th largest car producer, the 5th auto parts producer, and the 5th exporter in the world.

CHART 3

Mexico: Total and Manufacturing Exports, 2010-2023 (USD Million)

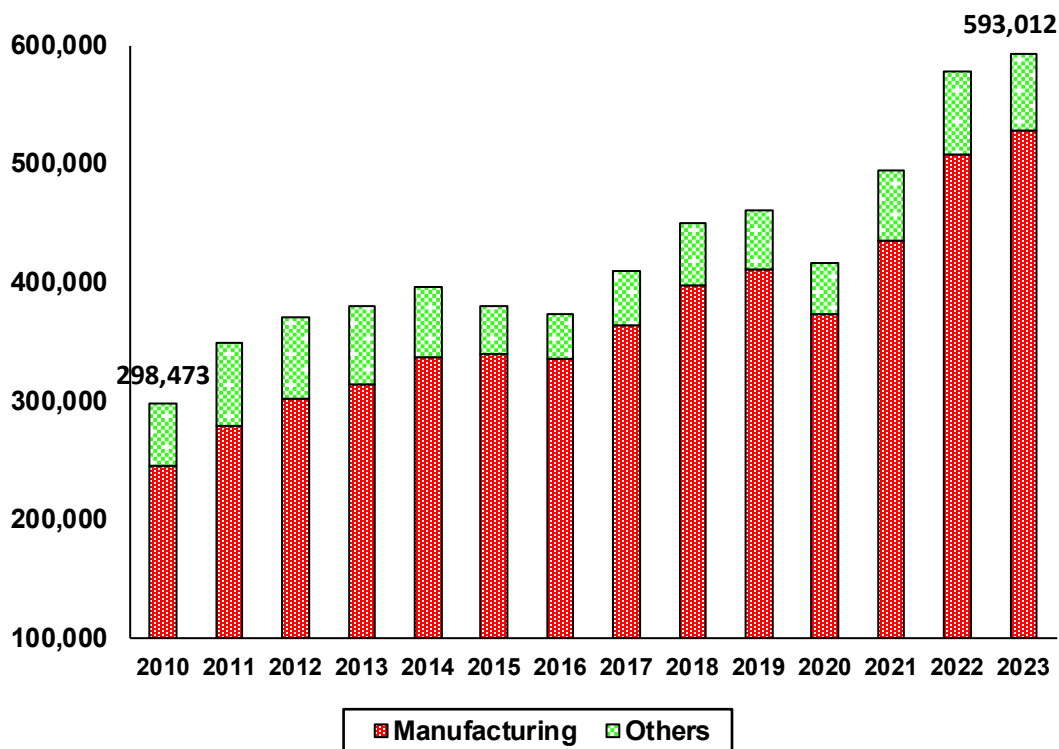
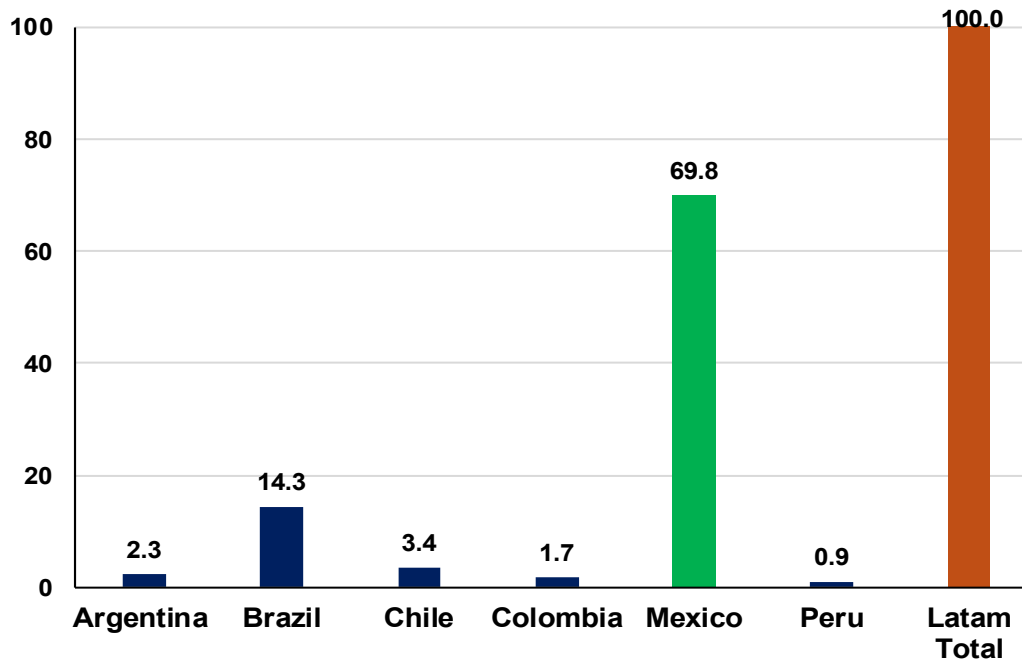


CHART 4

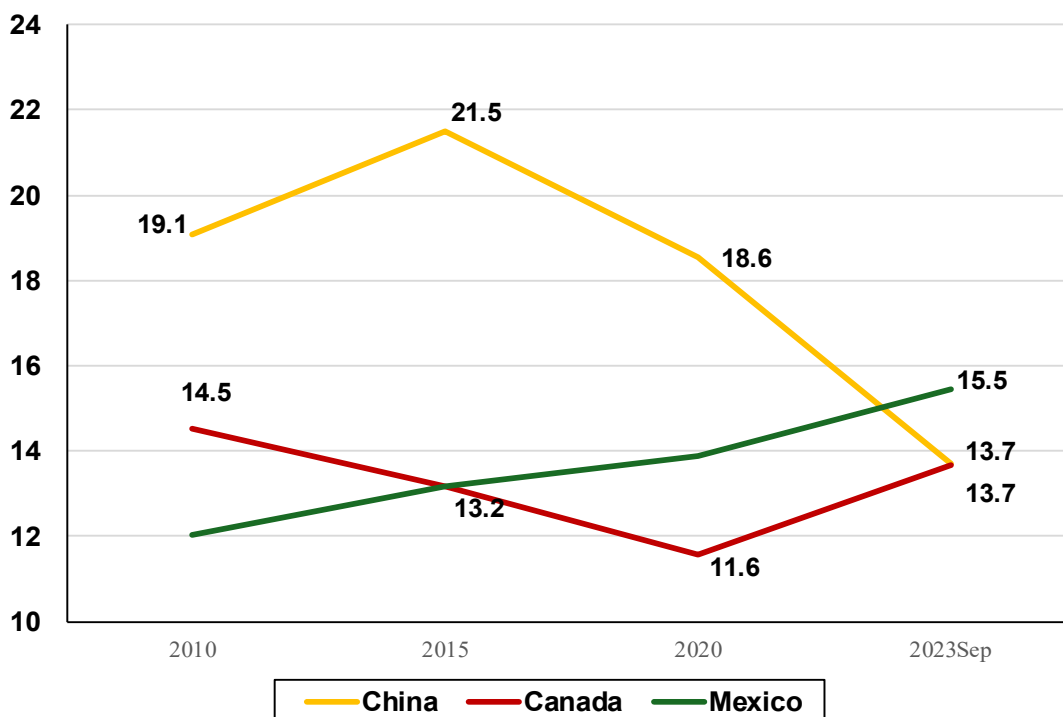
Latin America: Manufacturing Exports as a % of the Region's Manufacturing Exports, 2022



In 2023, after more than 10 years of China's lead, Mexico became the top exporter to the U.S. with a market share of 15.5% of total U.S. imports, and practically tied Canada as the U.S. top trading partner (imports plus exports). Mexico's trade with the U.S. is bigger than that of Germany, U.K., Ireland, France, Italy and the Netherlands together.

CHART 5

U.S. Imports by Country, 2023 (% share of total imports)



Although 62% of Mexico's exports go to its NAFTA partners, in the past 10 years its fastest growing markets have been Latin America, the European Union and Japan with an annual average growth rate of 11.0%, 8.8% and 8.6% respectively (vs. 6.4% for NAFTA countries).

Another important achievement has been the consolidation of macroeconomic stability for the past 20 years, with single-digit inflation figures. In 2015 Mexico registered its lowest inflation on record at 2.1%.

