

The background of the entire page is a photograph of the Independence Monument in Mexico City. The monument is a tall, dark stone column topped with a golden statue of an angel with wings, holding a laurel wreath. At the base of the column are several white statues of figures. The sky is a clear, light blue with some light clouds.

Investment in Mexico 2008

TAX

Investment in Mexico

The information contained herein is of a general nature Guide to increase business efficiency and productivity and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

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Preface

This guide has been designed to assist those contemplating investing or doing business in Mexico. It is intended to provide general information on a number of subjects important to business activity. However, it does not provide the comprehensive and detailed information necessary for making business decisions. When specific problems arise it is often necessary to refer to Mexico's laws and regulations and to seek proper counsel. Prepared with tax reforms approved by October 2007, to be in force in January 2008

Mexico City
Octubre, 2007.

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Chapter 1

General Information on Mexico

Official Name: ESTADOS UNIDOS MEXICANOS / (United Mexican States)

Population

The 2000 census indicated that the population of Mexico totaled 103.2 million inhabitants, with an annual growth rate of 1.0 percent. However, the revised figures, according to CONAPO (National Population Council), based on the results from the census of the National Institute of Statistics, Geography and Informatics (INEGI), are, as follows:

Km² Miles²

Land Area

	km ²	miles ²
Continental Area	1,959,248	756,469.0
Made up of Islands	5,127	1,979.0
Total Land Area	1,964,375	758,448.0
Exclusive Economic Zone *	3,149,920	1,216,190.9
Total Area	5,114,295	1,974,638.9

* Includes islands and sea area

Source: National Institute of Statistics, Geography and Informatics. April 2006

Table - Weight and Measurement

Meters	3.28 feet
Kilometers	0.6214 miles
Square meters	10.76 feet ²
Hectare	2.47 acres
Liters	0.264 gallons
Kilogram	2.205 pounds

Weights and Measurements

Mexico uses the metric system for measurement.

Geography

Mexico is located in the Western Hemisphere, west of the Greenwich meridian. It is part of North America together with Canada and the United States of America.

Mexico is a land of geographic diversity, from mountains and deserts to jungles and plains. In the central part of the plateau is Mexico City, the country's largest city and capital. Two important industrial cities are Monterrey and Guadalajara. Mexico City is located 2,238 meters (7,500 feet) above sea level with a pleasant climate all year round. Two important industrial cities are Monterrey and Guadalajara. Mexico City is located 2,238 meters (7,500 feet) above sea level with a pleasant climate all year round.

** Includes islands and sea area*

Source: National Institute of Statistics, Geography and Informatics. April 2006

Borders

The Mexican Republic shares a total of 4,301 km (2,676 miles) of borders with the United States of America, Guatemala and Belize.

History

Prior to the Spanish conquest, there were three main pre-Columbian cultures: Toltecs, Aztecs and Mayans. During the Spanish period (1521-1821), the Spaniard and local cultures merged to create today's Mexican people.

Independence from Spain was finally achieved in 1821, after 11 years of struggle. During the Nineteenth century, under President Benito Juárez and President Porfirio Díaz, there was a certain degree of development. However, it was after 1910 that the Mexican Revolution began, when fundamental economic and cultural changes took place.

Since 1940 Mexico was transformed from an almost predominantly agricultural nation to a modern industrial one, and a democratic system was established, which allowed Mexico to become a modern and prosperous nation.

Political Situation

In the past years, the country has reached a certain political stability. The Congress has focused on structural reforms and agreements; which have played a key role for Mexico's economic development.

The most important Political Parties are:

- Partido Revolucionario Institucional (PRI)
- Partido Acción Nacional (PAN)
- Partido de la Revolución Democrática (PRD)
- Partido Verde Ecologista de México (PVEM)
- Partido del Trabajo (PT)
- Convergencia

The federal government's strategic activities include: oil production and refinery; basic petrochemical production; and the sale of electricity to the public.

Government System

Mexico is a Constitutional Federal Republic that comprises 31 States and a Federal District, which is Mexico City.

