



# ICLG

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Richard Firth

**Published by**  
Global Legal Group Ltd.  
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# Mexico

Alejandro Calderón Aguilera



Calderón, González y Carvajal, S.C.

Arturo Carvajal Trillo



## 1 Tax Treaties and Residence

### 1.1 How many income tax treaties are currently in force in Mexico?

At this moment, Mexico has 80 tax treaties in force. In addition, Mexico is negotiating income tax treaties with another 13 states.

### 1.2 Do they generally follow the OECD Model Convention or another model?

Most of the tax treaties for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion follow the OECD model with some amendments. A few, within the Latin American region, follow some clauses of the UN model.

### 1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties do not have to be incorporated into domestic law before they take effect. Mexican domestic law provides that such treaties must be published before they take effect in the Mexican Official Gazette.

The normal procedure for a treaty to be effective in Mexico is that the Mexican Senate approves it.

### 1.4 Do they generally incorporate anti-treaty shopping rules (or “limitation on benefits” articles)?

Most treaties do not incorporate articles on limitation of benefits but in the case of dividends, royalties and interest the treaties only apply to the “beneficial owner”.

### 1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In Mexico, tax treaties cannot be overridden by any existing or subsequent domestic law whether or not this exists when the treaty takes effect, in accordance with what is stipulated in the Vienna Convention for Treaty Rights, to which Mexico is a party.

### 1.6 What is the test in domestic law for determining corporate residence?

Article 9 of the Federal Tax Code states that corporations are considered tax-resident entities if they established their business administration or principal place of effective management within Mexican territory.

## 2 Transaction Taxes

### 2.1 Are there any documentary taxes in Mexico?

No. There are no documentary taxes.

### 2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Mexico has a Value Added Tax (VAT) which is levied on the alienation of goods, rendering of independent services, granting the temporary use or enjoyment of goods, and on the importation of goods and services. The general VAT rate is 16%.

Exports and some other specified items are subject to the 0% rate, such as non-industrialised animals and vegetables, some products intended for food, medicines and agricultural services, books, newspapers and magazines published by the taxpayer.

This 0% rate grants the possibility to recover the favourable balance that is generated for the taxpayers that perform this kind of activities when VAT is charged on the consumption of goods or services that they use for such activities.

### 2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The Value Added Tax Law includes several exempt activities for such tax, for example, in the alienation of goods such as land, buildings attached to the ground intended or used as households, books, newspapers and magazines, used furniture goods, tickets and other vouchers that allow participation in lotteries, raffles, lotteries or games of chance and contests of all kinds, the sale of domestic and foreign currency and gold pieces and silver, or interests related to mortgages for the acquisition of property intended for use as households, among others.

Likewise, the aforementioned Law establishes several assumptions of services that are considered VAT-exempt, such as: services provided free of charge; services provided by the Federation and its decentralised agencies; public transport; international shipping of goods; public entertainment; professional medical services; author royalties; among others.

#### **2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?**

In Mexico, persons or corporations that are not registered as tax residents for income tax and Value Added Tax purposes cannot recover the VAT. In case a taxpayer is exempt for part of the transactions carried out, the VAT Law establishes an apportionment method in order to consider only the taxable portion of such transactions.

#### **2.5 Are there any other transaction taxes payable by companies?**

In Mexico, there is a state tax on the acquisition of real estate in most of the 31 states of the Federation and in Mexico City; the tax rates differs in each state, ranging between 3% and 5% of the value of the real estate.

#### **2.6 Are there any other indirect taxes of which we should be aware?**

There is the special tax on products and services that is payable on the sale of alcoholic and some non-alcoholic beverages, tobacco, gasoline and diesel. In Mexico there are also customs duties which are payable in certain cases with countries which have no free trade agreement in force.

### **3 Cross-border Payments**

#### **3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?**

In Mexico, there is a 10% withholding tax imposed on dividends paid by a locally resident corporation to a non-resident. The rate might be reduced in the relevant tax treaty.

#### **3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?**

Mexico imposes a withholding tax on royalties paid by a local company to a non-resident.

The Mexican withholding tax rate on royalty payments can be 5%, 25% or 35%. In case of royalties paid for the use or enjoyment of railcars such rate is only 5%. The 35% rate applies to royalties for the use of patents, inventions, trademarks, trade names and commercial names. In the case of royalty payments made to tax residents in a preferential tax regime, the withholding tax rate is 40%.