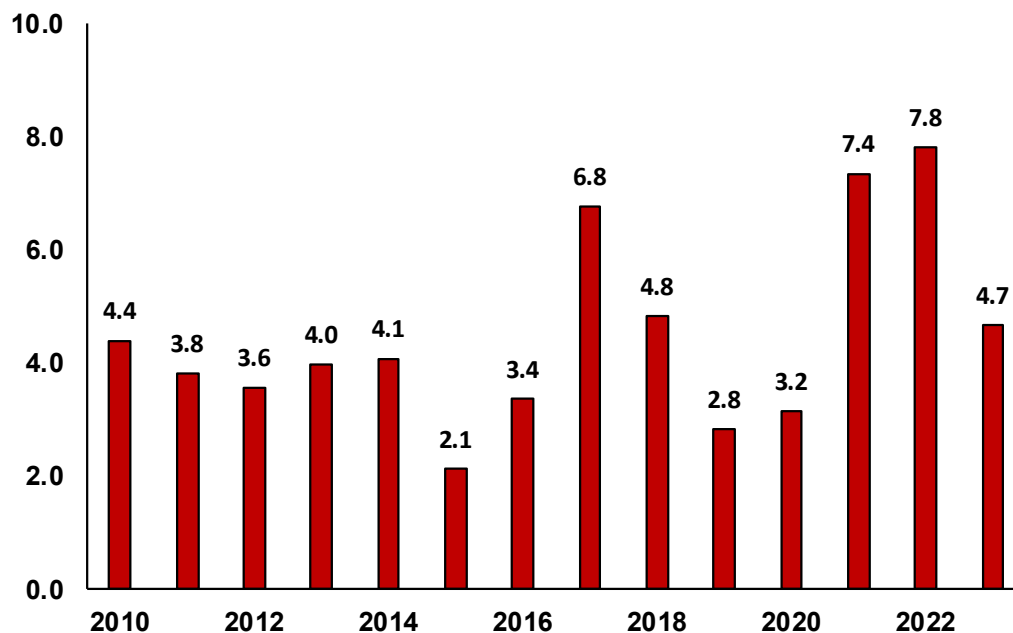
In 2021, however, as a consequence of the worldwide increase in commodity prices and the pressures on the global production chains, inflation rose above the Central Bank's target (3.0%, +/- 1%) to 7.4%. Thus, since mid-2021 the Central Bank has steadily increased its reference rate and has forecasted reaching its inflation target by 2025.

Macroeconomic stability has consolidated through a combination of fiscal (low government deficit) and monetary discipline with an independent Central Bank. During the 2020-2021 Covid pandemic the Mexican government maintained fiscal discipline in order not to increase public debt. As a result, Mexico's public debt ratio (debt/GDP) is substantially lower than most emerging economies, guaranteeing its investment grade rating.

Also, low inflation has allowed for a consistent recovery of the domestic market supported by a steady improvement in real wages and in bank credit. In 2022-2023, private consumption averaged 4.3% growth in real terms, while banking credit rose 3.7% on average.

CHART 6

Mexico: Annual inflation rate, 2000-2023 (%)



THE COVID-19 PANDEMIC IMPACT

The Covid-19 pandemic, as in most countries, had sharp impact on economic activity and employment in Mexico during 2020-2021. The combination of the two-month full lockdown of economic activities (with a few exceptions) in 2020 and some partial lockdowns in 2021, plus the fall in families' incomes led to a 4.8% drop in GDP. Nonetheless, it is important to note that this reduction was significantly lower than most forecasts at the beginning of the pandemic (for example, the IMF had forecasted in mid-2020 a 6.6% fall in GDP).

However, as the lockdown in the U.S. and Mexico was gradually eased, there was a sharp rebound in exports, tourism and remittances which, to some extent, compensated the contraction in the domestic market. The start of the new USMCA agreement in 2020 was a major factor for this recovery and is expected that in the medium term will provide an additional stimulus, particularly for the relocation of several production chains away from Asia to North America.

ENERGY SECTOR

In 2014 the Mexican Congress approved a Constitutional reform which ended 76 years of a government's monopoly in the oil and gas sector and 52 years in the electricity industry. This Energy Reform allowed for private investment participation in these sectors to both, complement and compete, with the state-owned companies (PEMEX and C.F.E.) that were monopolies for several decades.

The Reform's main elements were:

1. The Oil & Gas industry was no longer considered a "strategic activity of the State" in the Constitution; therefore, private investment is allowed in both upstream and downstream activities.
2. Although hydrocarbon resources in the subsoil continue to be property of the State, once they are extracted private ownership is allowed.
3. Contracts for upstream activities can be of the following types:
 - Pure service
 - Profit-sharing
 - Production-sharing
 - Licences (which will operate like concessions)
 - Any combination of the above
4. Private investment was allowed in midstream and downstream operations (natural gas processing, oil refining and transportation, storage, and distribution)
5. In the electricity sector, power generation and retail distribution are no longer deemed a public service, therefore private investment is allowed.

Additionally, concessions have been granted to private companies for the construction of pipelines, storage terminals, clean energy plants and electricity transmission lines. Mexican authorities estimated that investment in all these projects could amount to USD 80 billion over the next 15 years.

However, the current administration decided to carry out a thorough revision of all contracts to ensure that they were awarded with no corruption or any other wrongdoings. As a consequence, it suspended new allocations; also, it has suspended new private contracts in the electricity sector in an attempt to protect the government's electricity company.

Furthermore, the current administration has proposed several changes to the Constitution and different laws to limit private sector participation in oil and electricity markets, so as to protect the government's companies (Pemex and CFE, respectively). This has led to an array of legal controversies between private companies and the government which will be resolved in Court and, eventually, within the framework of the UMSCA and the Mexico-European Union agreement dispute settlement mechanisms.

With the upcoming June 2024 presidential and legislative elections, the most likely scenario is for these disputes to be resolved by the new administration that will take office in October 2024.

Nevertheless, these decisions have unquestionably sent negative signals to private investors and stalled new investments in the short term. It is possible that some sort of agreement may be reached mid-way between the current situation and the government's proposal.

BUSINESS ENVIRONMENT AND REGULATION

Trade liberalisation, the extensive Free Trade Agreements network and the increasing exposure to the world economy have led Mexico to embrace international standards and regulations in most areas of economic activity. In addition, Mexican authorities have pursued an active de-regulation policy and require that any new government legislation complies with a 'regulatory and competition impact' assessment.

These policies have significantly improved general business conditions and the ease of doing business in Mexico. Although in 2021 the World Bank decided to stop publication of its well-known report "Doing Business", its last edition showed Mexico ranked 60 (out of 190 countries) in the overall 'Ease of Doing Business Index', being the second highest ranked country in Latin America (See Table 1).

TABLE 1
Ease of Doing Business, 2019 rankings (190 countries)

	Argentina	Brazil	Chile	Colombia	Mexico	Peru
Ease of doing business¹	126	124	59	67	60	76
Starting a business ²	141	138	57	95	107	133
Getting credit ³	104	104	94	11	11	37
Dealing with construction permits ⁴	170	155	141	89	93	65
Trading across borders ⁵	119	108	73	113	69	102
Paying taxes ⁶	170	184	86	148	120	121
Protecting minority investors ⁷	61	61	51	13	61	45

Source: Doing Business 2020, World Bank.

- 1 – Average of the economies' rankings in the ten topics covered by the study.
- 2 – Procedures (number), time (days), cost (% of income per capita), minimum capital
- 3 – Strength of legal rights, depth of credit information.
- 4 – Time and cost to complete all formalities to build a warehouse and the quality control in the construction permitting system.
- 5 – Documents to export/import (number), time to export/import (days), cost to export/import.
- 6 – Taxes and contributions for a middle-sized company, administrative burden.
- 7 – Extent of disclosure and director's liability, ease of shareholder suits.

SOCIETY/CULTURE

LANGUAGE

Spanish is the official language of Mexico and business meetings are usually held in this language. However, English is quite well-accepted and spoken in many business circles. Therefore, it is likely that business hosts will have no problem communicating in English. Nevertheless, it is recommended that before any meeting takes place, participants make it clear in which language the meeting will be conducted.

While Mexican hosts are likely to adapt to the language needs of visitors, it is advisable for visitors to learn some Spanish if making frequent business trips to Mexico. Any attempt to communicate in Spanish will be greatly appreciated and is considered a sign of interest and respect.

All marketing literature, production manuals, warranty information and other relevant materials used in official documents must be in Spanish. It is also advisable to have information available in Spanish for business partners to show a serious intention of doing business in Mexico.

DRESS CODE

Mexicans tend to dress formally during business meetings. In large cities (Mexico City, Monterrey, Guadalajara, etc) they usually wear a suit and tie, and expect business partners to do the same.

However, in regions with hot weather, such as coastal cities or in the southern part of the country (e.g. Puerto Vallarta, Cancun, Villahermosa, Merida), business meetings can be attended wearing casual clothing and a jacket and tie are often not required.

NAMES AND TITLES

In Mexico, people use their given name and the surnames of both father and mother. It is also common for people to have two given names and in written form, all names are commonly used. When speaking, only the first and last names tend to be used, so for example, Ana Maria Vazquez Laredo may be addressed as Ana Vazquez or Ms. Vazquez.

SCHEDULING MEETINGS

When scheduling a business meeting, visitors should be aware of the very different concepts of time across Mexico. In the main cities, people tend to be on time for meetings, particularly in the northern region (Monterrey). In other important cities (Mexico City, Guadalajara, Chihuahua), a 10–15-minute delay is acceptable (due to traffic, parking, etc), though generally timeliness shows respect to the hosts. An exception is when meeting with government officials, where sometimes a considerable waiting time can be expected.

In medium-sized cities and particularly in coastal areas, the time of any meeting should be double-checked, as people tend to have a more 'easy-going' attitude. For example, a meeting scheduled at 5pm might easily start at 6pm.

It is also common to hold business meetings during lunch or dinner, so a long lunch/dinner appointment is not unusual. It is advisable to accept such invitations which provide the opportunity for a more personal relationship to develop in a more relaxed environment.

