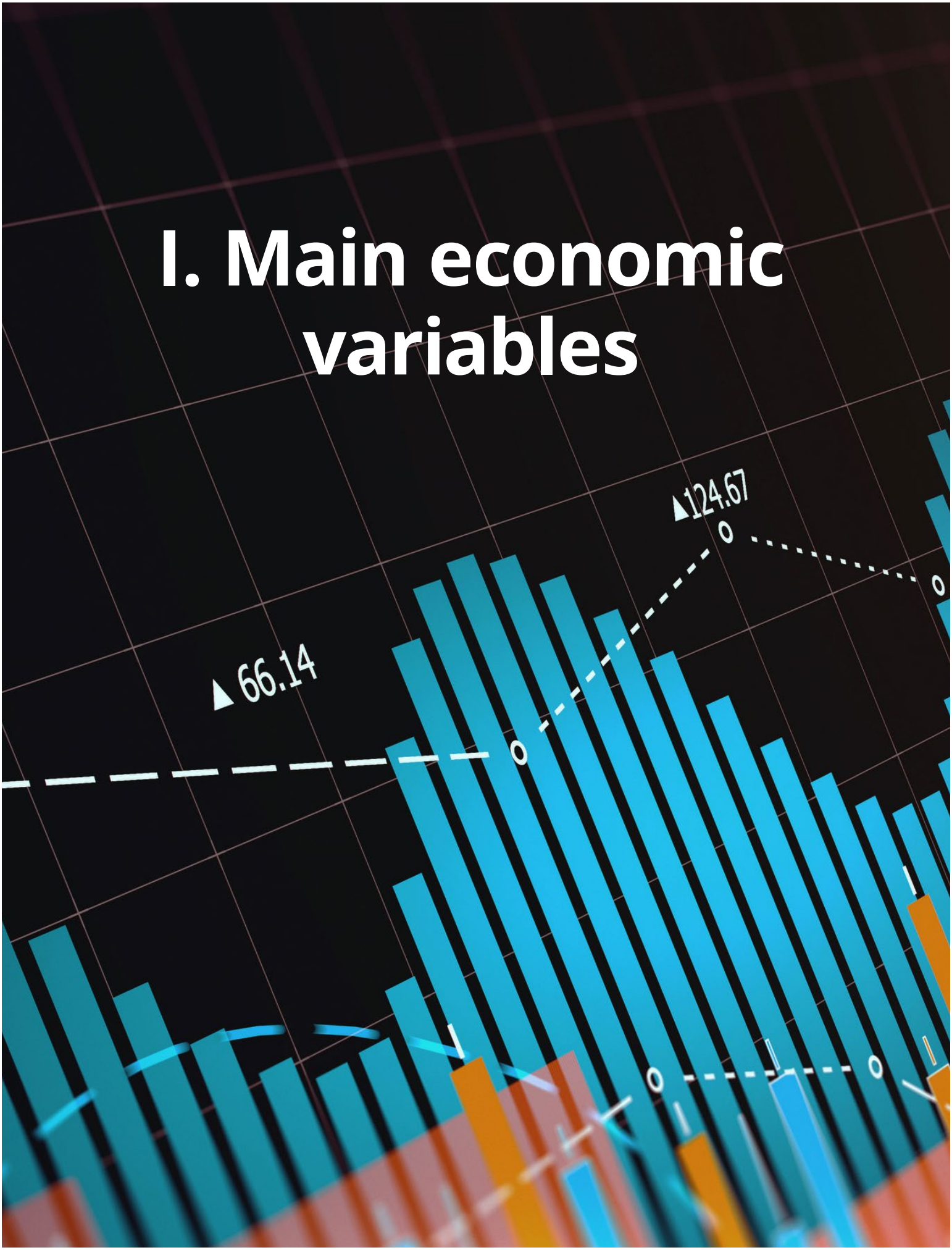
Deloitte.

Doing Business Mexico

I. Main economic variables



I. Main economic variables

GDP 2018: 1,220.8 billion USD

Position in the world:	**15** / 194

GDP growth
(Annual % variation, original figures)

2017	2018	2019e	2020e
2.1	**2.0**	**-0.1**	**1.0**

Macroeconomic context (figures at 2018 yearend)

GDP per capita	Reference rate	Inflation	Unemployment rate	Exchange rate	Population	FDI
9,698	8.25	4.90	3.32	19.24	126.1	34.61
Million USD	%	Annual % variation	%	USD/MXN	Million people	Billion USD

Macroeconomic context (figures at 2018 yearend)

Tax balance, % GDP	Primary balance, % GDP	Public debt, % GDP	Current account, % GDP	Trade balance, % GDP	Reserves, % GDP	Reserves, % Debt
-2.0	0.6	44.9	-1.8	-1.1	14.3	31.6
Balance, %	Balance, %	SHRFSP, %	Balance, %	Balance, %	Balance, %	Reserves/SHRFSP

Competitiveness

Position in the world: **46** / 140 (WEF, 2018)

Ease for doing business

Position in the world: **54** / 190 (Doing Bussiness, 2018)

Corruption perception index

Position in the world: **138** / 180 (TI, 2018)

Foreign trade (main assets)

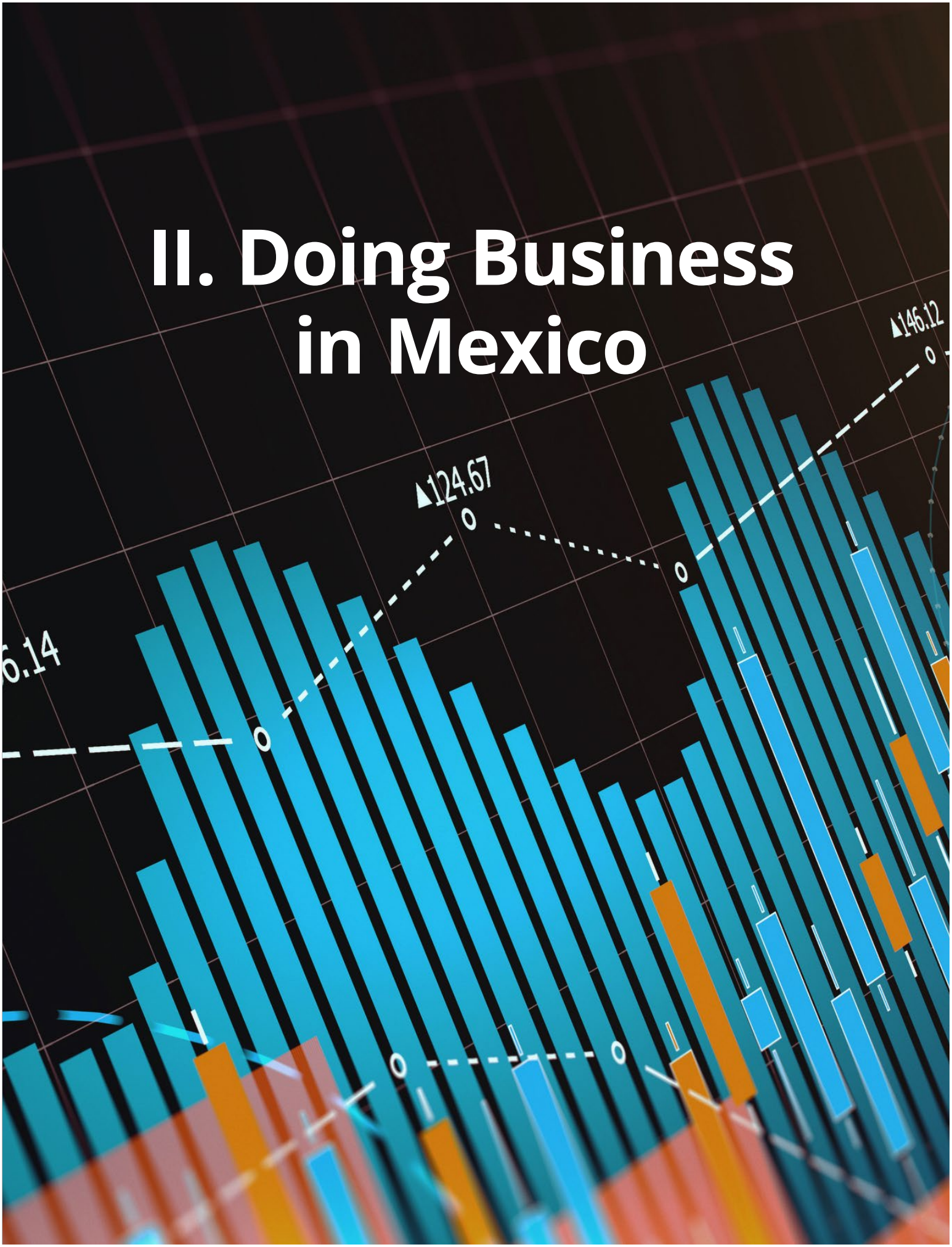
Exports		
Product	**Value** (billion USD)	**Share**
Machinery	156.0	37.0%
Transportation	112.0	27.1%
Mineral products	27.9	6.7%
Plant products	16.2	3.9%
Minerals	15.7	3.8%
Imports		
Machinery	116.0	32.0%
Transportation	43.9	12.1%
Metals	34.3	9.6%
Mineral products	34.2	9.5%
Plastics and rubber	29.4	8.2%

Foreign trade (main business partners)

Exports		
Product	**Value** (billion USD)	**Share**
United States	307.0	**73.0%**
Canada	22.0	**5.2%**
China	9.0	**2.1%**
Germany	8.8	**2.1%**
Japan	5.6	**1.3%**
Imports		
United States	182.0	**51.0%**
China	52.1	**15.0%**
Germany	14.9	**4.2%**
Japan	14.8	**4.2%**
South Korea	10.9	**3.1%**

Source: World Bank, International Monetary Fund (IMF), World Economic Forum (WEF), Transparency International, World Intellectual Property Organization (WIPO) and Economic Complexity Index (MIT).

