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DOING BUSINESS IN MEXICO





COMPANY FORMATION IN MEXICO

MAIN FORMS OF COMPANY/BUSINESS IN MEXICO

INCORPORATION

A notary public or a public commercial attester or broker are the only ones authorized to perform the incorporation of business entities. However, only a notary public may incorporate civil entities such as an SC (Sociedad Civil) or AC (Asociación Civil), and they are the only ones with authority to legalize powers of attorney.

It is not difficult to incorporate an entity in Mexico. Sometimes, however, it is a lengthy process, which involves the following steps (in order):

1. Obtaining a permit from the Ministry of Economy, including a name permit.
2. Formalizing the incorporation in a public instrument (Articles of incorporation) with a notary public or public commercial attester, as well as registering the company with:
 - a) The Public Property and Commerce Registry
 - b) The National Foreign Investment Registry
3. Registering the company before the Tax Administration Service (hereinafter referred to as "SAT"), Ministry of Finance and Public Credit. From this point the company may register before the Mexican Social Security Institute. With this Tax Identification Number, the company may open bank accounts.
4. Obtaining the proper permits for the performance of operations with local and state authorities, including:
 - a) Local payroll registration
 - b) Operating, advertising and other permits
 - c) Authorization from the Civil Protection Unit and the Fire Department
 - d) Ecological permits (Ministry of the Environment and Natural Resources - Semarnat), Ecological Impact Study
 - e) If required, Health Department permit

Companies must abide by and be guided by the articles of incorporation throughout their duration, and will always have to be registered by a notary public or a public commercial attester with the Public Property and Commerce Registry even when modified. These articles may never oppose the law, or high standards of custom.

In brief, the most common companies are:

1) Stock Company (SA)

- Characteristics: The capital is represented by registered stock; Partners have to pay for their shares both in cash or in kind
- Regulated by: The General Business Corporation Law
- Type of name: Denomination
- Minimum Capital: There is no minimum amount for the incorporation of an entity
- Reserves: 5% of annual profits up to 20% or a fifth of the fixed capital stock
- Number of partners allowed: Minimum: 2 - Maximum: unlimited
- Liability: Stockholders, up to the amount of their shares (contribution); Managers, unlimited by their actions
- Control and Supervision Bodies: General Stockholders' Meeting, Board of Directors (or Sole Manager) and Examine
- Remarks: The most common companies, based on protection and corporate veil prevailing

2) Limited Liability Company (S de RL)

- Characteristics: Investments are represented by negotiable social parts of the company
- Regulated by: The General Business Corporation Law
- Type of name: Firm name or denomination
- Minimum Capital: There is no minimum amount for the incorporation of an entity
- Number of partners allowed: Minimum 2, Maximum unlimited
- Liability: Partners, up to the amount of their shares; Managers, unlimited by their actions
- Control and Supervision Bodies: General Partners' Meeting, Manager and Supervision Board



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MANAGEMENT

The general stockholders' meeting or assembly (if any, the partners' or associates' meeting) is the supreme ruling body of any business entity. The meeting must be held at least once a year in the company's registered address before the end of April.

A board of directors or a sole manager must be in charge of the company. Both are appointed by the general stockholders' meeting. In the case of public companies, it is usually a board of directors instead of a sole manager.

The managers, directors, and legal representatives are jointly liable vis-à-vis the general stockholders' meeting and third parties for the company's damages resulting directly or indirectly from the violation of the law, its by-laws or regulations and from the abuse of authority, fraud or gross negligence. Managers, directors, and legal representatives may or may not be stockholders.

There is no need for a workers' or employees' representative in the board of directors.

FISCAL YEARS

All companies have to complete their operating or fiscal period on a yearly basis, from January 1st through December 31, except for the first year of operation or in case of merger, spin-off, bankruptcy, among others, when the fiscal year will start at the beginning of operations and will end on December 31. This is commonly called the fiscal year or calendar year. In other words, fiscal years must coincide with the calendar year.

STATUTORY EXAMINER (PLEASE SEE THE AUDIT SECTION)

The stockholders' meeting must appoint at least one examiner. This is optional in other mercantile companies. If a stockholder owns at least 25% of the shares, he or she may appoint an examiner. The examiner must never be a stockholder or a related party, a member of the board, a member of the corporate government or be related to a company's employee.

The examiner is usually an auditor (but it is not mandatory), due to the fact that supervision and implicit duties - such as reviewing the company's accounting books and submitting an annual assessment to the stockholders' meeting - are similar to auditors' review practices, except that they should report any undue or fraudulent situation detected, as well as situations requested by the company's stockholders or employees.

The examiner has the authority as well, to call a general stockholders' meeting if he or she deems it necessary.

REGISTERED ADDRESS AND FEDERAL TAXPAYER'S IDENTIFICATION NUMBER

Business entities must have a registered address in at least one State in Mexico. However, they must also have a fiscal domicile registered with the SAT, where accounting entries, supporting documents and the main business take place.