BUSINESS WOMEN

A formal handshake is appropriate, although women also kiss on the cheek when greeting and taking leave of someone. In general, in Mexico physical contact is important, and not just to say 'hello, nice to meet you'.

The attitude towards women executives is first-rate. Businesswomen are cosmopolitan, professional and respected. A woman looking to establish a business in Mexico, whether on their own or as part of an organisation, will be easily accepted and treated with courtesy and professionalism by most business people.

NEGOTIATIONS

When doing business in Mexico, it is important to remember that it can be critical to establish a personal relationship with Mexicans. In general, Mexicans make friends first and then do business, rather than the other way round. Not taking the time to develop a relationship of trust may hinder the possibility for a long-term business relationship, so businesspeople should initially focus on building relationships.

3 – FOREIGN INVESTMENT

Along with trade liberalisation, foreign direct investment (FDI) has been substantially liberalised over the past 20 years.

Foreign Investment is restricted in only a handful of areas, notably media, nuclear energy, radioactive minerals, and air transportation. Furthermore, there are no controls whatsoever (neither administrative nor special taxes) on capital flows, including profit repatriation and royalties' payments.

Foreign companies investing in Mexico are only required to notify the National Foreign Investment Registry (RGNI) of their operations for statistical purposes.

With the Sector Promotion Programmes and the In-bond for Export Programme (commonly known as the 'Maquiladora Programme'), registered companies benefit from special benefits on customs, local taxes and import duties.

As mentioned, the 2014 Energy Reform Law opened up upstream and downstream operations to private investment (both local and foreign) either in association with State oil company, PEMEX, or on their own. This opening was carried out on a gradual basis through the auctioning of different oil producing sites and exploration areas.

The recently negotiated USMCA with the U.S. and Canada has included provisions to guarantee foreign investors' rights in the energy sector.

In addition to provisions for investors' protection included in the different Free Trade Agreements, Mexico has also signed Reciprocal Investment Promotion and Protection Agreements with more than 30 countries.

FDI TRENDS

Traditionally, FDI has come mainly from the United States and has been concentrated in the manufacturing sector. However, over the past fifteen years there have been important changes both in terms of the countries of origin and in the sectors of destination for investment.

The importance of the US has gradually diminished, while that of countries such as Spain has risen; the removal of restrictions has led to important FDI flows to sectors such as the financial industry (banks, insurance companies and brokerage houses), retail trade (large international chains) and gas and electricity (mainly oil & gas pipelines and clean energy generation plants).

More recently, new sectors have benefited from substantial FDI inflows, like the aeronautical industry, information technology and financial services, where important 'clusters' have been developed in different parts of the country.

According to preliminary figures, in 2023 FDI into Mexico amounted to 36,058 million dollars, with the Manufacturing industry accounting for 50.0% and Financial Services 20.0% of the total. Within the Manufacturing industry, transportation equipment (autos and auto parts) represented 41% of the total, Food and Beverages 14%, Metallurgical products 13% and Information Technology 9.0%.

By country of origin, there has been a trend to diversification in recent years, although the U.S. remains as the main source (38% in 2023), followed by Spain and Canada (10% each), Japan (8.0%) and Germany (7.0%).

It is important to note that since the Covid pandemic, the Mexican economy had an inflow of 132,410 million dollars between 2020 and 2023. Further, while in the 2010–2016 period, Mexico received an annual average of USD 32,281 million, for the 2017-2023 this increased to USD 33,592 million.

CHART 7

Mexico: Foreign Direct Investment, 2010–2023
(US\$ million)

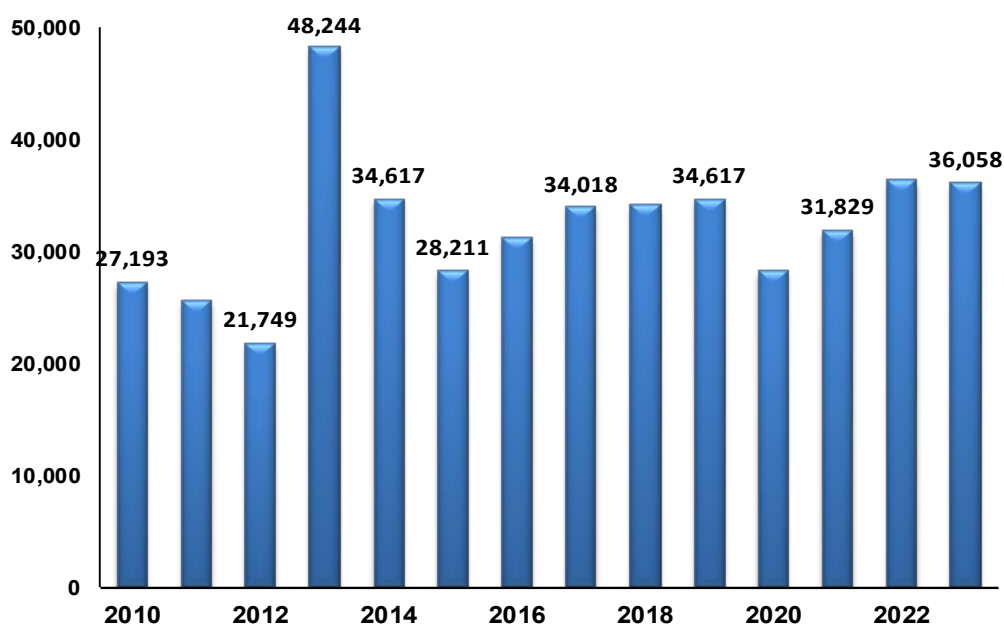
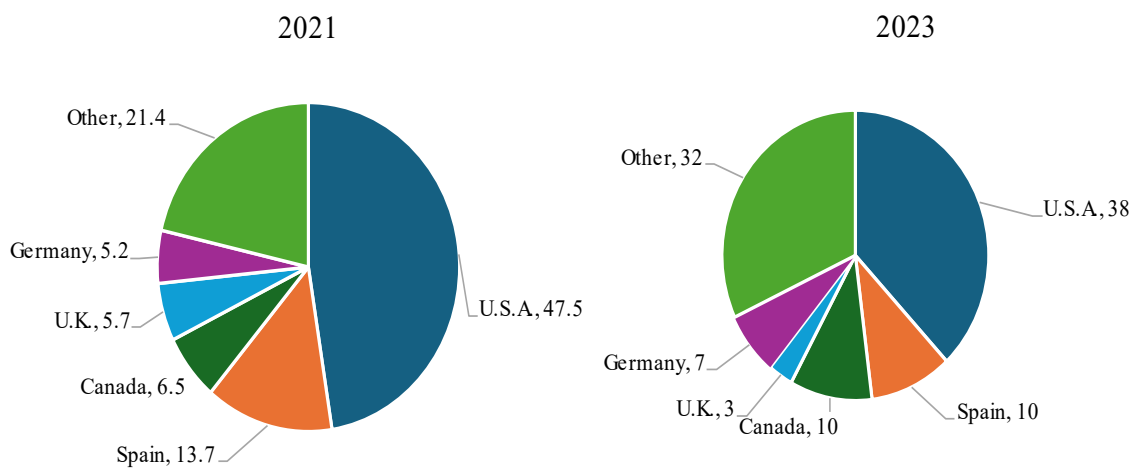


CHART 8

Foreign Direct Investment by Country, 2021-2023



NEARSHORING TRENDS & POTENTIAL

Mexico's potential benefits from worldwide nearshoring trends have been extensively discussed and analysed in Mexico and abroad over the past three years. The basic factors are the proximity to the U.S., the USMCA agreement and the already very high integration of manufacturing between the two countries.

Although the nearshoring effects have yet to be reflected in a significant increase in FDI flows, at the microeconomic level there already are very promising trends. Perhaps the most notable is the boom in industrial space demand over the past two years. Occupancy rates in industrial parks have reached historical levels at 97%-98% in the northern and central regions of Mexico, while construction of new space has increased at +30% rates per annum in 2022 and 2023.

Another a key element to detonate a significant nearshoring effect on the Mexican economy will be the USMCA revision scheduled to take place in 2026 (the so-called "sunset-clause"). Even though no major changes are expected, a critical issue is likely to be the treatment of information technology (Artificial Intelligence technology) and the relationship of the USMCA bloc with third countries, especially China.

4 – SETTING UP A BUSINESS

As an open economy to trade and investment, Mexico has a vast experience with foreign companies operating in its territory and offers a reliable institutional and legal framework for their operations.

The following section aims to provide basic guidelines for companies starting business in Mexico. These are general guidelines and their particular application depends on several factors, special laws and business activities.

Mexican laws are mostly federal in nature; therefore, this guide is applicable to virtually any state of Mexico and represents what can be done without any special permission or authorisation in the different states.

FOREIGN INVESTMENT RESTRICTIONS

The current law on foreign investment dates from 1993 and mainly specifies the sectors and activities where any types of restriction exist. All sectors and activities not specifically singled out by law are fully open to foreign investors.

The Foreign Investment Law states that the following areas are reserved exclusively for the state:

- Electricity distribution for public service, but not for own-consumption and that for the wholesale market
- Generation of nuclear energy
- Radioactive minerals
- Wireless transmissions
- Postal service
- Currency issuance and coining
- Airports, heliports, ports, and railroads control and supervision.

