

Mexico

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Main taxes on corporate transactions

1.

What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions? In relation to each tax/fee identified, explain briefly:

- Its key characteristics?
- What triggers it?
- Who is liable?
- The applicable rate(s)?

There are no transfer taxes applicable on corporate transactions.

However, local transfer taxes and notaries' fees apply on the acquisition of real estate located in Mexico, regardless of the residence of the purchaser. The local tax rate (plus notaries fees) is 5% or 6% of the transaction's price.

Notaries' fees are charged only if the documents must be granted or recorded before a notary public (protocolization). All sales of real estate exceeding approximately US\$2,000 (EUR1,652) must be made before a notary public. A schedule of charges exists for notaries' fees.

2.

What are the main corporate and/or capital gains taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- Its key characteristics?
- What triggers it?
- Who is liable?
- The applicable rate(s)?

Companies resident in Mexico are charged income tax on worldwide profits and capital gains. The tax is paid on 31 March of the calendar year following when the

income was accrued, although advance payments must also be paid every month on the 17th.

Capital gains tax is mainly triggered on the sale of shares or assets. The following methods of calculating gain apply:

- For assets the amount of gain is calculated by deducting the original cost (indexed for inflation) from the sale price.
- For shares, as well as deducting the original cost from the sale price, other elements must be taken into account such as profits or losses generated in the company whose shares are being sold.

The corporation income tax rate including capital gains is 30% for 2005, 29% for 2006 and 28% for 2007.

3.

What are the main value added and/or sales taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- **Its key characteristics?**
- **What triggers it?**
- **Who is liable?**
- **The applicable rate(s)?**

Value Added Tax (VAT) is applicable to the following transactions when they take place in Mexican territory:

- Sale of goods.
- Provision of services.
- Renting of goods.
- Imports and exports.

The standard rate is 15% and there is a reduced rate of 10% applicable in border areas. Most exports are subject to a zero rate, as are sales of basic foodstuffs (for example, meat, milk and corn) medicine and some other products. The tax is triggered in the month when the taxpayer is paid in cash or in kind.

The seller, provider of the services, importer and so on, is the liable party. However, the liable party transfers the tax to the buyer or recipient of the service. In the case of imports the tax is paid directly by the importer.

4.

Are any other taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- **Its key characteristics?**
- **What triggers it?**
- **Who is liable?**
- **The applicable rate(s)?**

There are generally no other taxes payable on corporate transactions. In some cases excise taxes or other minor taxes are applicable.

5.

In what circumstances will the taxes identified in *Questions 1 to 4* be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability). Consider:

- **Transfer taxes and notaries' fees.**
- **Corporate and capital gains taxes.**
- **Value added and sales taxes.**
- **Any other relevant taxes.**

Transfer taxes and notaries' fees

Local transfer taxes and notaries' fees apply on the acquisition of real estate located in Mexico, regardless of the residence of the purchaser (*see Question 1*).

Corporate and capital gains taxes

Non-resident companies with a branch or permanent establishment in Mexico are liable for corporate income tax (*see Question 2*) on the income attributable to that branch or permanent establishment.

The concept of a permanent establishment in the tax law is very similar to that of the OECD Model Tax Convention on Income and on Capital. That is, the term permanent establishment means any place in which business activities are wholly, or partially, carried on. The term incorporates branches, agencies, offices, factories, workshops, installations, mines, quarries and any other place of explorations for or extraction of natural resources.

Non-resident companies are also liable for tax on any income that falls within the definition of Mexican source income. There is no general definition of a Mexican source of income. However, the law defines what is considered as Mexican source income for each type of income, for example:

- Using intangible property in Mexican territory.

- Paying royalties **[**to**]** a non resident.
- Performing activities as an employee in Mexican territory.

Companies are considered to be residents of Mexico when either:

- The place of incorporation of the company is in Mexico.
- They have their main management or business centre in Mexico.

Value added and sales tax

Non-residents are liable for payment of VAT on sales if they deliver the goods in Mexico to the buyer. They must also support the transfer of VAT in the invoicing of those export services that do not qualify for the zero rate.

Asset tax

Non-residents with a permanent establishment in Mexico are liable to pay asset tax on any assets attributable to the permanent establishment.

Non-residents maintaining stock to be used in an industrial or manufacturing process and those renting out or lending the assets are liable for payment of asset tax.