II. Doing Business in Mexico



II. Doing Business in Mexico

a) General profile

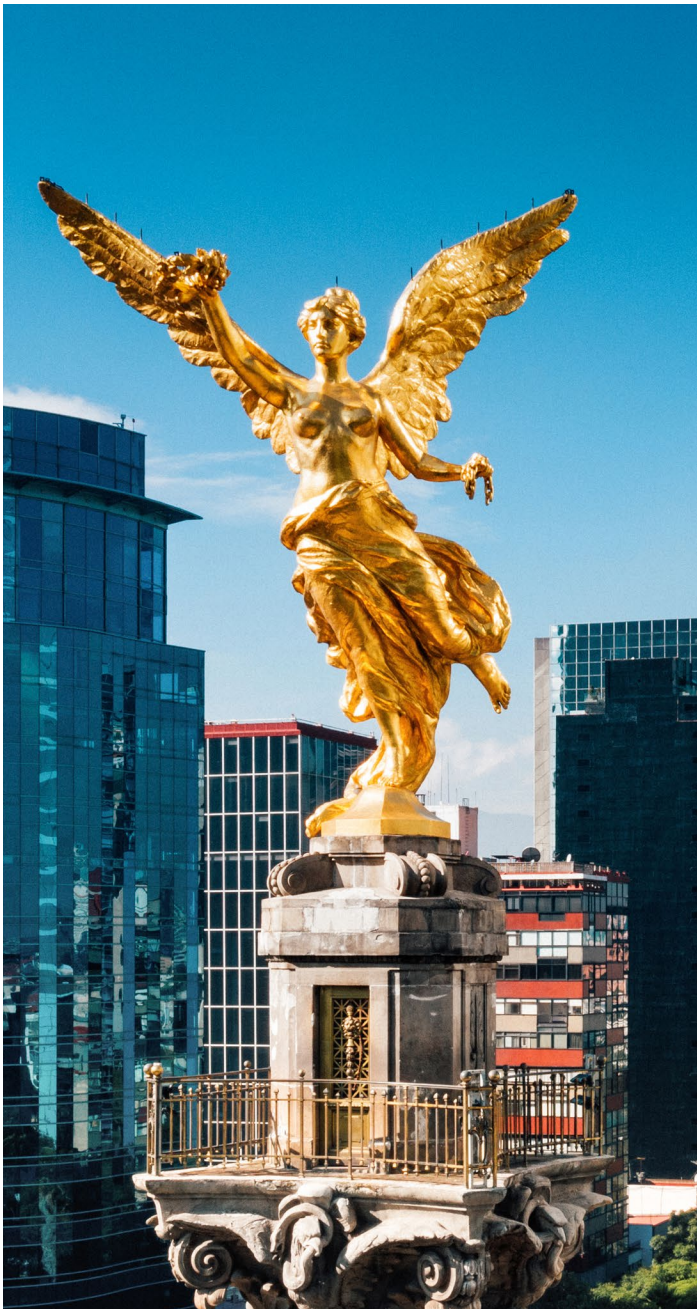
Mexico is the 15th largest economy in the world in terms of Gross Domestic Product (GDP) and the second in Latin America[1]. However, the country is in the 67th position, with 9,698 USD per citizen[2], as measured through GDP per capita.

Mexico has a population of 126 million citizens[3], which makes it the world's 11th most populated country. Most citizens live in or near Mexico City (the capital) and the neighboring State of Mexico, which together house 25.1 million people. The States with the largest number of citizens are Veracruz, Jalisco, Puebla, Chiapas and Nuevo León[4].

Mexico has a predominantly young population, compared to other industrial countries. In the last population census in 2015, over 55% of the population was under 30 years of age[5]. As for the level of education, the average degree of education nationwide among citizens over 15 years old is 9.1, which is slightly more than finished high school[6]. The illiteracy rate was 5.5% in 2015.[7]

Although the majority of the population speaks Spanish, over 7 million Mexicans still speak one of the 72 indigenous languages existing in the country, whereby Maya and Náhuatl are the most widely spoken. The States with the largest percentage of indigenous language speakers are Oaxaca, Chiapas and Yucatán[8].

In general terms, Mexico has a network of 13 treaties with over 45 countries, which gives it access to 61% of the world's GDP and over 50% of global trade[9].



b) Political regime

Constitution

The *Political Constitution of the United Mexican States* is the supreme law of Mexico, which defines this country as a representative, democratic and federal Republic, composed by 31 States and Mexico City. The Constitution also establishes the powers and responsibilities of the federal government, which is divided into three branches, the Legislative and Executive branches and Judiciary.

The human rights established both in the Constitution and in international treaties must guide the actions of the government and individuals, and in turn constitute a limit to their activities.

The Constitution establishes that the powers which are not expressly granted to the Federation are reserved for the States; in this regard, business matters (including banking) are federal, whereas civil matters are local: real estate ownership is therefore governed by the laws of each State.

Federal Branches

The Executive Branch enforces the law and is headed by the President, who remains in office for six years and is elected by direct and universal voting.

The Legislative Branch is composed by two Chambers, the *Chamber of Deputies* and the *Chamber of Senators*, and, among other aspects, is responsible for presenting and approving bills. In addition, each of the Chambers has exclusive powers regarding certain matters.

Finally, the Judiciary is composed of the *Supreme Court*, which is the highest instance, other courts and the *Federal Judiciary Council*, which is responsible for management, discipline and oversight of the latter (exception made by the Supreme Court of Justice of the Nation).

Rule of Law

With the existence of separate Branches, the recognition of human rights by the Mexican State and the system of checks and balances, which seeks to harmonize and restrict the capacities of each Branch, are all included in the Constitution. Accordingly, the rule of law is intimately intertwined with the Constitution.

Therefore, constitutional amendments, unlike general legal amendments, require adherence to an aggravated amendment procedure; i.e., such amendments only valid if certain obstacles are overcome, such as the approval by two-thirds of the members present in both Chambers, as well as approval by the majority of State legislatures. Nonetheless, that since the approval of the **Constitution** (in 1917), over 700 constitutional amendments have been enacted.

c) Economic structure

GDP is the sum of all the goods and services produced by a country and the most significant form of estimating the productive capacity of an economy. The three main economic sectors of GDP in Mexico are[10]:

- Primary sector: extraction activity involving agriculture, farming, forestry, hunting and fishing.
- Secondary sector: industrial transformation activity, mining, construction and manufacturing companies.
- Tertiary sector: services, retail and wholesale trade.

In Mexico, the tertiary sector is the largest component of GDP, followed by the industrial and agricultural sectors. It is estimated that 18% of the labor force works in agriculture, 24% in industry and 58% in the tertiary sector.

Chart 1
Sectoral composition of the GDP
(Billion USD and contribution %)

GDP 2018	Value	% GDP
Total	1,220.8	
Primary	41.3	3.2
Secondary	377.7	31.4
Mining	49.7	4.8
Construction	92.3	7.0
Manufacturing	211.5	17.3
Tertiary	734.2	64.5
Retail trade	113.6	9.3
Wholesale trade	116.0	9.5
Real estate services	118.6	9.7
Transportation	75.4	6.5
Financial services	48.3	4.0
Tourist services	32.8	2.7

Source: INEGI. Figures in constant values at 2013 prices. In the INEGI's satellite account, tourist revenues represent 8.7% of GDP, because they not only include tourist services, but also related services (transportation, restaurants, crafts, tourist trade, leisure, cultural and sports services and travel agencies).

Manufacturing industry

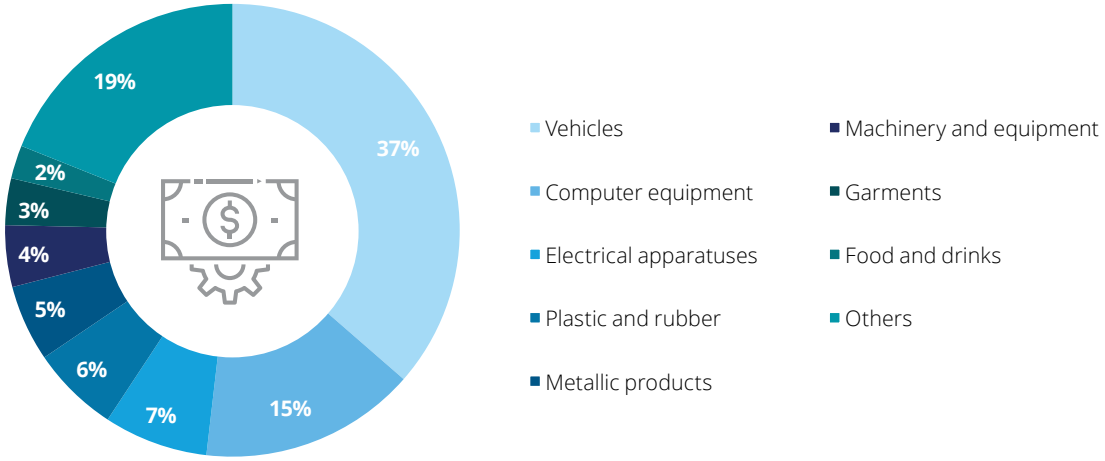
Mexico has become an important vehicle manufacturer (it is currently the sixth largest worldwide producer) and other goods, such as smartphones, computers and TVs.

Within the manufacturing sector:

- Transportation equipment (basically the automotive industry) is the most relevant, contributing 37% of the sector's total revenues.
- Followed by manufacturing of computer equipment and electrical devices.

One of Mexico's competitive advantages is its closeness to the world's largest economy: the United States. Additionally, another aspect which triggered manufacturing industry growth. In 2000, a worker earned approximately $1.7 USD per hour. Currently, although this cost has increased to $2.4 USD per hour, Mexico still has some of the lowest costs in Latin America[11], even when compared to several Asian countries.