Some economic activities are reserved exclusively for Mexican individuals or companies and others allow for a limited foreign investment. The Certificate of Incorporation of a company includes an article referring to the exclusion of foreigners as shareholders if the company is engaged in the following activities:

- Domestic land passenger, tourist and freight transportation, except parcel and courier services
- Liquefied gas distribution
- TV and radio broadcasting, except cable television
- Credit unions
- Development banking

However, the Foreign Investment Law allows foreigners to have 'neutral investment' in these companies and activities. This investment gives equal rights to profits and dividends, but prohibits foreign investors the right to vote on the board of directors and to have control of the companies. The Law also restricts foreign investment in some activities and companies to the following maximum percentages:

- Production co-operatives – 10%
- Domestic air transportation, taxi and specialised transport – 25%

- Insurance and bond companies, exchange offices, business retirement funds, investments trusts and other companies – variable %
- 'T' series shares in companies which have arable and forest lands – 49%
- Freshwater, coastal, deep-sea fishing, except fish farms – 49%
- Printing and issuing of national newspapers – 49%
- Port management – 49%
- Manufacture of and trading in firearms and explosives – 49%.

Foreigners may have more than a 49% stake in the following activities, but must have the approval of the National Foreign Investment Commission:

- Legal services
- Credit offices
- Brokerage houses
- Pipeline manufacturing for gas, oil and products, and transportation (except duct construction, operation and ownership); natural gas transportation, facilities and equipment for its distribution
- Railway construction and management
- Port services, such as tugging and docking
- Shipping companies
- Airports management
- Mobile phone services
- Private schools and universities

Except for the limitations stated above, foreigners can own up to 100% of Mexican companies without any licence from the Mexican government. Moreover, investment in manufacturing, assembling or merchandise processing companies for exporting purposes, does not need any licence. All Mexican companies which have foreign-owned capital must be in the National Register of Foreign Investments. No conditions apply to this register, except the aforementioned ownership restrictions. Each year the register is renewed by an annual financial report.

PROPERTY

In general, there are no restrictions on foreign ownership of Mexican property. However, in coastal or border areas, foreigners can own property for non-residential purposes only if such property is acquired through the ownership of the equity interests in Mexican companies. The National Commission of Foreign Investment must be notified of such acquisitions.

ESTABLISHING A BUSINESS IN MEXICO

ADVANTAGES

As mentioned, Mexico has more than 16 free trade agreements with 48 countries including UMSCA (United States, Mexico, Canada Agreement) and the European Union, and consequently companies incorporated in Mexico enjoy the benefits of such treaties, which must provide foreign companies the same treatment as a domestic investor.

BUSINESS CONSTITUTION

The establishment of a business as a legal entity is not an obligatory requirement. What makes this an important step, is the protection this provides for the personal assets of shareholders, because there are always risks in starting a business.

OUTLINE FOR FOREIGN COMPANIES IN MEXICO

The type of activity, form of administration and policies dictate the makeup of any company. Each company is therefore unique and market entry strategies must be tailored to suit each business.

Establishing a business focuses more on these three aspects than on legal requirements, but the most common ways of incorporating a company in Mexico are the following:

- Investing foreign capital in Mexican companies via:
 - Creation of a legal Mexican entity.
 - Acquisition of a Mexican company.
 - Merging with a Mexican company.

Under any one of the above, the most common legal form used in Mexico for establishing a company is a corporation, particularly a stock company and the limited liability company.

TYPES OF ORGANISATIONS

STOCK COMPANY

This form of company is the most popular. The minimum share capital required is set by the shareholders themselves. The amount cannot be decreased (in order to provide a guarantee to the various creditors of the company) and can be administered through a sole administrator or under a board of directors.

This type of company is required to keep four types of record:

- Minutes of the board of directors
- Meeting minutes
- Register of shareholders
- Capital changes.

Books are commonly managed and safeguarded by the lawyer for the company.

This is the only form of incorporation in which social capital is represented by common stock, depending on the social contract, and it provides various rights to its shareholders.

It can be used by any commercial company and capital increases or decreases do not require a formal motion, only a resolution to be passed at a shareholders meeting.

Usually, foreign companies prefer to invest in Mexico as corporations and not as individuals. This generates tax benefits in their respective countries of origin. However, the Mexican Commercial Law makes it mandatory to have at least two individual shareholders. (This means there could be just two shareholders, one with 99% of the company and the other with 1%.)

The entities which make up any company are the shareholders (or investors) and the board of administration (often known as the management board). The first group resolves the way in which the company shall be managed. But it is advisable for those who will run the company to be on the board of directors. This is more than an honorary designation, imposing obligations, and accountability for the running of the company.

The governing council is formed by at least two members –the president and secretary. The first proposes and establishes the key policy directives and the second executes directives and gives legal form to the resolutions. However, the board of directors may consist of an unlimited number of staff and may have as many nominations as the society requires, for example the positions of vice president, deputy secretary, members, legal representative, treasurer, director, etc.

LIMITED LIABILITY COMPANY (LLC)

This is a form of company often preferred by foreign companies in Mexico because of its similarity to institutions in their countries of origin. The minimum risk to guarantee the payment to various creditors is the amount the parties consider. The LLC can be administered by a sole administrator or a board of directors. With this type of company, the social capital is not represented by shares with free movement, but by parts which are not entitlements.

PARTNERSHIP

This type of company is becoming less popular, mainly because taxes are applied to the individuals and because the individual assets of partners are at risk. It does not require a minimum social capital and can be administered by a sole administrator or a board of directors.

BRANCHES

The opening of a foreign branch is advisable when a company wishes to do business with no income or income from Mexico. However, it is applicable only where the structure of ‘corporate governance’ and shareholders retains the same designation and distribution as abroad. In this case, registration with the National Commission on Foreign Investment is needed to obtain the necessary permission.

REPRESENTATION OFFICES

Representative offices are largely similar to branches, but have a different tax treatment, especially in the case of foreign banks where this is a legal imperative. With this type of organisation, companies must apply for a Tax Identification registration.

JOINT VENTURES

When investors have no prior knowledge of the country and its market, the risks of investing are often a major concern for foreign companies. In some cases, foreign investors therefore choose to use alternatives which reduce the risk, such as buying a Mexican society which has been duly constituted and has some experience and a track record in the local market. Or investors can enter into a joint venture with a local company.

There are two ways of establishing a joint enterprise –strategic alliances and joint ventures.

The strategic alliance does not require that the parties invest liquid resources in the business. However, companies are able to take advantage of benefits such as the use of infrastructure, establishment of branches without investment, the reduction of costs, and agreements to provide contracts and/or exclusive distribution etc. In the case of a joint venture, both companies invest a sum of money which is agreed upon to start the new business. A contract then sets out the way this business will be administered, the profit and dividend distribution, rights and obligations.

DOING BUSINESS IN MEXICO

DISTRIBUTION CONTRACTS

This form of entering the Mexican market does not involve direct investment of foreign companies and in some cases simplifies the sale of products. However, it involves a broker who keeps a significant portion of the profits. An advantage of distribution contracts is that, in many cases, dealers already have a network of customers. This allows distributors to facilitate contact with customers/consumers, which for a foreign company with no previous experience in the country would be difficult and may take some considerable time to achieve.

DISPUTE PREVENTION

Disputes which may arise can be diverse. The laws in Mexico are mostly federal, which fosters a favourable environment to prevent possible litigation. Attorneys should be contacted for information on corporate legal issues in various areas such as labour, trade, relations between partners and government procurement etc.

MANAGING COMPANIES WITH FOREIGN CAPITAL

The Foreign Investment Law allows foreign investors to establish their businesses in Mexico with up to 100% of foreign capital. However, there are specific regulatory requirements, particularly in relation to providing information to the Ministry of Economy. Some of the most common requirements are:

- Annual registration with the National Registry of Foreign Investment
- Notification of any change in the shareholder's structure
- A quarterly income reports
- Notification of any merger or division of the company
- Notification of changes to name or address
- Notification of any change in legal obligations, representatives etc. (in the case of branches and representative offices)
- Presentation of financial statements (in the case of branches and representative offices).

FOREIGN FRANCHISES

Currently, many foreign companies have found franchises to be the best way to become involved in business in Mexico and to distribute their products or offer services. This is because franchisees have a better knowledge of the local market.

Corporate lawyers at UHY in Mexico are duly authorised to support foreign companies wishing to establish franchises, including management and financial consulting. For more information contact our specialists.

5 – LABOUR REGULATIONS

Mexico's Federal Labour Law addresses employment relationships, their duration, and suspension of the effects of labour relations, lay-offs and termination of employment.

The law also establishes the length of working hours, rest days, holidays, remuneration rules and the right of workers to share in company profits.

The following section is a summary of the main items of general interest.

Labour inspectors regularly enforce numerous detailed requirements covering such matters as record-keeping and payment of overtime and benefits. Therefore, it is essential that the personnel department of any company is sufficiently knowledgeable about labour laws to deal with these matters.