It is important to mention that most of the tax treaties signed by Mexico with other countries provide a 10% or 15% withholding tax rate on royalty payments.

#### **3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?**

According to the Mexican Income Tax Law, there is a withholding

tax levied on interest paid. This withholding is computed by applying the rate indicated for each case depending on the kind of credit granted or the creditor, as follows:

- i) 10% on interest payments made to non-resident banks upon compliance with a specific registration before the tax authorities and disclosure requirements imposed by the tax authorities. A 4.9% tax rate will apply instead of the 10% mentioned on interest paid to banks if the bank is resident in a country that has a tax treaty with Mexico.
- ii) 4.9% on interest payments made to foreign financial entities in which the Mexican government is a stockholder. The same withholding tax rate will apply, complying with some requirements, to interest or gains from negotiable instruments traded in the stock exchange.
- iii) 15% on interest payments made to reinsurers.
- iv) 21% on interest payments made by Mexican credit institutions to creditors different from those contemplated in (i) above, or when the credit is used to pay foreign suppliers for the sale of equipment or machinery and in general for credit used to purchase inventory or for marketing, if the tax authorities are provided with the required financial information.
- v) 35% on interest deriving from credits that do fold on a specific case mentioned above.

It is relevant to mention that reduced withholding tax rates could be applicable to tax residents of countries that have a tax treaty with Mexico in force.

Some exemptions apply in the following cases: interest payments that derive from credit granted to the Mexican government; credit granted for a period greater than three years guaranteed by financial institutions located abroad dedicated to the promotion of exportation activities when such institutions are registered with the Mexican Tax Authorities; and credit granted by non-resident financial institutions in preferential terms in favour of institutions located in Mexico that are authorised to receive donations.

#### **3.4 Would relief for interest so paid be restricted by reference to “thin capitalisation” rules?**

In Mexico, thin capitalisation rules exist with regard to liabilities generating interest made with foreign related parties that exceeds triple the amount of the debtor’s assets.

In some cases, when the taxpayer has related parties resident abroad, the rule could be applied even if the creditor is an independent party.

#### **3.5 If so, is there a “safe harbour” by reference to which tax relief is assured?**

In Mexico there is no “safe harbour” where tax relief is assured.

It is important to mention that financial entities in Mexico are not subject to the restrictions derived from the thin capitalisation rules regarding loans obtained to carry out their business.

Furthermore, it is possible to file a ruling before the Mexican Tax Administration in order to exclude certain loans from the thin capitalisation rules.

#### **3.6 Would any such rules extend to debt advanced by a third party but guaranteed by a parent company?**

Regarding debt advanced by a third party and guaranteed by a parent company – known in Mexico as back-to-back loans – the thin capitalisation rules do not apply in such cases; however, in the Mexican Tax Law it is established that such interest payments are non-deductible and can be considered as deemed dividends.

### 3.7 Are there any other restrictions on tax relief for interest payments by a local company to a non-resident?

In Mexico there is no tax relief regarding interest, therefore the question does not apply to interest payments according to the Mexican Income Tax Law.

### 3.8 Is there any withholding tax on property rental payments made to non-residents?

According to the Mexican Income Tax Law, in Mexico there is a withholding tax on property rental payments made to non-residents at a 25% rate of the income received, without any deduction whatsoever. Non-residents can choose to pay 30% on the gain obtained instead of the 25% on the gross income.

### 3.9 Does Mexico have transfer pricing rules?

The Mexican Income Tax Law establishes transfer pricing rules when transactions are carried out between related parties. The mentioned Law considers parties to be related in two general cases: 1) if one party, either directly or indirectly, participates in the management, control or capital stock, of another; or 2) if one party or a group of parties participates, either directly or indirectly, in the management, control or capital of the other parties.

The Mexican Tax Authorities shall resolve rulings to determine the acceptable level of compensations for transactions between related parties in an advance method approach (Advance Price Agreements – APAS). These resolutions may result from a unilateral, bilateral or multilateral agreement between the Mexican and the other countries' tax authorities.

Normally, the interpretation of the transfer pricing rules is based in the OECD transfer pricing guidelines.