The Federal Government is divided into three branches:

- Executive
- Legislative
- Judiciary

Executive

The President is elected every six years by direct popular vote and cannot be re-elected. The current President (2006- 2012) is Felipe Calderón.

Legislative

The legislative branch consists of two chambers: the Senate and the House of Representatives. The Senate is composed of 128 members whose current distribution is:

Party	Members
PAN	52
PRI	33
PRD	26
PVEM	6
PT	1
Non - party member	1
Total	128

Source: Website Senate Chamber. February 2007

The Chamber of Deputies is composed of 500 members whose current distribution is:

Party	Members
PRI	106
PAN	206
PRD	127
PVEM	17
PT	12
Convergencia	17
Others	15
Total	500

Source: Website Senate Chamber. February 2007

Judiciary

Judges of the Supreme Court are appointed by the President and subject to ratification by the Senate.

Representative government has three levels: federal, state and municipal. State governors are elected every six years and state legislatures are composed of locally elected deputies.

Some Important Ministers:

Ministry of Treasury :	Agustín Carsterns
Ministry of Foreign Affairs:	Patricia Espinoza
Ministry of the Economy:	Eduardo Sojo

Infrastructure and Transportation

Privatization efforts have contributed immensely to more efficient transportation services, improving the connection of air, maritime, highway and rail links, and fostering the development of multimodal transportation.

A reliable, efficient and modern infrastructure is essential to Mexico's economic growth. Mexico's consistent effort to attract foreign investment in the last decade has led to the signing of NAFTA, as well as other global free trade agreements, such as the agreement with the European Union.

Highways

The highway system in Mexico is by far the most important means of transportation in the country, with over 350,000 km (217,490 miles) of highways.

Highway System - Vehicles Transit (Thousands of vehicles)

Year	Total
1991	103,912
1992	102,880
1993	118,224
1994	120,836
1995	114,104
1996	118,320
1997	128,455
1998	161,593
1999	225,588
2000	250,484
2001	273,192
2002	294,489

Year	Total
2003	313, 218
2004	335, 821

Source: Ministry of Transportation and Communications. June 2004.

Since 2002, steps were taken to pass federal and state legislation, and coordination with transporters to prevent accidents was intensified.

The socioeconomic benefits that these new communication routes represent are clear, as the Federal Government's effort is to fulfill the commitment to integrate the nation's economic zones.

The construction of these communication routes may be conducted by state or local governments or by the Communications and Transportation Department.

The Ministry determines the specifications of the highway, under the supervision of its own specialized civil engineers.

Railroads

The Mexican railroad system links the main productive centers, the most important cities and the marine ports, while also providing access to the United States' and Guatemalan borders. The system extends more than 26,500 km (16,467 miles).

From 2000 onwards, the Mexican Railroad System has accumulated substantial improvements as a result of its restructure. Such improvements transcend into greater safety, efficiency and competitiveness, opening up to private investment and the modernization of infrastructure, equipment and systems, as well as the elimination of government transfers regarding workers' rights and better wages for workers.

The national railroad system is divided between Ferrocarril Mexicano (Ferromex), Ferrosur, Transportación Ferroviaria Mexicana (TFM), Coahuila-Durango Line, Ferrocarril de Nacozari, Ferrocarril Tijuana-Tecate, Ferrocarril Chiapas-Mayab, Ferrocarril de Oaxaca y Sur, Ferrocarril del Istmo de Tehuantepec and the Valley of Mexico terminal.

Commercial Cargo in the Railroad System
(Thousands)

Year	Net Tons
1991	46,405
1992	48,705
1993	50,377
1994	52,052
1995	52,408
1996	58,831
1997	61,666
1998	75,914
1999	77,062
2000	77,164
2001	76,182
2002	80,451
2003	85,168
2004	88,097

Source: (1991-1996) Ferrocarriles Nacionales de México, (1997) Ferrocarriles Nacionales de México and TFM, (1998) Railroad concessionaries and Ferrocarriles Nacionales de México, (1999) Railroad concessionaries, (2000-2001) Railroad concessionaries. (2002) Ministry of Transportation and Communications.