Recently, the Mexican Congress has made several changes to the current Labour Law, one of the most important being the elimination of the system of closed-shop unions and to allow having more than a single union in companies. Thus, workers are free to join or not a company's union.

WORK RELATIONSHIP

A work relationship is deemed to exist, regardless of whether there is a formal contract, whenever an individual receives a regular payment for their services.

INDIVIDUAL EMPLOYMENT CONTRACT

An individual employment contract is required whenever there are no applicable collective agreements. At least one copy should be held by each party.

TEMPORARY EMPLOYMENT CONTRACTS

Since November 2012, the law allows for new hiring formats such as trial contracts and initial training contracts for inexperienced workers before a permanent contract is extended. These training periods can be as long as 180 days and there is no contingent liability to the employer should it choose to end the working relationship with the employee. Also, work agreements between employer and employee to be paid by the hour are allowed.

TERMINATION OF LABOUR RELATIONS

The worker or the employer may terminate the relationship at any time because of a justified cause, without incurring liability. Justified causes include a lack of integrity and honesty, aggression towards co-workers, the committing of serious acts against supervisors, their families or representatives, intentional damage to machinery or work equipment, immoral acts, revealing secrets, absence for more than three days without justification, disobedience, or working in an unhealthy environment, among others.

SEVERANCE PAYMENTS

When an employer decides to terminate a work relationship, if it was for a fixed period of less than one year, the employer shall pay an amount equal to the wages of half the length of service. If the employment exceeded one year, the employer must pay an amount equal to six months' wages for the first year and twenty days for each subsequent year the worker served.

If the employment relationship was for an indefinite period, compensation shall consist of three month's salary or wage plus twenty days' pay for each of the years of service.

OVERTIME

Overtime hours will be paid at a rate of 100% over the salary of the job.

REST DAYS

For every six days of work, the employee is entitled to one day of rest with full pay. Workers are not required to serve on their days off. If this provision is ignored, the employer must pay the worker, regardless of salary due to him, a double salary for the service.

It must be noted, however, that there is a proposal in Congress for reducing the weekly working hours to a maximum of 40 hours (instead of the current 48 hours). This is expected to be voted during the second half of 2024.

HOLIDAYS

Workers who have more than one year of service enjoy an annual period of paid leave, which will not be less than twelve working days. This increases by two working days (up to twelve) for each subsequent year of service for the first four years. After the fourth year, the holiday period is extended by two days for every five years in service.

Employees are entitled to a bonus of not less than 25% of wages on top of their normal pay during their vacation.

SALARY

The salary is composed of payments made in cash and fringe benefits such as housing and transportation aid, bonuses, commissions, benefits in kind and any other amount or benefit the employee is entitled to for their work.

Currently, workers are entitled to an annual bonus paid in December, equivalent to a minimum of 15 days' wages. To determine the amount of compensation payable to employees, the compensation shall be based on salary per day.

However, there also is a proposal to be discussed in Congress to double the minimum annual bonus to 30 days. There seems to be a good chance that this proposal is approved, although the increase may be gradual over the course of several years.

EMPLOYEE PROFIT-SHARING

Workers are entitled to a 10% profit sharing scheme on companies' annual profits to be paid, at the latest, on the fifth month after the closing of the fiscal year.

SOCIAL SECURITY

Social security contributions cover a number of areas.

Contributions cover:

- Work risks
- Sickness and maternity leave
- Disability and death
- Retirement, severance and old age

- Medical treatment and welfare

The employee's social security contribution is around 3.9% of its salary and is withheld by the employer. The employer's contribution is 23.5% of the salary, but with an annual maximum contribution for employees of MXN 27,534 (approximately EUR 1,377) and for employers of MXN 232,814 (EUR 11,640) per employee.

HOUSING FUND CONTRIBUTIONS

Employers must also contribute with an equivalent of 5% of salaries (limited to 25 times the minimum salary) to the government's housing fund. This provides financing for employees' house acquisition, remodelling and/or construction. The maximum annual contribution is MXN 49,535 (EUR 2,477) per employee.

RETIREMENT FUND

Employers must contribute 2% of salaries (capped at a maximum of 25 times the minimum salary) to a private pension fund managed by a financial institution on behalf of each employee. The maximum annual contribution is MXN 19,814 (EUR 991) per employee.

EXPATRIATE WORK VISA REQUIREMENTS

Depending on the place of residence, it is important for business visitors to Mexico to request a 'business visa'. This document gives the holder a legal capacity to do business in the country. A business visa can be requested at any Mexican consulate. The list of requirements and documentation needed to receive a visa can also be obtained at Mexican consulates.

Once a business visa has been obtained, it is important to know the specific procedures and requirements of the state where the business is to be based, such as:

- Registration of the company's name
- Registration at the Ministry of Finance for tax purposes
- Work, property and patent and royalties registry proceedings.

WORK PERMITS

Work permits are commonly granted for a period of one year. However, this may be extended. Usually, a foreign employee must show documentation that proves he/she has gained employment in Mexico and has sufficient income to sustain him/her whilst working in the country. This documentation could be a contract of employment or an employer's letter. The employee must provide a passport and official identification. This information is referred to the immigration department in the state where the employee will be living. Foreign nationals can be also work independently in Mexico.

PERMANENT IMMIGRANTS

Immigrants who have been legal residents in Mexico for a minimum period of five years can request to the Foreign Affairs Ministry a change of their migratory status to a permanent resident or request Mexican nationality.

FAMILY CONSIDERATIONS

Each family member must apply for their own separate visa. However, registration forms for family members are often processed alongside those of the employee. If a family member wants to work, he/she must apply for their own separate work permit.

6 – TAXATION

There are three levels of taxation in Mexico – federal, state and municipal (or local), with Federal taxes comprising both direct and indirect taxes.

DIRECT TAXES

- Income tax –on individuals and companies

INDIRECT TAXES

- Value added tax
- Real estate transfer tax
- Import tax or duty
- Excise taxes – ad valorem taxes on specific products and services
- Withholding Income

STATE AND LOCAL TAXES

Payroll tax, real estate transfer tax and land tax are the main state taxes.

INCOME TAX

Income tax is dependent on the type of taxpayer, according to the following classification:

- Mexican resident individuals and legal entities
- Non-residents having a permanent establishment in Mexico
- Non-residents who have income from a source located in Mexican territory, but who do not have a permanent establishment in Mexico
- Non-residents who have a permanent establishment but no income which is attributable to any sources in Mexico.

TAXABLE INCOME AND CORPORATE RATE

The taxable base is defined as the difference between taxable revenue and expenses. Since 2010, the top corporate rate has been 30%.

PAYMENT PERIOD

Although income tax must be paid annually, there is obligation to make monthly advance payments on account for the annual tax. The annual tax return has to be filed and tax paid within three months after the end of the fiscal year.

VALUE ADDED TAX

Mexico has a federal Value Added Tax (VAT or 'IVA'). The general rate is 16%, with certain goods and services with zero rate, while others are fully exempted.

VAT is territorial in nature, since taxed acts/activities are those performed within Mexico. VAT is not transferred to outbound operations, so exports of goods and services are taxed with a 0% rate.

Individuals and legal entities must pay VAT whenever they are engaged in the following activities within the Mexican territory:

- Transfer of goods
- Rendering of independent services

- Temporary use or enjoyment of goods
- Import of goods or services.

VAT must be paid on a monthly basis.

As of January 2019, the federal government established a scheme of fiscal incentives for six States in the northern border area with the U.S.A., comprising 43 municipalities. These incentives are: a reduction in the top corporate income tax rate to 20% (vs. 30% in the rest of the country) and a reduction in Value Added Tax from 16% to 8%. However, these reductions are not across the board, but are restricted to certain activities (mainly commercial) and taxpayers must fulfil a number of requirements.

OTHER TAXES

EXCISE TAXES

Excise taxes are levied on a number of specific products or activities such as the new vehicle sales, alcohol, alcoholic beverages, beer, tobacco and some fuels such as petrol and diesel. Rates vary according to each of these products.

IMPORT DUTIES

Import duties have considerably diminished their importance in Mexico's tax structure as a consequence of the deep trade liberalisation and free trade agreements. However, there still are some specific products where a duty applies.

The taxable base for importation duties is the customs value of goods, except for cases where the law sets forth a different taxable base.

CUSTOM REGIMES

Goods imported to or exported from Mexico may fall into any of the following customs regimes:

- Final
- Temporary
- Fiscal deposit
- Transit of goods
- Manufacture & conversion
- Strategic.

SPECIFIC FEATURES OF INCOME TAX LAW

Some specific features of Mexican corporate taxation are important to mention.

INTEREST TAX REGIME

Interest taxation considers the following elements:

- Inflationary annual adjustment
- Interest income and interest expense
- Exchange gains and losses.

A comparison of the annual average balance of debts and credits has to be made and if the former is higher, then the difference is multiplied by the inflation factor of the corresponding year and the result is the accruable inflationary annual adjustment.

Losses from inflation are deductible (as a deductible inflationary annual adjustment). In accordance with this procedure, if the annual average balance of credits is higher than the annual average balance of debts, the difference is multiplied by the inflation factor of the relevant year and the result is the deductible inflationary annual adjustment.