Transfer prices may be determined using any one of the following six methods, but taxpayers must first use the comparable Uncontrolled Price Method. Only if this method is found to be unsuitable may they use the other methods, as follows:

- Comparable uncontrolled price method.
- Resale price method.
- “Cost plus” method.
- Profit-split method.
- Residual profit-split method.
- Transactional profit-margin method.

## 4 Tax on Business Operations: General

### 4.1 What is the headline rate of tax on corporate profits?

According to the Mexican Income Tax Law, a 30% tax rate is applicable on all taxable income of Mexican corporations.

### 4.2 Is the tax base accounting profit subject to adjustments, or something else?

Yes, the tax base is the accounting profit subject to adjustments.

### 4.3 If the tax base is accounting profit subject to adjustments, what are the main adjustments?

The main adjustments are the following:

1. The moment in which the income deemed to be obtained according to the tax rules differs from that in the accounting rules.
2. Some financial effects recognised in the Mexican General Accepted Accounting Principles (GAAPs) are not considered by the Mexican tax laws, such as certain financial costs and expenses that cannot be deducted for tax purposes.
3. Some revenue is considered income by the accounting rules but not by the tax rules.
4. The tax rules and the GAAPs calculate certain deductions differently.

The tax reconciliation between the accounting and tax profit is shown in both the annual tax return and the auditor's report for tax purposes.

### 4.4 Are there any tax grouping rules? Do these allow for relief in Mexico for losses of overseas subsidiaries?

Starting in 2014, the Income Tax Law abrogated the consolidation regime. The legislation in force only allows the companies which have not been in the consolidation group for five years, to continue being taxed under this regime up until they reach the five-year term. As of 2014 there are new tax grouping rules which basically allow companies' tax results to be combined in a group, and also allow a tax deferral.

### 4.5 Do tax losses survive a change of ownership?

Yes, but if the income from the last three years prior to the change of ownership is less than the amount of the updated tax losses, such losses can only be deducted against the taxable profits obtained from exploitation of the same activity in which such losses were incurred.

### 4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Until 2013, profits in Mexico were only taxed at the corporate level, not at the shareholder level. Profits obtained and distributed in 2014 and the following years shall be levied with an additional tax of 10% at the shareholder level when such profits are being distributed to non-residents or individuals resident in Mexico.

If profits have not paid corporate income tax by the time said profits are being distributed, the tax is triggered at corporate level when such distribution (dividends) is decreed. Companies distributing profits or dividends shall calculate and pay a tax of 30% on the result of multiplying said profit or dividends by a factor of 1.4286 for 2014. Dividends paid are not subject to income tax if paid from the Net Tax Profit Account. This is because the Net Tax Profit Account reflects the profits that have already paid the corresponding corporate tax.

The tax paid for distribution of dividends can be credited against the corporate tax of the current fiscal year and the two following fiscal years, including in this latter case the monthly advance payments.

### 4.7 Are companies subject to any significant taxes not covered elsewhere in this chapter – e.g. tax on the occupation of property?

The main federal taxes for corporations are: income tax; Value

Added Tax; and a special tax on products and services. The main state taxes are: payroll tax; and real estate or property tax (which taxes the ownership of real estate).

## 5 Capital Gains

### 5.1 Is there a special set of rules for taxing capital gains and losses?

Yes. Capital losses can only be offset against capital gains and not against any other type of income. Capital losses can be carried forward up to five years.

Capital gains and losses are those on capital assets, like capital derivatives, shares and other securities whose yields are not deemed to be interest by the law.

### 5.2 Is there a participation exemption for capital gains?

No, there is not any participation exemption for capital gains.

### 5.3 Is there any special relief for reinvestment?

No, currently there is no special relief for profit reinvestment.

### 5.4 Does Mexico impose withholding tax on the proceeds of selling a direct or indirect interest in local assets/shares?

Yes. In cases of alienation of shares or of negotiable instruments representing title to assets, the source of income shall be deemed located in Mexico when the issuer is resident in Mexico for tax purposes, or when regardless of the tax residency of the issuer, the value of the shares proceeds directly or indirectly from real property located in the country.

In the case of assets located in Mexico, there shall only be withholding in the event such assets are real property situated in the country.