Graphic 1
Manufacturing industries
(Contribution to total revenues, %)



Source: INEGI. Data as of 2018 yearend.

Foreign currency revenues

In addition to **manufacturing exports**, which is the main line item generating the most US dollar revenues, Mexico has other significant revenue sources, such as remittances.

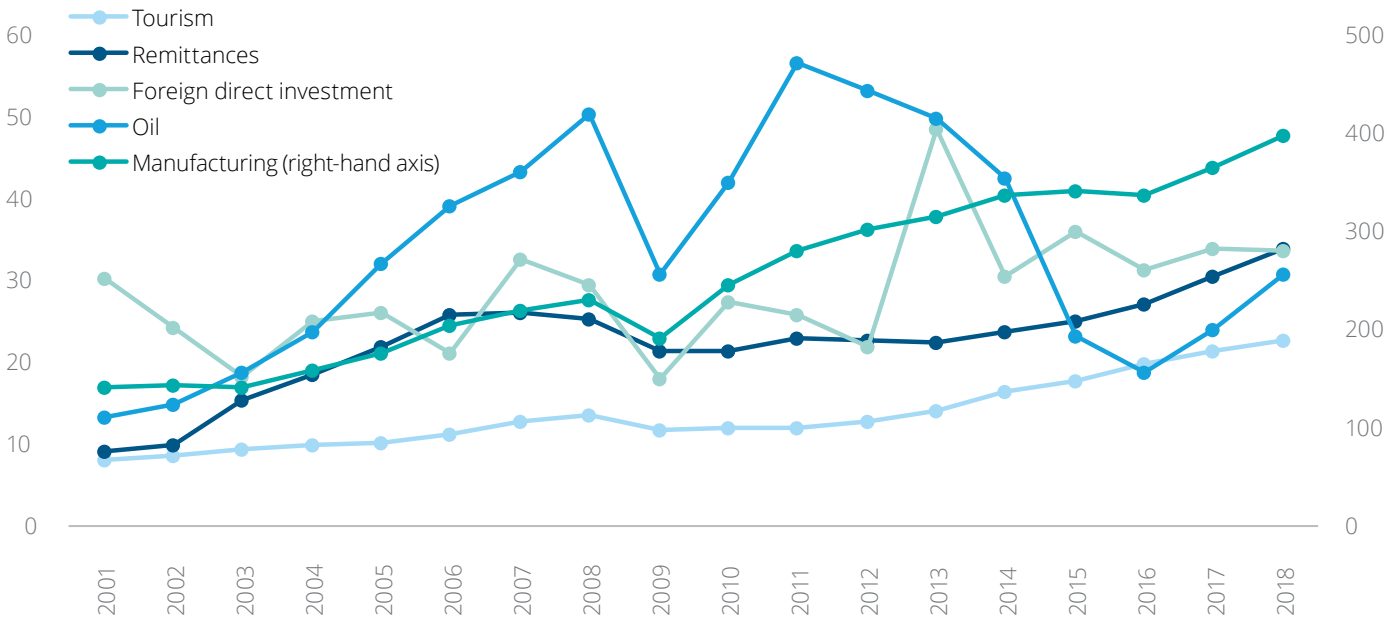
Mexico is the world's fourth largest remittance receiver[12] after China, India and the Philippines. Most of these resources are used to acquire basic consumer goods, which also explains the high share of private consumption in GDP.

Lagging behind is **FDI** (Foreign Direct Investment) which, despite certain fluctuations, continues to show a growth trend that is diversified in several States and economic sectors.

Oil follows FDI as a revenue source. It previously held a more significant position, but due to the country's industrialization and the lower national production, Mexico has reduced its reliance on this commodity.

Finally, US dollar revenues related to **tourism** (international travelers) have increased constantly. In 2018, these revenues totaled a record figure of 22.5 billion USD by housing 41.5 million international tourists[13], making Mexico the world's sixth most visited country.

Graphic 2
Main sources of US dollars in Mexico
(Billions of USD)



Note: All items include only US dollar inflows. Oil and manufacturing refer to the USD value of exports; tourism is based on foreign currency revenues from international travelers and remittances, while FDI are USD inflows.
Source: INEGI, Banxico, Tourism Department.

Foreign trade and investment

Most Foreign Direct Investment revenues come from:

- USA, which contributes 43%
- Spain, which contributes 11%
- Germany with 8%
- Canada with 7%

Given the robust manufacturing industry, most investments are in this sector, followed by financial services and trade. Similarly, the energy sector is positioned in the first places of FDI reception by receiving 7.3% of the total accrued from 2015 through 2018.

Chart 2
Main countries of origin of FDI
(Million USD, accumulated 2015 – 2018)

Total	United States	Spain	Germany	Canada
$131.9	$57.1	$14.9	$9.5	$9.9
% total	43%	11%	8%	7%

Source: Economy Department

Chart 3
Main investment sectors
(Billion USD, 2015 – 2018)

Manufacturing	Financial Serv.	Trade	Energy*
$66.2	$11.5	$10.1	$9.6
50.2%	8.7%	7.7%	7.3%

*Generation of electricity and gas distribution through gas pipelines.
Source: Economy Department

Figure 1
Concentration of FDI by geographic region and sector
(Billions of USD, 2018)

Center – North	FDI (MUSD)
Hospitality	401.02
Mining	397.68
Electricity	243.88

South	FDI (MUSD)
Electricity	652.12
Oil and gas	423.56
Mining	351.95

West	FDI (MUSD)
Transportation equipment	1,722.13
Metal industry	673.46
Electricity	417.31

Bajío	FDI (MUSD)
Transportation equipment	2,913.43
Electricity	605.54
Chemical industry	408.71

Center	FDI (MUSD)
Transportation equipment	1,351.01
Banking	1,065.66
Computer equipment	746.34

Border	FDI (MUSD)
Electricity	2,208.73
Transportation equipment	1,935.92
Computer equipment	365.69

Source: Economy Department.

Monetary and fiscal policy

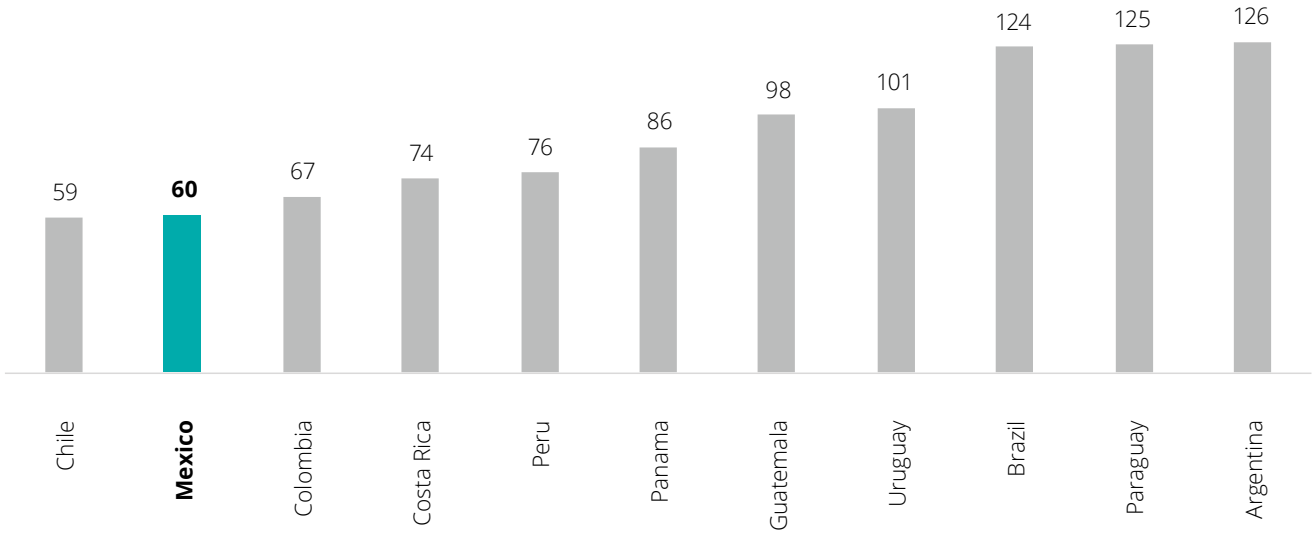
Mexico's Central Bank is independent of the government and has a unique mandate; i.e., its main objective is to maintain price stability. For this purpose, it sets an inflation objective, a range and a term to attain it. Similarly, it observes all causes which may affect inflationary behavior so as to implement adequate measures and, through the target interest rate, oversees compliance with this inflation range[14].

Furthermore, the **country's exchange scheme** is flexible, which means that the exchange rate is determined by market supply and demand.

Ease of doing business

The *Doing Business* report prepared by the World Bank measures how easy it is to do business in Mexico based on several variables. Currently, Mexico is in 60th position out of 190 assessed countries in 2019, with a rating of 72.1 points (graphic 3). Within Latin America, it lies in second place after Chile.