Interest income is included in the taxpayer's taxable income on an accrual basis. Accrued interest is deductible (at its nominal value, without any adjustment, since it will be subject to the inflationary annual adjustment) providing the funds obtained from the loan are invested in the business.

In order to be tax deductible, interest payments to a foreign-based related party should not exceed a 3:1 debt/capital ratio; also, as of 2020 net interest deductions cannot exceed 30% of the adjusted fiscal gain and if the annual results show a fiscal loss, the net interest expenses are non-deductible.

Exchange gains and losses resulting from financial assets and liabilities are deemed as interest for income tax purposes. If a Mexican company has foreign currency liabilities, a devaluation of the currency will result in an exchange loss. This loss is recognised on an accrual basis and is added to the interest expense for the month.

If a company has an exchange gain resulting from a financial asset denominated in a foreign currency, then the gain is added to interest income.

CAPITAL GAINS

An inflation adjustment is made to the acquisition cost of i) shares of stock or ii) fixed assets, to compute the gain on their sale. Capital gains and losses are treated as ordinary income.

DEPRECIATION

The basis for deductible depreciation is the acquisition value as defined in the Law, adjusted for inflation. Depreciation should be computed using the straight-line method at the maximum rates. Examples of such rates are shown in Table 5 below.

TABLE 2

Maximum rates for straight-line method of depreciation

	RATE
Buildings and other related structures	5%
Office furniture and fixtures	10%
Computer equipment	30%
Peripheral computer equipment	30%
Patents, trademarks, copyrights, etc.	15%
Automobiles, heavy trucks, tractor trucks, tow trucks, buses	25%
Anti-pollution equipment and equipment for conversion to natural gas consumption	100%
Equipment used in research of new products and development of technology	35%

In the case of railroads, telephone and satellite communications, depreciation rates are subdivided, according to the different kinds of assets they involve.

COST OF SALES

Since 2005, Mexican corporate income tax follows the cost of sales system which treats inventory purchases as deductible when sold. As such, it is necessary to compute the cost of goods sold for tax purposes.

EMPLOYEE PROFIT SHARING

Profit sharing contributions to employees are tax deductible.

DEDUCTIBLE AND NON-DEDUCTIBLE EXPENSES

PROVISIONS

Provisions to create or increase asset or liability reserves are not deductible.

CONTRIBUTIONS TO RETIREMENT PLANS

Contributions to retirement plans are only deductible when companies comply with the following requirements:

- Contributions should be funded through a trust
- They must be computed according to an actuarial study
- 30% of the reserves should be invested in government securities or in a bank trust.

NON-DEDUCTIBLE ITEMS

Other non-deductible items are:

- Goodwill
- Expenses incurred abroad and allocated on a pro-rata basis
- Payments to members of the board of directors, bondholders or other parties where the payments represent shares of profits or are contingent upon the taxpayer's profits
- Sanctions, indemnities for damages and contract penalties unless imposed by the Law
- Foreign tax credits.
- The amount paid for salaries in 53%, with in turn is exempt income for workers.

DIVIDENDS

When corporations distribute dividends, they must calculate the related tax by applying the 30% tax rate to the amount which results from multiplying those dividends by a factor of 1.4286, and there is a withholding tax of 10% for the shareholders.

This tax can be taken as a tax credit against the income tax of the year of dividend distribution and carried forward for the next two subsequent tax periods.

Dividends paid from the net profit account (CUFIN), which is defined as the income for which corporate tax has already been paid in past years, are not subject to the tax on dividends already mentioned.

TAX CONSOLIDATION

As of 2015, the tax consolidation regime was replaced by a limited consolidation scheme optional to conglomerates subject the following requisites:

1. The holding Company must have at least 80% of voting shares of the controlled company;
2. Each controlled Company must directly pay its taxes;
3. There no longer exists a consolidated fiscal profit account;

4. Distributed dividends among the companies of the group are subject to income tax in the year they are paid; and,
5. There no longer exists an annual consolidated tax filing

LOSSES CARRY FORWARD

Tax losses can be carried forward for ten years. The amount of the tax loss which can be carried forward to any given year is adjusted for inflation. Loss carry backs are not allowed.

PERMANENT ESTABLISHMENTS

A permanent establishment of non-residents can be created under the following circumstances:

- By conducting business activities in whole or in part within Mexico
- By performing construction or installation projects, maintenance or assembly activities on real estate property or supervisory activities in connection therewith, should such activities last more than six months (including working days of subcontractors)
- When performing business activities in Mexico through a trust fund (“fideicomiso”)
- When conducting business activities through a dependent agent
- When acting through an independent agent which does not act pursuant to the ordinary course of its own activities, occurring when the agent:
 - Exercises the authority to enter into contracts on behalf of the foreign entity
 - Assumes risks in the name of the resident abroad
 - Acts under instructions or general control of the resident abroad
 - Performs activities which economically correspond to the foreign resident and not to its own activity
 - Obtains guaranteed remuneration, regardless of the results of its activities
 - Has inventories with which deliveries are made on behalf of a foreign entity
 - Carries out operations with the resident abroad, establishing prices or compensation which are different from those which would be used between independent parties in comparable operations
- Insurance companies which obtain insurance payments from within Mexico.

Essentially, permanent establishments are subject to the same tax rules as Mexican resident companies. The income tax treaties which Mexico has in force establish narrower definitions under which a permanent establishment is deemed to exist.

NON-RESIDENTS

NON-RESIDENTS HAVING TAXABLE SOURCE OF WEALTH

Non-residents, either legal entities or individuals which do not have a permanent establishment in Mexico, may be liable for tax on certain specific sorts of revenues which are derived from wealth sources located in Mexico.

In general, the Mexican payer must withhold on the gross payment made to a foreign corporation. Mexico’s income tax treaties with other countries reduce the withholding tax rates on certain Mexican source payments made to non-residents. A Mexican taxpayer who is subject to withholding must deliver the income tax when i) the payment becomes due or ii) when the payment is actually made, whichever occurs first. In addition, gross payment is subject to withholding tax without deductions.

Under specific cases, the non-resident may be subject to taxation on a 'net' basis, instead of on a 'gross' basis, which is the general rule. This occurs when the non-resident has a tax representative in Mexico who remains jointly liable for the tax incurred.

Some of the relevant tax rates levied on gross income are:

- Services on real estate projects –25%
- Rental of property and assets –25%
- Sale of real estate and shares of stock –25%
- Technical assistance –25%
- Royalties on the use of patents, trademarks, and commercial names –25%
- Interest paid to foreign banks registered with the tax authorities –10%.
- Interest from certain securities –4.9% or 10%
- Interest paid to suppliers of machinery and equipment –21%.
- Interest paid to other creditors – the maximum tax rate for resident individuals applies (i.e. 30%)
- Any payment to residents of territories with preferential tax regimes (tax havens) –40%
 - Except for income from dividends and profit sharing from companies or interest paid to foreign banks and interest paid to foreign residents derived from securities.

It is important to stress that dividends paid by Mexican resident companies are not subject to taxation for non-residents. The reasons for this are that the Mexican company either i) distributes profits previously taxed at the corporate level, or ii) triggers income tax itself upon such dividend distribution.

TRANSFER PRICES

As a consequence of Mexico's incorporation into the OECD in 1994 its transfer pricing rules have been adopted since 1997.

In interpreting/applying this regime, authorities and taxpayers use the OECD Commentaries, and over time Mexican tax authorities have taken a more 'international approach', rather than a local one when auditing related parties' transactions.

This transfer pricing regime is widely accepted by a large number of countries and in Mexico, both authorities and taxpayers are used to its application, even though it is still awaiting a Supreme Court revision as to its constitutionality. Mexican authorities have been very active over the past four years conducting transfer pricing audits and, as of today, there has not been any tax controversy raised for constitutional analysis.

PERSONS AND/OR ENTITIES SUBJECT TO TRANSFER PRICING

Transfer pricing rules apply to related resident and non-resident juridical entities and individuals, permanent establishments or fixed base activities established in Mexico by non-residents and to activities carried out through trust funds.

The term juridical entity includes commercial and civil entities, governmental agencies developing commercial activities, credit institutions and associations. Neither not-for-profit organisations nor mutual funds are included in this definition.

Mexican joint ventures ('asociacion en participacion' agreements) are treated as taxpayers and, therefore, subject to transfer pricing regulations. The pricing of transactions is regulated only in the case of transactions between related entities.

It should be stressed that Mexican resident companies are obliged to apply this system not only with respect to their transactions with related parties residing abroad, but also with other resident parties in Mexico.

Two or more parties are related when one party participates directly or indirectly in the management, control or capital of the other, or when one party or group of parties participates directly or indirectly in the management, control or capital of others.

The Mexican definition is broader than the one included in US regulations and, in principle, could extend the transfer pricing regulations to companies or individuals which own a small participation in other companies, thus exceeding the scope of the US definition of controlled taxpayer.

It is worth mentioning that when related parties enter into transactions, they are compelled to determine their taxable revenues and/or deductible items considering the prices and/or considerations which would have been agreed upon by unrelated parties in comparable transactions.

TRANSACTIONS SUBJECT TO TRANSFER PRICING

Transfer pricing rules are applied to any import or export of goods, services and rights entered into between related parties.