## 6 Local Branch or Subsidiary?

### 6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed upon the formation of a subsidiary in Mexico.

### 6.2 What is the difference, if any, between the taxation of a locally formed subsidiary and the branch of a non-resident company?

A locally formed subsidiary as a Mexican tax resident has to pay corporate income tax on its worldwide income. A branch of a non-resident company that is a permanent establishment according to Mexican law shall pay income tax only on income attributable to that permanent establishment.

Subsidiaries and permanent establishments of non-resident companies are subject to the same taxes, in respect of the constitutional principle of tax equality.

### 6.3 How would the taxable profits of a local branch be determined in its jurisdiction?

Permanent establishments of foreign companies are taxed only on income attributable to said permanent establishments. Deductible expenses shall be allocated proportionally between the Mexican permanent establishment and the headquarter office or any other branch abroad. For the deduction to be allowed, it is necessary that some legal requirements are met, and the head office or the other branch is located in a country that has a tax treaty and an exchange of tax information treaty with Mexico.

Deductions of remittances by permanent establishments in Mexico to their headquarters or to other branches abroad are not allowed, regardless of whether such transfers represent royalties, fees or similar payments for patents, rights, commissions or interests.

The costs of goods received by permanent establishments in Mexico from their headquarters or from any branch abroad are deductible but shall not be higher than the custom value declared.

### 6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Profits of permanent establishments of foreign entities are subject to the same corporate income tax as that of local corporations.

### 6.5 Would a branch benefit from double tax relief in its jurisdiction?

Both individuals and companies, whether Mexican residents or residents of the other treaty country, are entitled to benefit from the remedies for double taxation provided in the relevant treaty, on condition that the legal requirements are met.

### 6.6 Would any withholding tax or other similar tax be imposed as the result of a remittance of profits by the branch?

If the profits remitted by the permanent establishment come from the Net Tax Profit Account or from the Capital Remittances Account, the remittance of such profits is tax-free.

The Capital Remittance Account is a special account in which permanent establishments add distributable profits and remittances received from their head offices and other branches abroad, and contrariwise reduce cash payments and other remittances made to their head offices or other branches.

If the distributed profits do not come from the Net Tax Profit Account or from the Capital Remittances Account, the corporate tax regime for the payment of dividends applies.

## 7 Overseas Profits

### 7.1 Does Mexico tax profits earned in overseas branches?

Mexican tax residents are taxed on their worldwide income, and the tax shall be paid when such income is deemed to be obtained. Mexican law has adopted an anti-deferral regime (CFC rules) which applies when the foreign entity receives passive income, when the foreign entity is located in a country where it shall pay less than

75% of the amount that it should have paid in Mexico, or when it is a pass-through entity in the country where it is located.

### 7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

Yes, dividends received by a local company from a non-resident company will be subject to taxation. In certain cases, the law allows a foreign tax credit for taxes paid abroad with respect to such dividends.

### 7.3 Does Mexico have “controlled foreign company” rules and, if so, when do these apply?

Yes, Mexico has CFC rules that apply when the foreign entity receives passive income, when the foreign entity is located in a country where it shall pay less than 75% of the amount that it should have paid in Mexico, or when it is a pass-through entity in the country where it is located.

## 8 Taxation of Real Estate

### 8.1 Are non-residents taxed on the disposal of real estate in Mexico?

Yes. According to article 160 of the Mexican Income Tax Law, non-residents are taxed on the disposal of real estate located in Mexico. The tax rate is 25% on total revenue obtained, with no deduction or 30% on the profit if certain conditions are met.

### 8.2 Does Mexico impose tax on the transfer of an indirect interest in real estate located in Mexico and, if so, what constitutes an indirect interest?

Yes. Mexico taxes the transfer of an indirect interest in real estate located in Mexico. An indirect interest refers to the alienation of property through the alienation of shares or interests in any entity if more than 50% of the value of the shares or interests proceeds from immovable property.

### 8.3 Does Mexico have a special tax regime for Real Estate Investment Trusts (REITs) or their equivalent?

Yes. Article 188 of the Mexican Income Tax Law provides the regulation of Investment Trusts dedicated to the acquisition and development of real estate in Mexico, for the purpose of leasing or selling it. These vehicles have some tax benefits such as tax deferrals, and eliminate the obligation to make advance payments during the year for income tax purposes.