International Trade in Railroad System - Carried Tons
(Thousands)

Year	Export	Import	Total
2001	7,897.7	27,583.9	35,487.16
2002	9,864.9	31,298.8	41,163.7
2003	36,615.9	11,341.2	47,957.1
2004	38,696.5	14,206.8	52,903.3

Source: Ministry of Transportation and Communications. February 2006

Airports

In recent years, the air transportation subsector was opened up and deregulated, allowing the introduction of new service providers, the increase in its offer and the broadening of routes and more competitive prices.

Airports operate under new service standards, more efficiently and safely in order to meet the demand of the growing operation of better capitalized airlines that will develop in a fairer competitive scenario.

Fifty-six domestic airlines are currently operating. Mexico has 62 airports, of which, 47 offer services for domestic and international flights. The remaining 15 are dedicated exclusively to domestic routes.

Air Transportation System - Passenger Flow

Commercial Airlines

(Passengers)

Year	
1994	52,623,095
1995	44,568,861
1996	45,673,295
1997	49,967,533
1998	54,375,602
1999	58,332,728
2000	59,366,199
2001	58,779,727
2002	57,080,326
2003	60,946,387
2004	65,968,171

Source: Ministry of Transportation and Communications. Annual Report 2004

Air Transportation System - Carried Tons (Thousands)

Year	
1994	237
1995	252
1996	285
1997	335
1998	388
1999	407
2000	379
2001	351
2002	389
2003	410
2004	467

Source: Ministry of Transportation and Communications. Annual Report 2004

Ports

Maritime routes constitute a fundamental base to support the growth of foreign trade in Mexico. According to the World Trade Organization, in 2003, Mexico was the 12th most important trader country in the world by total exports and imports, as well as being the most dynamic in Latin America.

Ports are very important for the Mexican economy. They handle more than 80 percent of exports and 35 percent of the country's total freight. Industrial ports offer important advantages such as ample space for the establishment of new industrial and service plants, as well as a modern infrastructure.

International Trade in the Maritime Transport - Carried Tons
(Thousands)

Year		
1994	185	374
	903	
1995	186	261
	460	
1996	208	581
	691	
1997	219	652
	794	
1998	237	379
	967	
1999	231	440
	430	
2000	244	252
	371	
2001	244	430
	502	
2002	253	045
1/	873	
2003	264	738
	691	
2004	266	007
	830	

1/ Data modified by the source

Source: Coordinación General de Puertos y Marina Mercante.

Source: Ministry of Transportation and Communication. Annual Report 2004 Maritime ports are classified into: individual, federal and state ports, the most important being:

Pacific Coast:

- Manzanillo
- Lázaro Cárdenas
- Salina Cruz

Gulf and Caribbean Coasts:

- Tampico
- Altamira

Year Revenues

Year	Revenues
1999	107,250.2
2000	134,218.7
2001	149,155.9
2002	163,624.6

Trade by Type - 2002

Source: API Lázaro Cárdenas (Integral Port Management of Lázaro Cárdenas), API Tampico (Integral Port Management of Tampico) and API Veracruz (Integral Port Management of Veracruz). Ministry of Transportation and Communications. June 2004 Mexico has 108 ports, 24 of which work under the Integral Port Management (IPM) scheme. An IPM is a private entity, which operates with a concession granted by the Federal Government, and manages, promotes, builds, develops and maintains the Port Warehouse infrastructure. The objective is to offer a quality port and service infrastructure, creating favorable conditions to attract new businesses, through private investment that allows the construction of new terminals and specialized installations.

All ports are conditioned for coastal traffic (domestic marine transportation) and just 36 are dedicated to ocean-going shipping (export and import).

Telecommunications

Mexico's telecoms market began to open up to competition with the privatization in 1990 of Telmex and a concession for mobile operations. The long-distance market was opened to competition in 1997 and the local market in 1998. However, Telmex continues to wield considerable market power and has been frequently accused of abusing its position. Telmex continues to dominate most market segments, including 95% of local telephony, 80% of long-distance calls, 75% of the mobile telephone market and 70% of Internet services. The Comisión Federal de Telecomunicaciones (Cofetel, the telecoms industry regulator) has tried many times to rein in the company, with little success. The Office of the United States Trade Representative (USTR) has pressed more successfully, and in 2004 received a favorable World Trade Organization (WTO) ruling on the openness of the Mexican telecoms market, which is setting the stage for a lowering of interconnection fees.