A federal taxpayer's registration number (commonly known as "RFC") has to be obtained as a means to identify the company with the SAT, which has become the official Identification number with government agencies. It is issued by the Ministry of Finance and Public Credit through the SAT.

If required, the company will have to be registered with the Mexican Social Security Institute, not only at the registered address where it operates, but at any branch or business unit where it actually operates.

INTELLECTUAL PROPERTY

Mexico's current legislation has been developed in accordance with the international standards set up by the World Intellectual Property Organization and the GAAT. Mexican trademark and patent standards are similar to those in industrialized countries.

The intellectual property registration is performed by the Mexican Intellectual Property Institute, and the Ministry of Economy.

Intellectual property refers to creations of the human mind, including:

- Inventions
- Literary, artistic and image work
- Symbols
- Names
- Images and or drawings
- Models used in trade





PERMANENT ESTABLISHMENT IN MEXICO: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

Foreign Branches ('Permanent Establishments' for Tax Purposes)

Branches from foreign companies may have business operations as soon as they are registered in the National Foreign Investments Register, upon the previous authorization of the Ministry of Economy, and the Public Property Registry.

Such authorization has to meet the following requirements:

- 1) It has proven that the company is duly incorporated in accordance with the law of its country of origin
- 2) The partnership agreement or the articles of agreement thereof are not contrary to Mexican laws
- 3) Its purpose is not subject to exclusion of foreign investors from certain economic activities
- 4) It has appointed a legal representative who will be liable for the company's activities and who lives in the area where the company will
- 5) Operate within the country

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

The main difference is that for Mexican Legal purposes a subsidiary must be a mercantile society or entity duly incorporated under Mexican Laws.

TAX AND ACCOUNTING OBLIGATIONS

Same as Mercantile Entities.



HOW TO HIRE MY FIRST EMPLOYEE IN MEXICO

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

Labor Relations

The Federal Workers Law has been in force since 1970 and all employers and employees must abide by it. The labor relationship between employers and employees can be established either on an individual or a collective basis.

The aforementioned Law sets forth the requirements and procedures, including working periods, holidays, vacations, unions, working conditions, and basic fares, among other things. According to this law a "working relationship" is based on any subordinate relation between an employee and its employer. So any subordinate relation is considered in Mexico as a labor relation.

The "work or labor relationship" starts at the time any Service is provided. Practically, a work or labor relationship assumes the existence of a contract, and the lack of it is imputable to the employer. There is a labor relationship in a permanent activity, in other words, individuals do not deal with isolated company operations and a subordinated job is being performed. A permanent activity is also any activity carried out on a regular, customary and common basis, either by season, campaign or any other mode rather than incidentally, occasionally or sporadically.

Practically, the term subordination means the firm has legal authority in response to a subordinate duty by the individuals providing the Services entrusted by the company with which it will benefit. Subordination and thus a labor relationship exists when individuals are bound to provide Services under a firms' or firm representatives' control, according to guidelines, policies, rules or regulations set by the firm and which result in subordination; subordination and work relationship means, as well, that the firm has the power within working hours to direct individuals in relation to Services entrusted by the firm and correlatively, they are bound to meet the conditions and requirements established by the firm. (See Types of Compensation section).

Work Contracts and Agreements

Regardless of the name given to the contract entered into between the parties, this will be a work contract if on the one hand a personal subordinated service has to be provided and on the other, a wage or consideration has to be paid (regardless of what it is called). On a legally practical basis, a contract is simply a meeting of the minds. Contracts may be:

- 1) Individual agreements: an individual binds himself or herself to perform a personal subordinated work for another.
- 2) Collective bargaining agreements: An agreement entered into between one or several workers' union and one or several employers or one or several employers' unions, aimed at establishing working conditions at one or more firms or business units.

Types of Compensation

The types of employee compensation are as follows:

- 1) Wages and salaries: Common compensation. In this scheme, the income tax, social security fees, and local taxes are withheld. The firm or individual will issue the relevant receipt. The VAT is not paid.
- 2) Fees: A usual scheme for commission agents and temporary professionals. A labor relationship could emerge as provided for in the Labor Relations section. Contrary to the wages and salaries scheme, individuals issue a receipt for tax purposes including income tax and VAT withholdings. There are no social security or additional tax withholdings.
- 3) Subcontracting: Firms that provide personnel service may be subcontracted in order to avoid a labor relationship. Note: Sometimes, a labor relationship has been proven to exist in this type of scheme.

Salaries and Minimum Wage

The working process in Mexico is highly competitive due to its low wages and salaries. Nonetheless, skilled labor is high.

The minimum wage for Mexico City is 73.04 pesos a day for fiscal year 2016.

Workweek

Working hours in Mexico are 48 divided by 6 days (morning shift). Saturday is usually half day's work at manufacturing and maquiladora plants. In the service area, however, an attempt is made to counteract hours distributed throughout the week. So in this particular area of work, 48 working hours are distributed from Monday to Friday. Working periods must include a minimum of 1 hour for lunch.