## 9 Anti-avoidance

### 9.1 Does Mexico have a general anti-avoidance or anti-abuse rule?

No, Mexico only has special anti-avoidance or special anti-abuse rules.

### 9.2 Is there a requirement to make special disclosure of avoidance schemes?

No. There is no legal requirement to make a special disclosure, nor is there a legal definition of the term “avoidance scheme”. Taxpayers are required to file a notice if they have offshore investments that are subject to the CFC regulations.

## 10 BEPS and Tax Competition

### 10.1 Has Mexico introduced any legislation in response to the OECD’s project targeting Base Erosion and Profit Shifting (BEPS)?

Yes. Since 2014, fraction XXXI of Article 28 of the Income Tax Law states that taxpayers cannot deduct interest, royalties and technical assistance payments made to a foreign entity controlled by or in control of the taxpayer, in accordance with the following:

- i) If the entity in receipt of the payment is fiscally transparent, such payment will not be deductible in the proportion in which the shareholders of that foreign entity are not subject to income tax for the income received through it.
- ii) If the payment is considered non-existent for tax purposes in the state or territory of the foreign entity, or the foreign entity does not consider the payment as taxable income under tax provisions, such payment will not be deductible.

Since before BEPS, Mexico has had a provision (article 171 of the Income Tax Law) which establishes a withholding tax of 40% on any payment to a resident of a preferential tax regime; some exceptions may apply.

### 10.2 Does Mexico maintain any preferential tax regimes such as a patent box?

No. The only preferential regime in Mexico is the so-called “Maquiladora Regime”, which gives some administrative, customs and tax benefits.

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**Alejandro Calderón Aguilera**

Calderón, González y Carvajal, S.C.  
Campos Elíseos 400-701  
Lomas de Chapultepec  
Mexico, D.F.  
Mexico

Tel: +52 55 5554 6210  
Fax: +52 55 5554 6210  
Email: [alejandrocalderon@cgctax.com](mailto:alejandrocalderon@cgctax.com)  
URL: [www.cgctax.com](http://www.cgctax.com)

Mr. Calderón's main areas of practice are: Corporate Tax; Tax Aspects of Cross-border Transactions; International Tax Planning; Consultation and Litigation, including Transfer Pricing and Advance Pricing Agreements; Tax Controversy; and Competent Authority Proceedings.

He has advised and litigated complex cross-border transactions and tax treaty issues. During 2011 he won the first case before the Supreme Court involving fundamental rights of taxpayers.

He is co-author of the books, "International treaties to avoid double taxation", "Introduction to international taxation", "Interpretation of tax treaties" and "Transfer pricing, theoretical, legal and practical framework", among others.

He is a member of the Executive Committee of IFA Mexico and former chairman of the Scientific Committee. He is also an active member of the Tax Committee in the Mexican Bar, IBA and Academy of Tax Studies.

He has been mentioned as a leading tax practitioner by the International Tax Review and Chambers and Partners Latin America.

**Arturo Carvajal Trillo**

Calderón, González y Carvajal, S.C.  
Campos Elíseos 400-701  
Lomas de Chapultepec  
Mexico, D.F.  
Mexico

Tel: +52 55 5554 6210  
Fax: +52 55 5554 6210  
Email: [arturo.carvajal@cgctax.com](mailto:arturo.carvajal@cgctax.com)  
URL: [www.cgctax.com](http://www.cgctax.com)

Mr. Carvajal's main areas of practice are: Mexican Federal Taxes; Tax Compliance; International Tax Planning; Consultation including Transfer Pricing and Advance Pricing Agreements; Tax Controversy; and Competent Authority Proceedings.

He has advised on complex cross-border transactions and tax treaty issues.

He is the author of such books as "Tax treatment of the usufruct of shares" and "VAT treatment on credit right transfer", among others, and co-author of other tax books and tax analysis papers and articles. He has participated in negotiations about several tax reforms in Mexico.

He is the Chairman of the Tax Committee in the Mexican Institute of Financial Executives. He is also an active member of the International Fiscal Association (IFA) Mexican Group, Mexican Institute of Public Accountants, Mexican College of Public Accountants and the Academy of Tax Studies.



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59 Tanner Street, London SE1 3PL, United Kingdom  
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255  
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