METHODS

The arm's length nature of a transaction between related parties (i.e. a controlled transaction) is tested by comparing the pricing, terms, and other characteristics of the transaction in question with the pricing, terms and other characteristics of comparable transactions entered between unrelated parties (i.e. uncontrolled transactions).

The comparable uncontrolled price method pre-empts the applicability of other methods and only where it is not suitable for the taxpayer's circumstances, should the taxpayer elect to follow any other of the five additional methods established by the law.

The methods that are acceptable/needed for transfer pricing purposes are the following:

- Comparable uncontrolled price method (CUP) –the CUP method requires comparison of pricing in the controlled transaction to pricing in uncontrolled transactions
- Resale price method – under this method, the resale price charged by the controlled party to unrelated purchasers is reduced by an appropriate gross profit amount to determine the deemed sales price on the sale between the controlled parties
- Cost plus method – in this method, the cost from the company selling to the related party is first determined and then an appropriate gross profit margin is added to this amount, so as to obtain the appropriate deemed sales price between the controlled parties
- Profit split method – under this method, the profitability of a related company group is allocated among members of the group proportionally to their economic contribution to the company

- Residual profit split method – this consists in assigning the operation profit obtained by the related parties in the same proportion as it would have been assigned among unrelated parties
- Operation marginal transactional method – in this method, the operational profit for transactions among related parties is determined according to the operational profit which would have obtained from comparable unrelated companies in similar transactions.

STANDARDS OF COMPARABILITY

The lack of comparables in Mexico is one of the problems that Mexican taxpayers face.

Current sources of comparables used by taxpayers are the following:

- Internal comparables
- Data from the Mexican stock exchange (approximately 170 companies are traded on the stock exchange)
- Public sector Mexican company's database (which contains information from approximately 90% of companies belonging to the public sector).

If no comparables are found in these sources, Mexican taxpayers may use foreign databases (from the US and Europe) and make price adjustments taking into account the specific characteristics of the Mexican market.

Although Mexican law allows for the use of secret comparables, they have not yet been used by authorities and according to tax administration officials, should only be used as a last resort resource.

ARM'S LENGTH RANGE

In some cases, application of a pricing method will produce a single result which is the most reliable measure of an arm's length result. However, in other cases, application of a method may produce several results from which a range of reliable results may be derived. A taxpayer will not be subject to adjustment if results fall within that range (the arm's length range).

Mexican Income Tax Law does not establish a specific method with respect to financing transactions as loans between/among related parties.

ADVANCED PRICING AGREEMENTS (APA)

In 1998, the Mexican Government created a committee to approve APA resolutions. Current APA regulations allow this committee to approve APAs for the effective year requested, as well as for one prior and three subsequent years. However, although forward-looking APAs are allowed for, most APAs issued to date are for prior years.

INFORMATION AND DOCUMENTATION REQUIREMENTS

With respect to transactions with non-residents only, Mexican law provides for information and documentation requirements in order to be able to demonstrate, when required, that the arm's length principle has been accomplished.

There is no specific legal provision establishing that this information/analysis needs to be obtained when performing transactions with Mexican residents' parties; however, it is a fact that such information is needed in order to prove before the Mexican tax authorities that there has been due compliance with the transfer pricing rules.

SECONDARY ADJUSTMENTS

According to transfer pricing principles, when a principal adjustment is made by the tax authorities, it is reasonable to expect that a secondary adjustment will be needed.

However, under the Income Tax Law, the possibility for secondary adjustments is only explicit with respect to international transactions in which a contracting party is a resident of a country with which Mexico has in effect an income tax treaty.

Under Mexican Income Tax Law and transfer pricing rules, taxpayers are obliged to: i) accrue as taxable income principal adjustments derived from those rules, as well as to ii) deduct the taxable items considering the same transfer pricing amounts.

TAX HAVEN RULES

As of 1 January 2005, provisions regarding tax havens moved from a territorial-based criterion based on those territories contained in the Black List to a conceptual criterion.

Since 1 January 2008, Mexican tax residents are subject to this special tax treatment when:

- Income is generated indirectly through foreign legal entities or legal representatives in which they participate directly or indirectly, in proportion to their participation in such legal entities or representatives, as long as said income is subject to preferential tax regimes (PTR), or
- Income is obtained through fiscally transparent foreign entities or legal figures.

INCOME SUBJECT TO PTR

It is deemed that income is subject to PTR if it is generated indirectly through foreign entities or representatives in which Mexican tax residents participate directly or indirectly, in the proportion of their participation in such entities or legal figures, as long as such income:

- Is not taxed abroad, or
- The income tax triggered and paid abroad results in less than 75% of the income tax which would have been paid in Mexico in accordance with the provisions of the Income Tax Law.

Although the sole fact of indirectly generating income subject to PTR triggers the application of the special tax regime, the Income Tax Law establishes some exceptions to this general rule (e.g. lack of control exception, active income exception, royalties' exception, etc).

As of 2008, a lack of control statutory exception entered into force (applicable even in cases of direct participation). Such an exception provides that income generated through foreign legal entities or representatives will not be considered subject to PTR whenever the Mexican taxpayer does not have effective control of the vehicle or control of the vehicle's administration, in such a degree as to decide upon distribution of income, profits or dividends, whether directly or through third parties.

INCOME OBTAINED THROUGH TAX TRANSPARENT ENTITIES OR LEGAL REPRESENTATIVES

Income obtained through foreign entities or legal representatives which are fiscally transparent is subject to this special tax treatment, even if such income is not subject to PTR (ie even where it is taxed abroad with less than 75% of the income tax which would have been paid in Mexico).

Tax transparent legal representatives or entities are those which:

- Are not considered as income taxpayers in the country in which they are incorporated or where their main administration or seat of effective direction is located

- The revenues generated through such an entity or legal representative are attributed to its members, partners, shareholders or beneficiaries.

TAX CONSEQUENCES

In general, income under this special tax treatment is subject to tax in the fiscal year in which such income is generated abroad, even though the income has not yet been distributed. The payment of the corresponding income tax has to be made together with the annual tax return of the fiscal year in which the income is generated.

INFORMATIVE TAX RETURN

Taxpayers must file in the month of February of each year an informative return before Mexican tax authorities regarding:

- Income generated in the previous tax year subject to PTR
- Income generated in jurisdictions of the 'Black List'
- Transactions carried out through tax transparent foreign legal entities or representatives (Art. 178 ITL).

THIN CAPITALISATION RULES

Thin capitalisation rules were established in 2005, providing for a five-year period to attain a 3:1 debt/net worth ratio; thus, as of 2010, these rules were in full force.

The most important features of this regime are:

- Interest derived from debts with foreign related parties which exceeds three times the net worth of the company, is not deductible
- The procedure established to determine the non-deductible interest may produce awkward effects contrary to the spirit of the provision. In certain events, the higher the proportion of debt contracted by a company with its foreign-related parties, the higher the proportion of non-deductible interest will be and the lower the proportion of debt and deductible interest
- Debt contracted in the following circumstances:
 - By the members of a financial system in the performance of their activities
 - For the construction, operation and maintenance of productive infrastructure linked with strategic areas
 - By taxpayers who obtain an advance price agreement, who will not be considered for thin capitalization purposes.

TAX TREATIES

Mexico has a vast array of tax treaties on income tax matters.

Tax treaties only provide benefits with respect to what is set forth in Mexican law. Therefore, such treaties may not impose burdens which are not established in Mexican law.

Income tax is covered by the treaties; however, due to the recent effectiveness of the business flat tax, an effort to include this within the purview of the treaties has been actively made by the Mexican tax authorities.

Examples of treaty benefits are:

- Lower rates than those provided in the local law

- Stringent cases (compared with those established under the local law) under which a permanent establishment is deemed to exist.
- Revenues not subject to taxation under provision of the local law, for example 'know-how' services payments.
- A non-discriminatory principle, which entails that the treaty partners resident may not be taxed higher than local tax residents.

RELEVANT PERSONAL TAXES FOR EMPLOYEES

INCOME TAX

Residents and non-residents in Mexican territory are subject to individual income tax if they obtain income in cash, in kind, in services or in any other way. Foreign resident individuals who carry out entrepreneurial activities or provide independent personal services in Mexico through a permanent establishment are also required to pay tax on the income attributable to this establishment.

Income for the provision of independent personal services includes salaries and other benefits derived from a labour relationship, including employee profit-sharing and benefits received as a result of the termination of the work relationship.

The maximum tax rate for individuals is 35%. For the purposes of this tax, this income includes the following types of income:

- Social security
 - The social security contribution in Mexico is paid for by the employee and the employer
- Remuneration of public employees
- Advance payments from production cooperatives, civil law partnerships and civil law associations
- Fees received by board members, statutory auditors, etc.
- Fees for services rendered primarily for a client
- Earnings of independent service providers that elect this tax treatment
- Earnings of individuals with entrepreneurial activities that elect this tax treatment.

7 – ACCOUNTING & REPORTING

In June 2004, the Mexican Council for Research and Development of Financial Information Norms (CINIF) took over responsibility for issuing accounting regulations in Mexico.