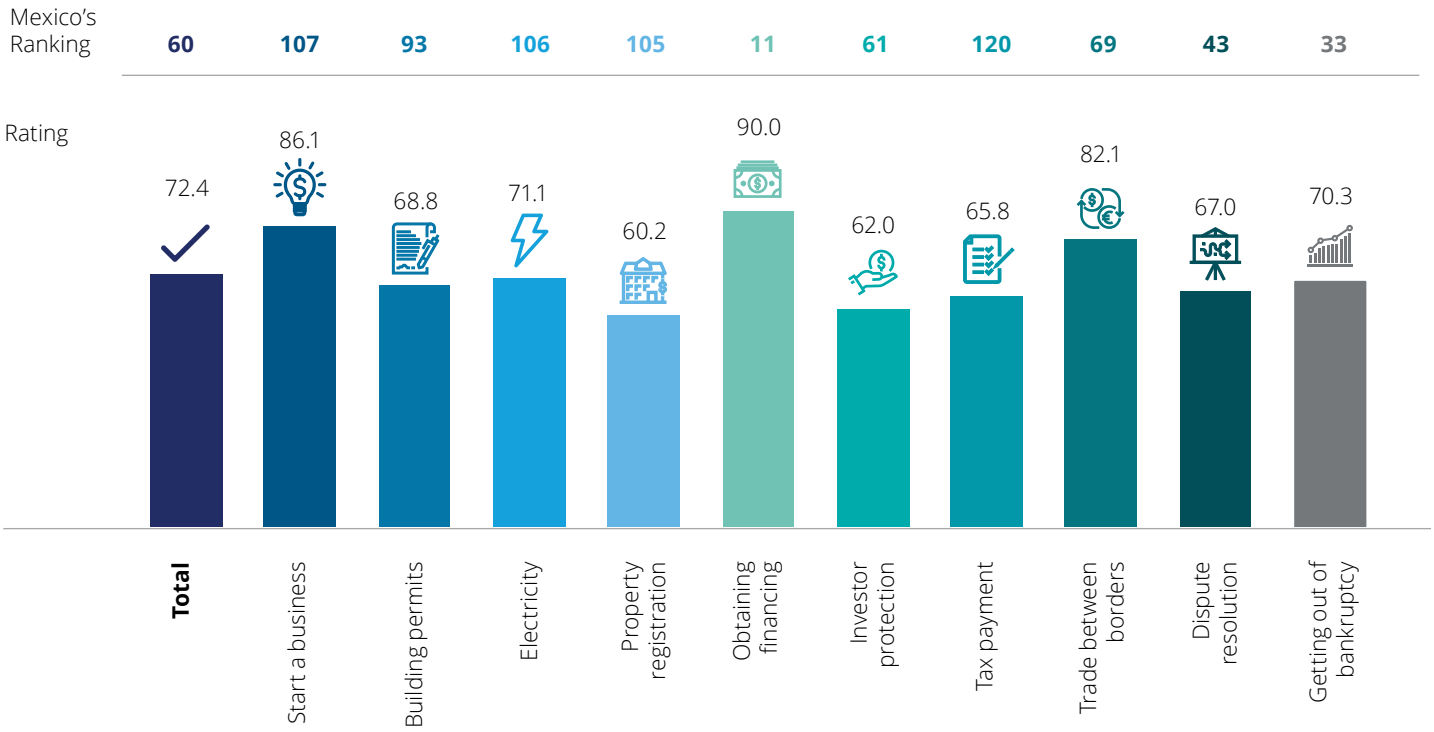
Graphic 3
Mexico, the second best business environment in Latin America
(Position of different economies in the Doing Business from World Bank report)



*The ranking classifies where each of these countries is located with respect to 190 economies (the closer to one the better and vice versa).
Source: Doing Business, World Bank, 2019.

As seen in the following chart, the country has the best rating as regards obtaining loans, followed by starting a business, which includes the number of steps which must be fulfilled by new businessmen, the average time it takes and the cost and minimum capital required. On the other hand, Mexico is in last place with regard to minority investor protection and property registration.

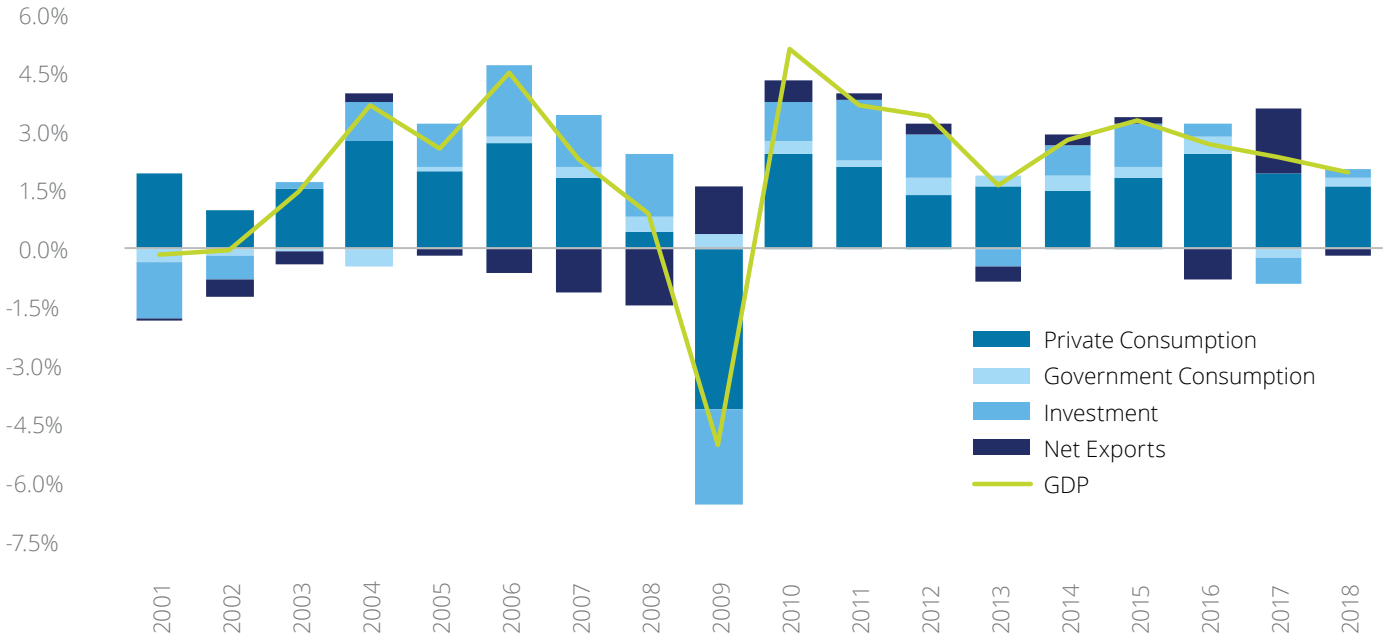
Graphic 4
Doing Business in Mexico
(Mexico's world ranking –general index and variables- and point rating).



*The ranking classifies where Mexico is located compared to other 190 countries (the closer to one the better and vice versa). The score is a rating between 1 and 100 points which measures the ease of each variable (the closer to 100 the better and vice versa).
Source: Doing Business, World Bank, 2019.

Current economy

Graphic 5
GDP growth and contribution of aggregate demand components
(% of GDP)

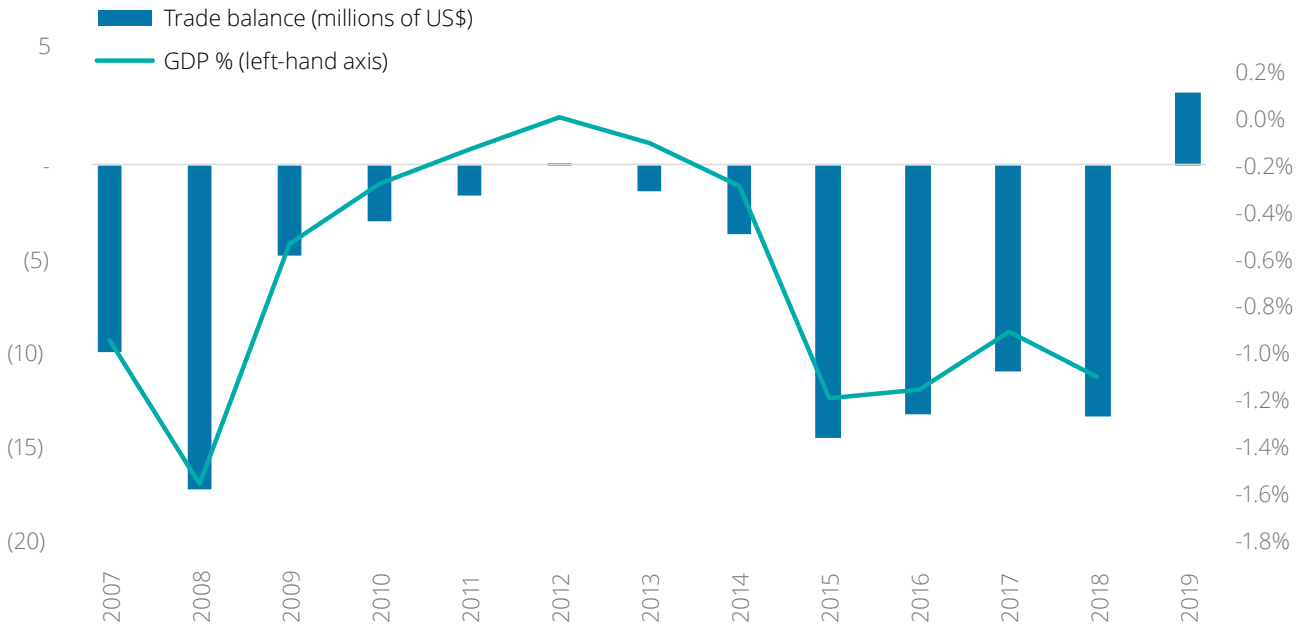


Source: INEGI

At the 2018 yearend, private consumption represented about two thirds of GDP and approximately 46% of the country's aggregate demand. Exports represented close to 28% of demand, although imports had a greater contribution, meaning that the net balance was negative. On the other hand, fixed equity gross investment contributed 16% and government consumption represented 11% of aggregate demand. Business inventories, measured through stock variance, comprised approximately 1.0% of demand. GDP growth has shown a downward trend since 2010. An economic growth of the -0.1% is forescated for 2019.