Asset tax is 1.8%, but can be set off by a permanent establishments against:

- Income tax.
- Withholding tax on income generated from renting out or lending assets.

Asset tax does not apply on corporate transactions by corporations resident in Mexico.

Share acquisitions and disposals

6.

What taxes are potentially payable on a share acquisition/disposal? (List them and cross-refer to Questions 1 to 4 as appropriate.)

Transfer taxes and notaries' fees.

There are no transfer taxes applicable on corporate transactions.

Corporate and capital gains taxes.

Tax is levied on capital gains arising from the sale of shares (*see Question 2*).

Value added and sales tax

Sales of shares are exempt from VAT.

7.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Transfer taxes and notaries' fees

There are no transfer taxes applicable on corporate transactions.

Corporate and capital gains taxes

Income from disposals of shares by a company within the same group qualify for tax relief if certain requirements are met and subject to the condition that the corresponding shares are owned by the acquiring company for a minimum period of two years from the [****acquisition****]. Examples of some of the requirements are:

- Authorisation from the tax authorities.
- The consideration for the transfer of the shares must consist of shares issued by the acquiring company.
- An auditor's report prepared by a registered public accountant (who calculates the tax base of the shares) must be filed.
- The companies involved in the reorganisation of the group should be resident in a country with a non-restricted exchange of tax information treaty with Mexico; if not, additional conditions are requested.

Rollover relief

Rollover relief is available for the disposal of shares in a controlled company that is within a group that files a consolidated tax return.

Tax exemptions

Tax exemptions apply on the disposal of shares as a result of a merger or a split up.

Tax losses

Tax losses incurred by companies on the sale of shares can be indexed and carried forward to offset capital gains obtained on the sale of shares in the same fiscal year or in the five following fiscal years.

8.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Dividend strips (pre-sale dividends) are a useful tool to reduce the capital gains when the profits that are distributed have already been subject to corporate income tax.

Capital reimbursement before the sale could also be a way to reduce the capital gains, taking advantage of the capital contribution account recorded in favour of the selling company.

In some cases when a minority interest is to be sold a contribution to capital by the new shareholder with payment of a premium can be effective to reduce the capital gains.

Asset acquisitions and disposals

9.

What taxes are potentially payable on an asset acquisition/disposal? (List them and cross-refer to Questions 1 to 4 as appropriate.)

Transfer taxes and notaries' fees

An acquisition of real estate is taxable under a local tax in Mexico City and most of the 32 states (*see Question 1*).

Corporate and capital gains taxes

The disposal of assets is subject to corporate income tax (*see Question 2*). Payments for transfer of goodwill are not deductible for the purchaser.

Value added and sales tax

Disposal of assets triggers VAT except for land disposal (*see Question 3*).

10.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Local taxes and notaries' fees can be avoided on transfer of real estate by purchasing shares instead of assets.

VAT transferred to the buyer of real estate can be credited against future payments or reimbursed. Sale of land is exempt from VAT.

It is possible for the buyer of fixed assets to take the accelerated depreciation in one year if the assets are going to be used for the first time in Mexico.

The buyer of fixed assets is allowed to deduct cost at the price of purchase of the assets increased by indexation.

In the case of a share purchase, the cost base of the assets continues to be the cost recorded in the accounting of the target company.

11.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Depending on the specific case, an analysis must be carried out to determine the convenience of selling or buying assets or shares.

For example, if the target company has losses pending to be credited, those losses can be offset against the gains derived from the transfer of assets and the transaction will remain at the level of the target company. However, if the shares to be transferred have a relevant tax base, a transfer of shares may be a good option to minimise the tax burden.

Legal mergers

12.

What taxes are potentially payable on a legal merger? (List them and cross-refer to Questions 1 to 4 as appropriate.)

Taxes potentially applicable in a legal merger are:

- Corporate income tax (*see Question 2*).
- VAT (*see Question 3*).
- Local transfer taxes and notaries' fees (*see Question 1*).

13.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

The surviving company will be exempt from federal taxes applicable in a merger (corporate income tax and VAT) if it complies with the following requirements:

- It serves notice to the tax authorities within a month of the merger.
- It files the tax return and other annual reporting requirements relating to the disappearing company.
- In some specified cases, the income of the surviving company must come from the same activities carried out by the disappearing company for at least one year after the merger.