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Night shifts are 42 hours a week, and mixed shifts are 45 hours a week. By law, double pay is payable for the first nine extra hours, and triple thereafter. For employees who work on Sundays and Holidays, a 25% extra pay is applicable, commonly known as "Sunday bonus". Finally, a vacation bonus is granted when vacations are used by employees, of 25% of their daily pay.

Employee Benefits

Employees are entitled to a six days of vacations period after one year working period. Subsequently, one day is added to the vacation period per year worked until the employee reaches their 5-year anniversary, which means the employee has been working in the same place for at least 5 years. And after 5 years, two vacation days are added to every vacation period.

As a constitutional right, employees are entitled to half a month's pay as a Christmas bonus due on December 20.

The retirement bonus/premium amounts to 12 days' pay for every fiscal year worked.

Individual dismissed without cause are entitled to three months' pay, plus 20 days for every fiscal year worked, as well as proportional amount of the benefits including Christmas bonus, vacation bonus and workers' profit sharing.

Workers' Profit Sharing

Employees are entitled to 10% of the profits, based on reconciliation similar to that of the Income Tax. The result is divided by a prorate system and includes all the employees except the managing director and top executives.

The employee profit sharing is due on May 31 of the subsequent fiscal year. To avoid this issue companies, establish a secondary services company, which must maintain certain restrictions and obligations.

Worker Unions

Workers may organize a union with 20 or more members with the purpose of protecting their interests. Also, workers may join existing legally organized unions.

In many industries collective bargaining agreements are modified every one or two years; however, wages are modified every year.

Social Security (Mexican Social Security Institute, "IMSS")

All employees and workers have the right to receive social security benefits. Such benefits are paid by the employer and the employee on a monthly basis at an estimated rate of 16% and 4% respectively, based on the salary of employees. Such benefits are the following:

- 1) General medical services
- 2) Retirement funds
- 3) Home Loans





TAXES, TARIFFS AND TAX ADMINISTRATION

GENERAL TAX OVERVIEW

Mexican residents and persons are subject to federal taxes including the Income Tax, and the Value Added Tax⁵. For tax purposes, residents are:

- i. Companies with their main office or main business place in Mexico, and companies with a permanent establishment or a fixed base in Mexico.
- ii. Individuals:
 - a. Residing in Mexico
 - b. Residing in a foreign country, but with more than 50% of the income on a worldwide basis coming from Mexico
 - c. Rendering professional services in Mexico
 - d. Having Mexico as their vital source of income
 - e. Having a permanent establishment in Mexico (based on certain rules)

Income Tax (ISR)

Income tax is calculated at 30% tax rate applied to the net taxable income, which is computed by subtracting the allowable deductions. The net result is the net tax profit or loss. In case of tax profits, taxpayers are alluded to apply carry forward losses.

Tax payments must be filed in advance periodically during the year. These payments are credited against the year-end income tax return, which is due March 31 of the following year.

Tax Losses or Net Operating Losses

Previous tax losses may be carried forward over a period of 10 years from their year of claim, and be deducted from the net tax profit for the period.

Value Added Tax

A Value Added Tax or "IVA" rate of 16% is applicable to the final price of:

- i. Sale or disposal of goods and merchandise
- ii. The leasing of goods and services
- iii. The rendering of services, and
- iv. Imports of goods and services.

Exports are considered to be subject to a 0% tax rate.

It should be noted that the IVA is applied to operations but not to income earned, regardless of the person's address or the manner in which the operation was performed. Furthermore, this tax is calculated for monthly periods rather than for annual periods, as for the ISR.

Some articles as food (excluding restaurants), medicines, exports and certain imports are subject to a 0% (zero) IVA rate.

The IVA payable is the result of the IVA issued on the company's invoices and the IVA paid by the company. The value added tax is paid on cash flow basis, i.e., only the amount actually paid is subject to this tax.

Temporary imports from maquiladoras and companies in the IMMEX program are not subject to the IVA on imports.

Federal Tax Incentives

Every year, the Federal Government decrees the incentives to be applied. For 2016, such incentives are:

- 1.) Accelerated depreciation over certain assets.
- 2.) Investments made on technical research and development may receive an additional credit against the ISR. (R&D)
- 3.) Certain industries that need diesel may take a credit on the excise tax (IEPS).
- 4.) Ecological technology devices for the production of clean energy will be 100% deductible in one period.



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Tax Treaties

Mexico has tax treaties in force that may often have a reduced withholding rate for at least: Dividends, Royalties and Technical Assistance, Interests, among others.

Transfer Pricing Study

Obligated for all taxpayers who conduct transactions with related parties

Payments to “Preferred Tax Regimes”

IT withholding of 40% is applicable on certain payments done to entities located in a Preferred Tax Regime

Review by Tax Authorities

Tax authorities have the right to review the accounting and the tax payments of any entity or person. However, if the entity is audited for tax purposes, the review is limited at first, if the external auditor provides the sufficient and required information.

The right of tax authorities to review an item expires after 5 years of filing the relevant tax return. (Statutory Limit)