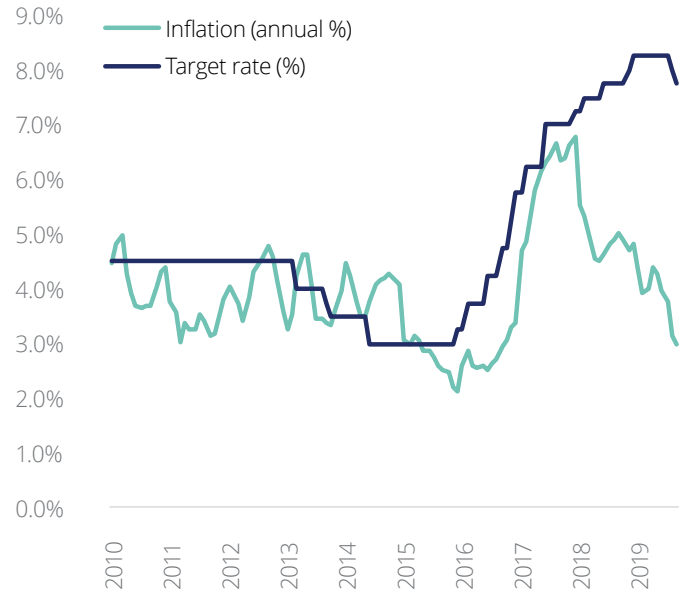
Mexico has had trade deficits for several years. However, in 2019, imports decreased due to the reduced internal demand, whereas exports increased due to larger orders from the USA. Accordingly, there may be trade surplus in 2019, the first since 2012.

Graphic 6
The trade balance will be positive in 2019
(Billion USD, % of GDP)



***The 2019 balance is up to August.**
Source: INEGI

Graphic 7
The Bank of Mexico begins a rate reduction cycle due to lower inflation
(Inflation and reference rate)



Source: INEGI

Graphic 8
The Mexican currency maintains resilience
(USD/MXN)

Source: INEGI

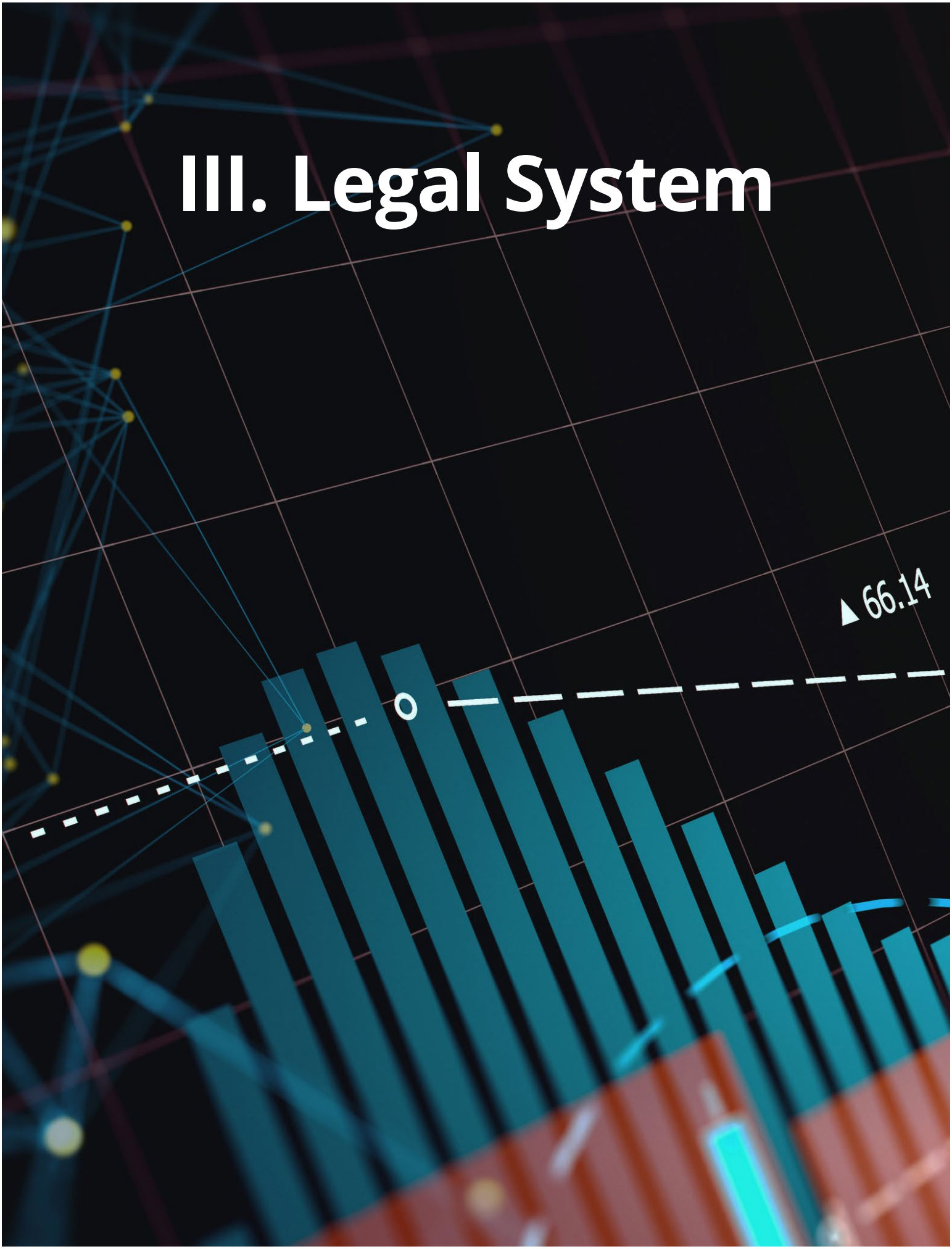
After reaching a historical minimum inflation of 2.1% in 2015, the price index began to rise following the increase in fuel prices, which led to price increases in other goods. To restrain the price increase, the Bank of Mexico progressively increased the reference rate to 8.25%, the highest since 2008. Currently, inflation maintains a favorable course and, since August 2019, it reached the Central Bank's target of 3.0%, confirming the year at 2.83%. The Bank has therefore started to reduce the reference rate. In 2019, the rate ended at 7.25%, while by 2020, it would continue to decline to 6.25%

The Mexican currency fell to its lowest historical level in early 2017 following the election of Donald Trump, after which it began to rise, favored by the country's high interest rate.

So far in 2019, the currency has ranged between $19.0 and $20.0 Mexican pesos per US dollar, a favorable behavior compared to other emerging currencies that faced significant volatility this year as a result of increased global risks.

Source: INEGI.

III. Legal System



III. Legal System

a) Corporations

Private business corporations are recognized as entities independent of their partners or members and, therefore, exist independently of the latter. In this regard, private entities are:

The most frequently used business corporations governed by the General Corporate Law:

- Limited Liability Company (S. de R.L.)
- Stock Company (S.A., the most commonly used in the business environment)

The business corporations governed by the Securities Exchange Law, whose objective is to eventually become debt or equity issuers in the Mexican market:

- Stock Investment Promotion Company (S.A.P.I.)
- Listed Stock Investment Promotion Company
- Public Stock Company (S.A.B., equity issuers in the public market)

In addition to business corporations, there are civil corporations (which may have different names and regulations according to the State in question) as follows:

- Civil Corporation (S.C.)
- Non-profit Association (A.C.)

In this regard, business corporations are those established to attain a primarily economic objective, whereas non-profit associations have the opposite purpose.

Main Business Corporations

In theory, there are no one-person corporations in **Mexico**, except for certain exceptions. Corporations may therefore be incorporated by two or more partners, who may be foreigners.

The most common business corporations in Mexico and their main characteristics are as follows:

	Stock Company (S.A.)	Limited Liability Company (S. de R.L.)	Stock Investment Promotion Company (S.A.P.I)
Stockholders/ Partners	Minimum: 2 stockholders. Maximum: unlimited.	Minimum: 2 partners. Maximum: 50 partners.	Minimum: 2 stockholders. Maximum: unlimited.
Common Stock	There is no minimum capital required to establish a company and it is represented by shares (credit instruments).	There is no minimum capital required to establish a company and it is represented by partnership interests (which do not constitute credit instruments).	There is no minimum capital required to establish a company and it is represented by shares (credit instruments).
Liability and Common Stock	The stockholders' liability in an S.A. is limited, in theory, to their paid-in capital amount. Common stock is represented by shares, which give their holders corporate rights; there may be different share series which grant different corporate rights, such as limited corporate or economic rights.	The partners' liability in an S. de R.L. is limited, in theory, to their paid-in capital amount. The common stock of an S. de R.L. is divided into partnership interests, one per partner, and is not represented by shares.	The stockholders' liability in an S.A.P.I. is limited, in theory, to their paid-in capital amount. Common stock is represented by shares, which give their holders corporate rights; there may be different share series which grant different corporate rights, such as limited corporate or economic rights.
Transfer of Partner Capacity	The transfer of shares may be limited in the bylaws; in principle, they may be freely traded.	Partnership interests may be assigned with the approval of at least the majority of partners.	The transfer of shares may be limited in the bylaws; in principle, they may be freely traded.
Management	Management may be entrusted to a Sole Administrator or a Board of Directors.	Management may be entrusted to a Sole Manager or a Board of Managers.	Management is exclusively entrusted to a Board of Directors.
Oversight	One or more examiners.	If applicable, oversight board.	One or more examiners; if the listed company scheme is applied, instead of the examiners, an independent external auditor and an audit committee will be appointed.
Variable Capital or "CV"	The three types of companies allow the issuance of variable capital, which grants significant flexibility for its increase or decrease purposes		
Purpose	It is the most commonly used company type in Mexico given its similarity to stock companies in other jurisdictions and its internal organization flexibility (e.g., Stockholders' rights and obligations, limitation on transfer of shares, administrative body, etc.)	In certain jurisdictions (e.g., USA), this type of company is considered a flow-through entity (partnership) which allows the election of a "check-the-box" for tax purposes	This type of company is intended as preparation for issuing and listing shares in the stock exchange by establishing the bases to become a public stock company or "S.A.B."