Local transfer tax and notaries' fees (*see Question 1*) owned by the disappearing company and transferred to the surviving company must be paid by the latter.

14.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

In order to take advantage of the ability to offset tax losses against profits, the company with losses must be the surviving company, since tax losses of the disappearing company cannot be taken by the surviving one. To take this relief the profits must come from the same activities that caused the tax losses in the disappearing company.

Joint ventures

15.

What taxes are potentially payable on the establishment of a joint venture company (JVC)? (List them and cross-refer to Questions 1 to 4 as appropriate.)

See Questions 1 to 4.

16.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

See *Questions 1 to 4*.

17.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

See *Questions 1 to 4*.

Company reorganisations

18.

What taxes are potentially payable on a company reorganisation? (List them and cross-refer to *Questions 1 to 4* as appropriate.)

Corporate income tax is (*see Question 2*) the only tax potentially payable for a capital gain incurred in a transfer of shares as a result of a reorganisation.

19.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

It is possible to carry out a tax free reorganisation if tax clearance is obtained from the tax authorities. However, the tax authorities can only provide an exemption or relief according to the law or the text of a double tax treaty.

20.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

A tax-free reorganisation is granted in mergers or split ups by getting a tax clearance from the tax authorities (*see Question 5*).

When non-resident shareholders are involved, some tax treaties provide for tax exemption on reorganisations.

Demergers

21.

What taxes are potentially payable on a company demerger? (List them and cross-refer to *Questions 1 to 4* as appropriate.)

Corporate income tax and VAT are payable on a demerger (*see Question 2 and 3*). If real estate is transferred, then local transfer taxes and notaries' fees are also applicable (*see Question 5*).

22.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

It is possible to have a tax free demerger provided that at least 51% of the shares of the company demerging are owned by the same shareholders one year before and two years after the demerger.

If one of the companies disappears as a result of a demerger, the demerging company must fulfil the obligations of the disappearing company in relation to filing the tax return and other annual reporting requirements with the tax authorities.

23.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Profit sharing to employees is not a tax but the economic effect is almost the same as a tax since employees are entitled 10% of the company's pre-tax income. In some cases demergers are used to minimise this payment by either:

- Creating a service company into which all employees are transferred and leaving the operating company (profit centre) with no employees.
- Not transferring the employees, but creating a new operating company (profit centre) through the demerger.

Share buybacks

24.

What taxes are potentially payable on a share buyback? (List them and cross-refer to Questions 1 to 4 as appropriate.)

Not applicable.

25.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Not applicable.

26.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Not applicable.

Private equity financed transactions: MBOs

27.

What taxes are potentially payable on a management buyout (MBO)? (List them and cross-refer to Questions 1 to 4 as appropriate.)

Not applicable.

28.

Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Not applicable.

29.

What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Not applicable.

Clearances

30.

Is it possible to apply for tax clearances from the tax authorities before completing a corporate transaction?

Tax clearances are only granted on real situations (that is, advance clearance is not given for hypothetical tax plans). Applications must be made in writing and must disclose all the necessary information. It is not possible to apply for a tax clearance on an anonymous basis.

Reform

31.

Please summarise any proposals for reform that will impact on the taxation of corporate transactions?

Corporate tax rate will be reduced from 30% to 29% in 2006, and to 28% in 2007.

Box: Checklist: Asset or share acquisition

Please outline the key tax advantages and disadvantages in your jurisdiction of:

- A share sale for a seller
- An asset sale for a seller.
- A share sale for a buyer.
- An asset sale for a buyer.

Seller - share sale

Advantage. The buyer acquires all the responsibilities of the target companies.

The sale of shares is exempt from VAT.

In some cases the profit generated can be offset against operating losses.

Seller - asset sale

Advantage. The seller may credit losses of previous years generated at corporate level.

Buyer - share sale

Advantage. There is no transfer of VAT because the sale of shares is tax exempt.

Local transfer tax and notaries' fees do not apply, even if the real estate is the only asset of the target company.

Buyer - asset sale

Advantage. When a buyer purchases the assets the new basis for the tax depreciation is the price paid instead of the book value in the target company. If the assets have not been used in Mexico before the purchase, the buyer can take the accelerated depreciation of the price in:

- The year of the purchase;
- The year when they are used for the first time in Mexico.
- The year following this last event.