The CINIF carries out its functions through study, research and consultation with professional organisations, financial and businesses communities and other interested sectors, leading to the issuing of so-called 'Norms of Financial Information' (NIF). The philosophy of the NIF is to ensure, on the one hand, the harmonisation of particular norms used by different sectors of the economy, and on the other, to converge to the greatest possible degree with the norms of the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

There are, however, many companies in Mexico which draw up their financial information based on the IFRS due to their comptroller's request and/or parent companies.

BASIC CONCEPTS

Some general principles are followed for financial statements.

Assets are presented at a fair value or net resale value, with the exception of non-financial assets which must be presented in a specific way. According to the accrual method, yields are recognised when they are made and costs are considered when they are incurred.

Accounting policies must be applied from one period to another. All reasons for non-compliance must be informed.

Accounting concepts relevant to investors are described below.

LEASEHOLD

Leases which substantially transfer the advantages and risks of the property are considered as acquired assets and become liable. Other leases are considered as operating leases. Accounting rules for leases are similar to those of the generally accepted accounting principles (GAAP) in the US.

INTANGIBLE ASSETS

Acquired intangible asset costs are registered as assets and are amortised on the estimated period of the assets' useful life – an important difference from US GAAP. The maximum period of amortisation under Mexican GAAP is 20 years.

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are imposed on income where liable, similar to the US GAAP practice. However (and this differs from the US GAAP), in some instances, start-up costs are not taken into account.

CONSOLIDATION

A company with more than a 50% interest in another company must provide consolidated financial statements, and include the investor's financial statements. This principle is similar to provisions in the US GAAP.

EXCHANGE RATE PROVISIONS

Foreign currency transactions are filed using the exchange rate on the day the transaction took place. Assets and liabilities expressed in foreign currency are converted into Mexican pesos at the exchange rate prevailing at the time of reporting. Exchange differences are reflected in the net income.

AUDIT REQUIREMENTS

Mexican companies may prepare financial statements. Furthermore, Mexican GAAP requires a report on changes in the financial position, rather than one on the cash flow. Mexican publicly quoted corporations, governmental companies, financial sector companies, insurance sectors and most other companies which exceed a certain minimum in assets must present annual financial statements.

Annual audits must be carried out the year after the closing of the fiscal year and the audited financial statements are disclosed at the annual stockholders meeting, to the Treasury authorities and to the public through the CNBV.

DEFERRED INCOME TAXES

The NIF requires the recognition of deferred taxes to profits by the total of the differences between the financial and the fiscal value of assets and liabilities, thus eliminating the differences in the accounting treatment of income tax and employee's profit sharing.

It also establishes the re-classification of retained profits unless these are identified with accounts recognised in the shareholders equity and which comprise integral profit (loss) and have not been reclassified to income statement.

WORKERS' FRINGE BENEFITS

Under Mexican Labour Laws, companies must pay an indemnity to employees with 15 years' service who cease employment voluntarily, involuntarily or due to death.

This requirement –and any applicable pension requirement – increases with length of service. In most dismissal cases, indemnities and compensations must be paid to employees given that current accounting practices identify these payments as contingency remuneration.

ALLOCATION OF PROFITS

Costs associated with profit distribution are recognised (in a similar way to income taxes) after the pre-tax income. Companies must provide annual financial statements approved by stockholders.

REPORTING REQUIREMENTS

Financial statements must be presented at the annual stockholder meeting and approved. All companies must have a statutory inspector (corporation official) assigned to this position by the stockholders. This person is generally an independent public accountant and is usually from the accountancy firm which carries out inspections/audits.

Companies meeting certain criteria must file an annual tax return with the authorities for the last annual fiscal period. Companies filing a tax return may or may not be subject to an external audit by Mexican authorities. Consolidated and audited financial statements must be presented alongside this tax return.

BENEFICIAL OWNER

As of January 2022, based on the Mexican Federal Fiscal Code, all Legal Entities, trusts, as well as the contracting parties or members, in the case of any other legal figure, are obliged to obtain and keep, as part of their accounting, and to provide to the Tax Authorities (SAT), when the said authority so requires, the trustworthy, complete and updated information of their **Beneficial Owners**.

The **Beneficial Owner** is the individual person or group of individual persons who: Directly or through another or other persons or any legal act, obtains the benefit derived from their participation in a legal entity, a trust or any other legal figure, or who ultimately exercise the rights of use, benefit, or disposition of an asset or service or in whose name a transaction is carried out.

ELECTRONIC ACCOUNTING

Since 2016 electronic accounting is mandatory for all companies, which must submit accounting records and entries to tax authorities on a monthly basis. Among the main requirements are: all information must be in Spanish and in Mexican Pesos and the trial balance at the main accounts and secondary accounts levels must be sent every month.

The information must be submitted by internet through the Tax Authority Drop Box ("Buzón Tributario") and must be signed with each company's electronic signature ("Fiel"). Journal entries ("Pólizas") are mandatory and must be submitted upon the authorities' request or when the company is requesting a tax refund or a tax compensation.

ELECTRONIC INVOICES (CFDI)

Electronic invoices have substituted traditional paper invoices. The electronic invoice, or CFDI, is a digital voucher implemented by the tax authority that describes the cost of goods or services and the taxes paid. The CFDI must be electronically stamped by an Authorized Certification Provider (PAC).

OUTSOURCING

Outsourcing (sometimes referred to as "contracting out") is a common business practice used to reduce costs or improve efficiency by shifting tasks, operations, jobs or processes to an external third party for a significant period of time. These functions that are contracted out can be performed by the third party either onsite or offsite of the business.

Outsourcing expenses must comply with specific requirements in order to be tax deductible. The main requirements are: the contractor must obtain a copy of the tax receipts from the payment of salaries of the workers who have carried out the subcontracted service, of the acknowledgments of receipt as well as the declaration of the whole of the withholdings of taxes made (income tax and value added tax) to the said workers and of payment of the social security contributions. Otherwise, the service will not be deductible.

MULTINATIONAL GROUPS' OBLIGATIONS

As of 2017, multinational companies' groups were required to provide information to tax authorities in the immediately following year to the current fiscal year on:

I. Related parties:

- a) Organizational structure
- b) Description of activities, intangibles and related financial operations
- c) Financial and fiscal position

II. Local related parties:

- a) Organizational structure, strategic and business activities and related parties' operations
- b) Information on operations or companies used as comparable

III. Group's individual country:

- a) Revenues and taxes paid
- b) Location of economic activities.
- c) List of the group's entities and their permanent establishments

8 – UHY REPRESENTATION IN MEXICO



UHY GLASSMAN ESQUIVEL Y CÍA S.C. MEXICO



CONTACT DETAILS

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SOCIAL MEDIA CONNECTIONS

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- LinkedIn: mx.linkedin.com/pub/uhy-glassman-esquivel/51/378/979
- Twitter: twitter.com/geuhy

Year established: 1989
PCAOB registered?: Yes
Number of partners: 6
Total staff: 101

ABOUT US

Growing Together

OTHER IN-COUNTRY OFFICE LOCATIONS AND CONTACTS

Ciudad de México - Sede Sur C.P.C Oscar Gutierrez Esquivel
Monterrey - Nuevo Leon C.P.C Oscar Gutierrez Esquivel
Villahermosa – Tabasco C.P.C Oscar Gutierrez Esquivel
Querétaro - Querétaro C.P.C Oscar Gutierrez Esquivel

BRIEF DESCRIPTION OF FIRM

UHY Glassman Esquivel y Cía, S.C. serves a variety of middle-market companies, including insurance companies, not-for-profit organisations, large retail companies, commercial operations, professional services, manufacturing and the health care sector.

SERVICE AREAS

Accounting services
Audits
Business consulting
Business valuations
Employment law advisory services
Financial planning
Internal audit services
IT services
Legal services
Management consulting



The network
for doing
business



Mergers and acquisitions
Taxation services

SPECIALIST SERVICE AREAS

Sarbanes-Oxley services

PRINCIPAL OPERATING SECTORS

Insurance
Retail
Commercial
Professional services
Manufacturing, retail, distribution
Health care
Not-for-profit

LANGUAGES

Spanish, English.

CURRENT PRINCIPAL CLIENTS

ALKHORAYEF PETROLEUM MEXICO SA DE CV
THERMON LATINOAMERICANA, S. DE R.L. DE C.V.
PAULO HEAT TREATING MEXICO S, DE R.L. DE C.V.
CHASE PLASTICS DE MEXICO S, DE R.L. DE C.V.

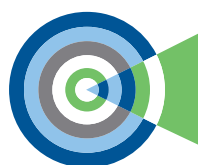
OTHER COUNTRIES IN UHY CURRENTLY WORKING WITH, OR HAVE WORKED WITH IN THE PAST

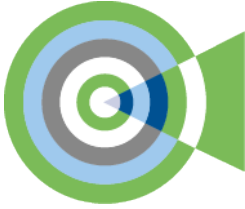
Spain, US, UK.

BRIEF HISTORY OF FIRM

Founded in 1989 as an independent accounting and business consulting firm, Glassman Esquivel & Cia, began its operations by offering a wide range of professional services to companies that develop their activities in the various economic areas in Mexico in one of the most important periods in the development of our country.

The firm joined UHY in 2000.





LET US HELP YOU ACHIEVE FURTHER BUSINESS SUCCESS

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