Financial Sector

Financial intermediaries are regulated by typically specialized, decentralized entities pertaining to the Treasury Department, which is responsible for managing tax resources, overseeing the government's budget and the Bank of Mexico. Financial authorities are as follows:

National Banking and Securities Commission (CNBV)
Responsible for most financial intermediaries, including, among others, stock exchanges, brokerage houses, banks and ancillary credit organizations.

National Insurance and Bonding Commission (CNSF)
Supervises insurance companies, brokers, bonding companies and other sectoral entities

National Retirement Savings System Commission (CONSAR)
Supervises the retirement savings system, which includes mandatory pension funds for Mexican employees.

National Commission for the Protection and Defense of Financial Service Users (CONDUSEF)
Unlike the others, this commission is independent of the Treasury Department and is responsible for defending financial service users (consumers).

In **Mexico**, only full service banks or development banks may receive deposits from the public; these depositors are covered by insurance provided by the Bank Savings Protection Institute (**IPAB**), which is created with specific bank reserves.

In the past, foreign investment was limited in Mexico, although over time these historical restrictions were eliminated. Nowadays, there are no restrictions on foreign investment in Mexican banks (except with regard to foreign governments). In fact, foreign financial institutions may be established in **Mexico** through an affiliate.

Infrastructure

Public infrastructure projects may be financed through public debt or private investment. In either case, the principles established by the **Constitution** must be followed; i.e., they must be executed using procedures that ensure resources are managed efficiently, effectively, with economy, transparency and honesty and, more specifically, through public bids.

There are, of course, exception procedures for public bids: direct awards or restricted invitations; however, even these procedures must comply with the above conditions.

The main laws governing federal government contracting and public works are the *Public Sector Procurement, Leasing, and Services Law, the Public Works and Related Services Law and the Public-Private Association Law*; the latter enables the execution of long-term agreements or contracts whereby a private developer may finance and supply, partially or in full, the infrastructure required for the adequate provision of public services, for example, hospitals, highways, etc.

Investment Vehicles

Mexico has different mechanisms and ways of making investments, for example:

- *Joint-venture agreements*
- Capital contributions
- Private capital investment trust
- Non-business administration trust
- Debt contracting (including convertible debt and hybrid instruments)
- Trusts issuing:
  - Capital Development Certificates (CKDs)
  - Investment project certificates (CERPIs)
  - Real Estate Fiduciary Securitization Certificates (FIBRAs or REITS in the USA)
  - Energy and Infrastructure Fiduciary Securitization Certificates (FIBRA E)
- Investment funds

Foreign Investment (FI)

Mexico has, in principle, no restrictions concerning FI; there are, however a few sector-specific restrictions and some other review-regimes applicable to FI, in some cases, for example, for national-security or public-interest reasons; in accordance with the foregoing, the restrictions, as well as the activities which are reserved to the Mexican government, envisaged in the FIL are:

(I) Hydrocarbon exploration and extraction, the planning and control of the national electric grid, electric power transmission and distribution (without prejudice of the possibility of the Mexican government to enter into hydrocarbon exploration and extraction and supply of electrical energy contracts with private parties, pursuant to the regulatory laws on the subject); nuclear energy production; money issuance; mail service; etc.

(II) Activities reserved to Mexican individuals or entities whose bylaws include a foreigner exclusion clause, such as the domestic overland transportation of passengers, tourism and cargo (excluding courier and parcel services)

(III) Activities in which **FI** is limited to certain thresholds, for example, 49% in companies engaged in manufacturing and the sale of explosives, fire arms, shells, ammunition, and fireworks, newspaper printing and publication, radio broadcasting, domestic regular and non-regular air transportation; non-regular international air transportation services in air taxi form and specialized air transportation services.

(IV) Activities in which **FI** is limited to certain thresholds which may be exceeded with the approval of the *National Foreign Investment Commission*, such as the provision of legal services, port services for vessels for the performance of internal navigation operations, such as towage, line mooring and freight charge, navigation companies engaged in the exploitation of high-traffic vessels, operators or permit holders of public service airfields, etc.

Agreements and Treatie

Mexico has 34 reciprocal investment promotion and protection agreements ("**APRIS**"), 32 of which are currently in effect, together with 17 commercial treaties with investment protection provisions.

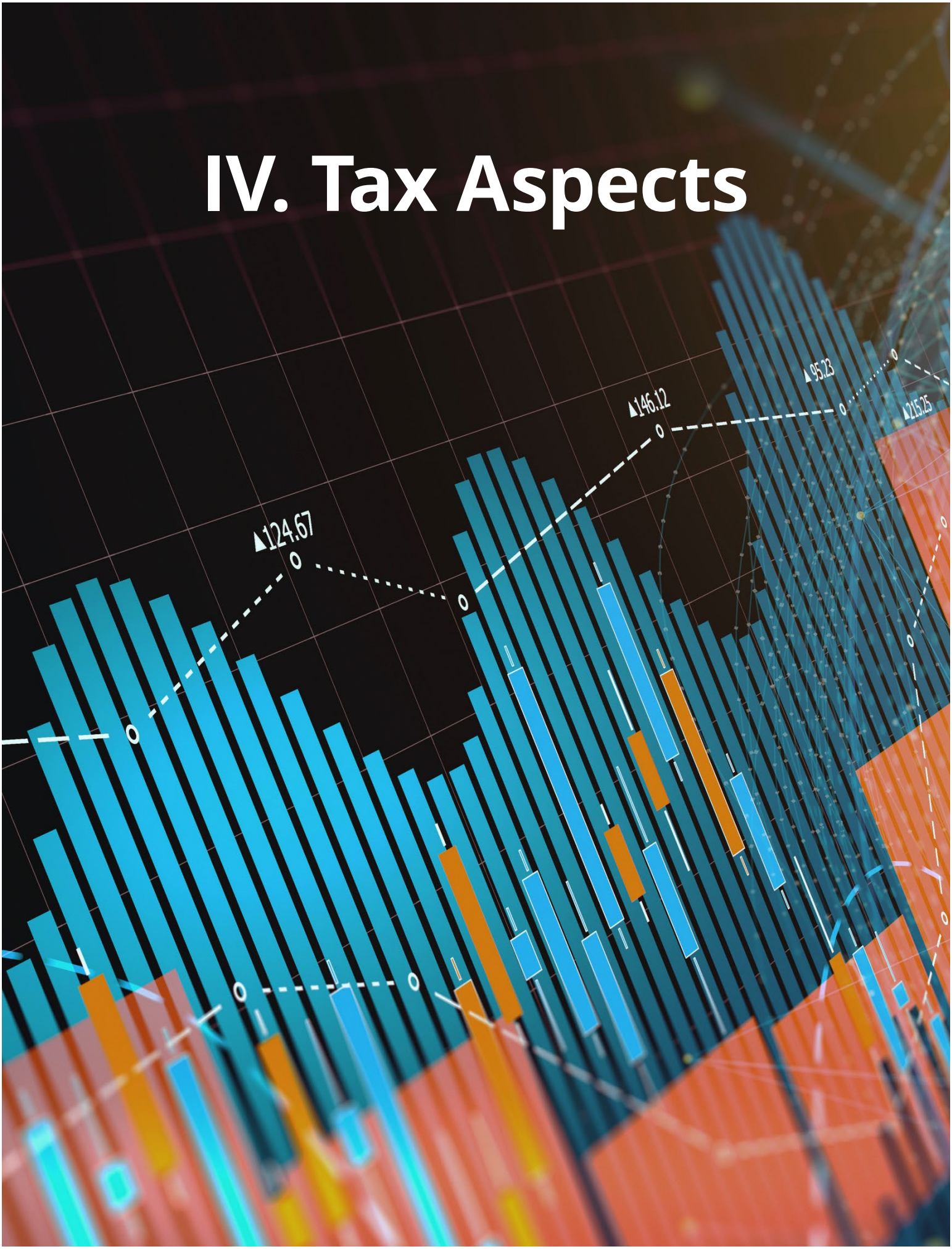
Both **APRIS** and **Commercial Treaties** offer foreign investors a series of guarantees, such as fair and equal treatment, no discrimination (for example, under clauses of domestic treatment and most favored nation), expropriation compensation (direct and indirect) and access to arbitration.

USMCA

One of the most critical and significant commercial treaties for **Mexico** is the "United States-Mexico-Canada Agreement" ("**USMCA**"). Upon becoming effective, the **USMCA** will replace the North America Free Trade Agreement ("**NAFTA**") currently in effect which, among other things, establishes the provisions applicable to trade between **Mexico** and the **United States** and **Canada** in relation to agriculture, investments, technical barriers on trade, digital trade, labor, regulatory best practices, macroeconomic policies and exchange policies.

The **USMCA** was executed on November 30, 2018, in Buenos Aires, Argentina, after almost 15 months of negotiation and was finally ratified by the Mexican Senate on June 19, 2019, although ratification is still pending in the **USA** and **Canada**.

IV. Tax Aspects



IV. Tax Aspects

1. Overview

The main taxes applicable to companies doing business in Mexico are Income tax (ISR), Value Added tax (IVA), Excise Tax (IEPS) and social security fees, which must be paid on behalf of employees. Notwithstanding, there are also other relevant taxes such as Real Estate Transfer Tax (ISAI).

Similarly, companies with employees must distribute and pay an amount equal to 10% of tax profits to their employees. Profits must be distributed within 60 days after filing the annual ISR return and no later than May 31 of the following year.

Mexico has a tax incentive and facility system for "maquiladoras", focused on fostering the manufacturing of export goods and provision of certain services including as data processing, among others.

Similarly, Mexico is an active member of the Organization for Economic Cooperation and Development (OECD). Accordingly, Mexican laws have included transfer pricing provisions applicable to transactions with domestic and foreign related parties. In this regard, Mexico has a broad network of bilateral tax treaties which are mostly based on the OECD Model Convention.

As a consequence of the Base Erosion and Profit Shifting (BEPS) initiative of the OECD, Mexican laws have incorporated several provisions to prevent tax evasion and abusive use of tax treaties.

2. Tax residence

A company is a Mexican resident if main business management function is located in Mexico.

3. Tax base and rates

Mexican resident companies pay taxes on the tax profits derived from all their income. Non residents only pay taxes on income from a Mexican wealth source. In general terms, the source of wealth is deemed to be located in Mexico when the activities and/or assets involved in the transactions are located in Mexico or when payments are made by Mexican entities to foreign residents.

The corporate ISR rate is 30%. The same rate applies to Mexican branches of foreign entities under the permanent establishment figure, which is aligned with the principles issued by the OECD in this regard. Furthermore, the ISR rate applicable to individuals is progressively determined based on their income, with a maximum applicable rate of 35%.

3.1 Tax income

The gross income of a legal entity resident in Mexico includes all revenues received in cash, in kind, services or credit, including any revenues obtained abroad. This also includes transaction profits, passive income like interest, royalties, rentals and capital gains.

A company's tax income is the result of subtracting from annual gross income the costs, deductible expenses and investments, as well as tax losses incurred in up to ten prior years. Income and expenses are recognized on an accrued basis.

3.2 Deductions

Costs, expenses and investments are deductible upon compliance with certain requirements which, among others, require that these amounts be duly recorded in accounting, be strictly indispensable for the company's operations and backed by digital electronic invoices that comply with the formalities and requirements established by applicable tax provisions.

In addition to general deduction requirements, there are specific requirements and limitations for certain deductions. For example, in order to deduct expenses related to employee remunerations, obligations involving the withholding and payment of taxes and social security fees must be fulfilled. Similarly, expenses related to employment benefits, which consist of benefits generally granted to employees, may only be partially deducted by express provision. In the case of investments, maximum annual deduction rates are defined according to the type of assets or industry involved. As regards interest, there are certain limitations, such as company capitalization requirements for interest paid to foreign related parties, or limitations recently introduced to the Mexican tax scheme which tend to restrict the interest expense deduction to 30% of a special tax income before taxes, interest, depreciation, and amortization, among other cases.

3.3 Inflation

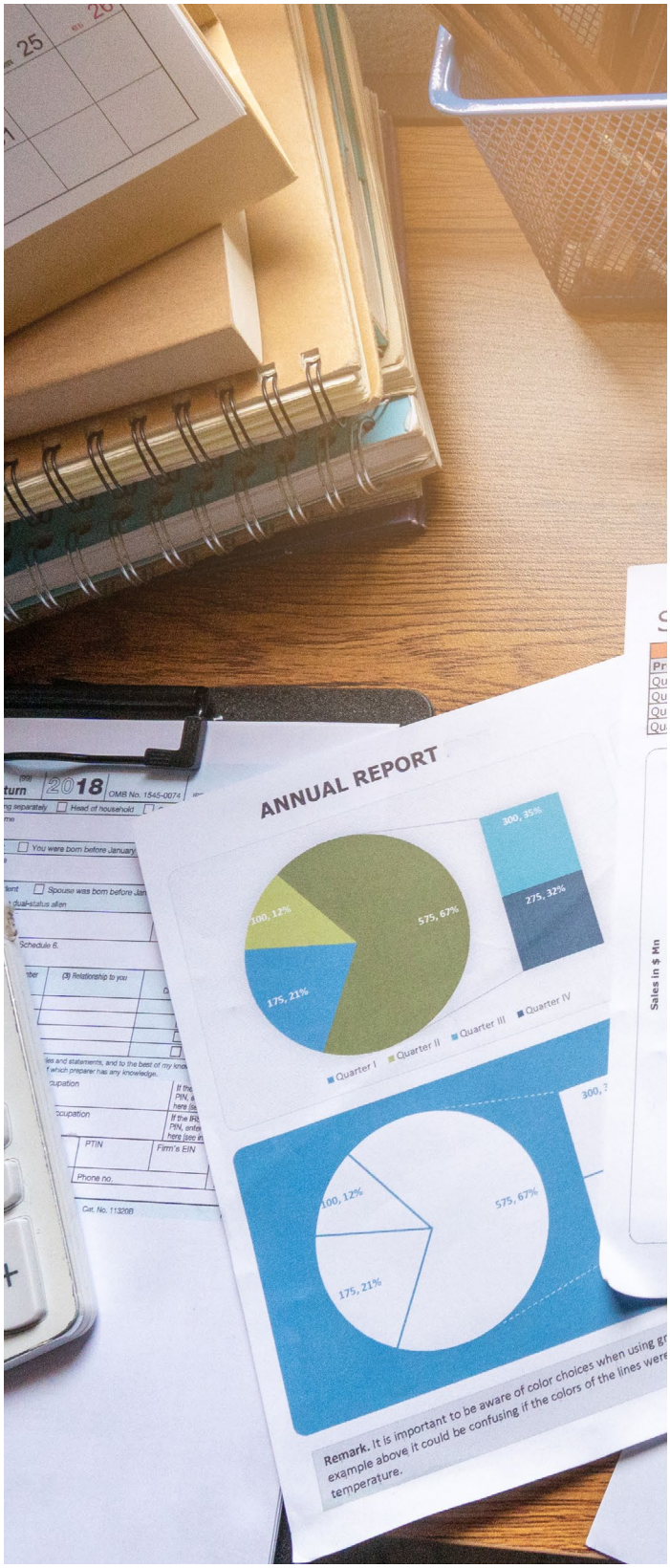
The Income Tax Law recognizes the effects of inflation in Mexico. The main effect corresponds to the recognition of revenues respect to the taxpayers' liabilities, as well as the recognition of the deduction on loans maintained as a consequence of business operations. Similarly, the value of other assets may be adjusted for the effects of inflation, such as the deduction of investments (fixed assets), as well as tax losses and recoverable tax balances.

4. Capital gains

Capital gains derived from the sale of fixed assets, shares and real property are considered as regular income and subject to the general 30% rate.

Nonresidents selling the shares of Mexican entities are subject to a 25% ISR rate on the total transaction amount, or may opt to pay 35% on the profit if the nonresident has a legal representative in Mexico.

Nonresidents who obtain profits on the sale of Mexican shares listed in the stock exchange are subject to a 10% tax withholding on the profit, albeit with certain limitations. This tax must be withheld by the transaction broker.



5. Distribution of dividends and capital returns

Regardless of the tax withholdings which may apply to dividends, as discussed below, Mexican companies must keep a record of profits on which corporate ISR has been paid through a special account commonly known as CUFIN (Net tax Income Account).

Essentially, dividends or profits distributed in excess of this account balance incur tax for the paying entity. The tax paid, however, may be credited against the tax of the year in which this tax was paid or in the following two years.

Similarly, Mexican taxpayers must keep a record of the capital contributions received from their stockholders through the contributed capital account or CUCA. In principle, capital reductions backed by this account balance may be distributed to stockholders without paying additional taxes. Notwithstanding, when the amount of this reduction exceeds the CUCA balance, the difference is considered as profit-sharing for tax purposes, which is subject to the rules described in the above paragraph.

6. Payments made abroad

Mexican companies making payments to nonresident individuals or corporations must withhold and pay tax to the Mexican tax authorities on behalf of the recipients in certain circumstances. As withholding agents, companies must file an annual informative return detailing the transactions performed with foreigners. Withheld taxes must generally be paid before the 17th day of the month following that in which tax was withheld.

As withholding agents, companies are jointly responsible for the incorrect withholding and/or lack of payment and may be subject to additional interest and fines as a result of noncompliance. Below is a description of the tax rates withholding applicable to the most common payments:

6.1 Dividends

In addition to the possible tax on dividends discussed above (CUFIN), Mexico applies an additional tax based on a 10% withholding on dividends distributed by a Mexican entity to a nonresident individual or corporation. This is considered as a final tax, although the rate may be reduced under the terms of an applicable tax treaty.

6.2 Interest

Mexico has different tax withholding rates for interest paid abroad. These rates are as follows:

- 4.9% on interest paid to the financial system
- 15% on interest paid to reinsurance companies and capital lease interest
- 21% on interest not subject to the 4.9% or 10% rates and interest paid to nonresident suppliers which finance the acquisition of machinery and equipment included in the company's fixed assets
- 40% on interest paid to a related party located in a tax haven
- 35% in all other cases

6.3 Royalties

Payments made abroad for technical assistance, know-how, the use of models, plans, formulas and similar technology transfers, including the use of commercial, industrial or scientific information or equipment, are subject to a 25% ISR withholding rate. Royalties paid to a foreign patent, trademark and trade name licensor, without the provision of technical assistance, are subject to a 35% withholding rate, unless this rate is reduced under the terms of an applicable tax treaty.

Corporations which pay rentals to a foreigner must withhold a 25% tax on these payments. An informative return must be filed in this regard with the tax authorities in February of the following year.

Other items subject to tax withholdings are service fees, the leasing of movable and real property, capital gains derived from the sale of shares or other assets and the payment of reinsurance premiums, among other transactions.

Please note that payments originating in Mexico and made abroad to related parties located in low tax regimes are subject to a 40% withholding rate instead of the withholding rates applicable to different items, albeit with certain exceptions.

6.4 International treaties

Mexico has a signed broad range of tax treaties, mostly in line with the OECD Model Convention. Among other objectives, these treaties generally provide measure to avoid double taxation by limiting or eliminating the taxes of signatory countries with regard to the income obtained by their respective residents.

As regards the revenues or income obtained directly by foreign residents in Mexico, tax treaties frequently grant a benefit consisting of the reduction or elimination of taxes withheld on income from a source of wealth located in Mexico, as long as certain requirements and formalities are fulfilled. Furthermore, these treaties generally include information exchange provisions that are compliant with OECD guidelines.

To obtain the benefits of tax treaties, the income recipient must prove its residence in the applicable jurisdiction and comply with treaty provisions. Please note that Mexico has signed the Multilateral Instrument for the Implementation of Measures Related to Tax Treaties to Prevent Base Erosion and Profit Shifting, the provisions of which, when applicable to relevant treaties, must be observed as of their effective date.

The network of Tax Treaties signed by Mexico is as follows:

Argentina	South Africa	Panama
Estonia	Belgium	Ukraine
Korea	Hong Kong	Colombia
Romania	Malta	Ireland
Australia	Spain	Peru
Finland	Brazil	United Arab Emirates
Kuwait	Hungary	Czech Republic
Russia	Netherlands	Israel
Austria	Sweden	Poland
France	Canada	United Kingdom
Latvia	Iceland	Denmark
Singapore	New Zealand	Italy
Bahrain	Switzerland	Portugal
Germany	Chile	United States
Lithuania	India	Ecuador
Slovakia	Norway	Japan
Barbados	Turkey	Qatar
Greece	China	Uruguay
Luxembourg	Indonesia	Costa Rica

Note: The above table indicates the Tax Treaties signed by Mexico

Please note that laws recently approved in Mexico establish new requirements regarding the substance and business reasons for taxpayers' transactions. Similarly, new restrictions are applicable when claiming deductions for transactions performed with foreign related parties, when the income in the respective jurisdiction is subject to low taxation.

Indirect taxes

1. IVA

Value Added Tax is applied to the sale of goods, the provision of services, the import and export of goods or services and leasing transactions.

The standard IVA rate is 16%, although an 8% rate is applicable in certain municipalities situated along Mexico's northern border. IVA on imports is calculated based on their customs value. Similarly, a zero rate is applicable to exports and services utilized abroad if the services in question are contracted and paid for by a foreigner without permanent establishment in Mexico.

Companies may credit IVA payments against their payable IVA; if the excess tax cannot be fully credited, the taxpayer may request a refund.

2. IEPS

IEPS is applicable to certain specific goods and services. For example, this tax is levied on the import and sale of tobacco, alcoholic beverages, mobile telephony services, automotive fuels and other hydrocarbons, energy drinks, flavored drinks, fossil fuels, pesticides, etc. Tax rates vary depending on the type of product.

There is also a special 8% tax on high calorie content foods, including snacks, ice cream and other products.

Taxes on individuals

1. Residence

An individual is deemed to be a resident when they have a permanent home in Mexico. If an individual has a home in two countries, the key factor is the location of their center of vital interests. Foreign citizens, in principle, are considered as tax residents, subject to the permanent home and/or center of vital interests test.

2. Tax base and rates

Resident individuals, regardless of their nationality, are subject to the payment of ISR on their worldwide income. Nonresident individuals only pay taxes on income of Mexican origin.

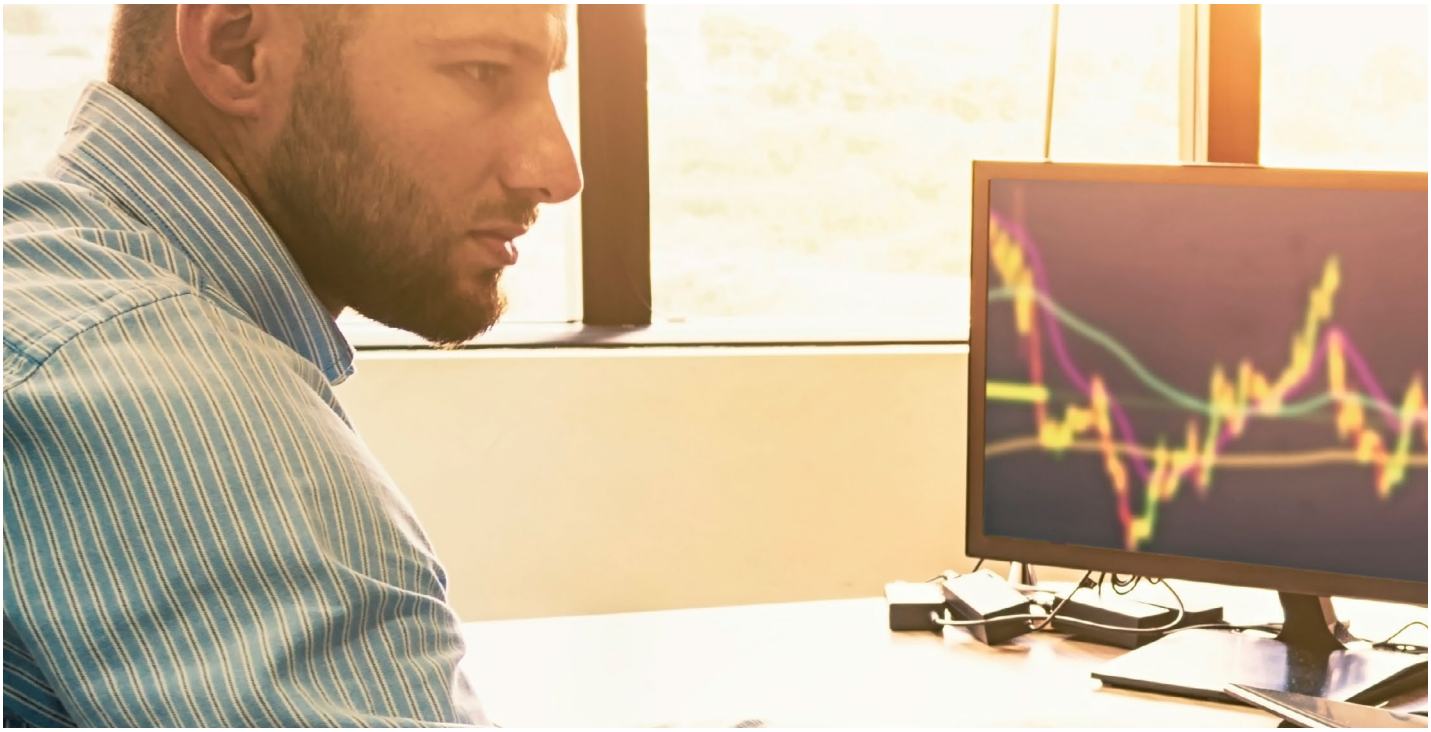
2.1 Tax income

Individuals pay taxes on income received in cash, in kind or credit and, in certain cases, in services. Tax income includes the remuneration of personal services (including wages, bonuses and special benefits like housing), interest, corporate dividends paid with gross income, capital gains, leasing income, etc.

Some States and Mexico City levy separate taxes on wages and salaries, which are generally payable by employers.

2.2 Deductions

Individuals may deduct the following expenses, among others, when calculating tax income for ISR purposes:



- Medical and dental fees and psychology and nutrition professional service fees, as well as hospital expenses incurred by the taxpayer and the taxpayer's spouse.
- Unlimited medical and dental fees and hospital expenses incurred by a disabled taxpayer.
- Health insurance premiums and charitable donations.
- Mortgage interest payments (with limitations).
- Social security contributions.
- All personal deductions (except those discussed above) are limited to the lower of: (i) five times the annual minimum wage or (ii) 15% of total income (tax and non-tax).

2.3 Rates

The ISR rates applicable to individuals are progressive and are limited to 35%. Employers withhold estimated tax payments on salary income.

Income on dividends is added to other tax income and taxed at the appropriate progressive rate.

Capital gains arising from the sale of listed shares by an individual, including derivative financial transactions related to those shares, are subject to 10% capital gain tax.

Nonresidents on temporary assignments working for companies or affiliates located in Mexico are exempt from ISR on the first $125,900 Mexican pesos received in a 12-month period; 15% tax on income between 125,901 and 1 million Mexican pesos and 30% tax on all income above 1 million Mexican pesos, without deduction.

Nonresidents on temporary assignments paid by nonresident foreign companies are exempt from ISR if the employee stays in Mexico less than 183 days, not necessarily consecutive, within a 12-month period. Otherwise, the employee will be subject to the payment of tax. Taxes paid by nonresidents are considered as definitive and they have no obligation to file an annual tax return.

First steps (Soft Landing in Mexico)

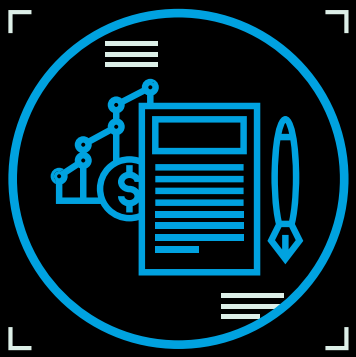
Deloitte Mexico has prepared a more detailed pamphlet on these activities. However, the most relevant steps for companies seeking to invest in Mexico are as follows:

Legal

- Corporate and legal analysis of investment characteristics.
- Incorporation of the new company.
- Preparation of the powers of attorney that will be granted abroad to represent the companies when creating the new company in Mexico.
- Obtain a corporate name permit from the Economy Department.
- Preparation of the bylaws of the new Mexican corporation.

Tax

- Analysis of the operating model transaction to define tax effects in Mexico and/or abroad.
- Application of corporate taxes on transactions, including tax withholding rates in Mexico.
- Analysis of the basic tax aspects to ensure compliance with domestic and/or foreign payment deductibility requirements.



Accounting, payroll and tax compliance

- Prepare accounting records and monthly financial statements under Mexican accounting standards, in Mexican pesos and in Spanish in accordance with Mexican rules.
- Prepare monthly corporate tax returns (ISR, IVA and withheld taxes).
- In accordance with current tax rules, monthly file electronic files containing Mexican accounting data.
- Design an electronic billing procedure and obtain authorization from the tax authorities.
- Upon hiring the first employee, obtain an employer's registration, prepare the official payroll in conformity with local rules and monthly file employment tax returns.

Expatriate employees

- Determine their tax residence, while considering local laws and income tax treaties
- Analysis of the expatriate's investments in Mexico or abroad to determine the respective tax treatment.

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