New telecommunications legislation to replace the current law dating from 1995, which would address continuing regulatory weaknesses, particularly Cofatel's lack of enforcement capability, has been presented by the Fox administration, but has languished in the opposition-dominated Congress.

Many of the companies originally licensed to participate in fixed, long-distance, and mobile telecoms services in Mexico proved unable to cope with high interconnection charges, poor infrastructure and bad debts, and are no longer in business. Of the 18 companies licensed to provide fixed-line and fixed wireless local telephony services and the 32 companies licensed to provide long-distance services, there are currently only a few operators in each subsector. Of the nine mobile companies in operation in 2000, only four remained in 2005. The dominant player in fixed-line services is Telmex, followed by Avantel and Alestra. In the mobile market, Telcel (part of América Móvil, a Telmex spin-off) also dominates, although it does face growing competition, particularly from Telefónica Móviles México (TEM, an affiliate of Spain's Telefónica group), which has emerged as the second-largest operator in the country.

By revenue, fixed telephony is the largest telecoms sector. Within the fixed market, local telephony is the largest subsegment, accounting for over US\$6bn in sales in 2005. Local telephony revenue has received a significant push from value-added services, such as caller ID, call waiting and three-way calling. Long-distance revenue is being pressurized by falling tariffs and migration to voice over Internet protocol (VoIP). Corporate data communications and the Internet are the fastest-growing subsegments within the fixed market. The mobile market is growing just as rapidly, with total revenue estimated to have risen to US dollars (hereinafter USD) \$8bn in 2005, from less than USD\$4bn in 2000. Voice services still make up the vast majority of the mobile market. Data revenue was only around 10% of the total in 2005, although this proportion is growing quickly. Low-cost SMS services still dominate the mobile data market.

Telecoms investment reached USD\$3.5bn in 2005, well up on the low of USD\$2.6bn registered in 2003, a period of economic stagnation and regulatory uncertainty and legal disputes between many of the major players in the telecoms market. However, investment is still well below the peak of USD\$5.7bn recorded in 2001. This partly reflects the completion of large projects, but weak investment also reflects the inability of Cofetel to provide a regulatory environment that lessens the near monopolistic position of Telmex and offers more opportunities and incentives for smaller carriers. In terms of credibility, Cofetel ranked ahead only of Venezuela's telecoms regulator in a survey of seven major Latin American countries.

Given the dominance of Telmex and Telcel, their choice of preferred technology largely determines technological developments in the Mexican market. DSL is Telmex's preferred broadband platform, and is consequently expanding rapidly. Telcel is Mexico's only TDMA (Time Division Multiple Access)/GSM (Global System for Mobile Communications)/GPRS (General Packet Radio Service)/EDGE operator. TEM operated a CDMA (Code Division Multiple Access) and GSM/GPRS/EDGE network, while Iusacell (1.6m subscribers in 2005) and Unefon operate CDMA networks. GSM is estimated by Pyramid Research to account for more than 40% of overall mobile subscribers in 2005. There have been no licenses issued for 3G mobile technologies and there are unlikely to be until after 2006. WiFi was introduced in Mexico by Telmex in 2003, and coverage is expanding rapidly. WiFi hotspots are regularly found in hotels, large shops and airports, in over 50 cities and in tourist areas. Market players are also looking to convergence, offering combined voice and data and fixed and mobile services. Aventel and TEM are to launch merged fixed and mobile services; other prime areas for convergence in Mexico include Internet telephony and broadband, and broadband and pay TV (there were 4.6m pay-TV subscribers in Mexico in 2004).

The provision of telecoms services is dominated by the incumbent, Telmex, and its subsidiaries. Telcel, the biggest player in the mobile market, is a subsidiary of América Móvil, a Telmex spin-off that operates across Latin America. Telmex accounts for 60% of Internet users via its affiliate, Prodigy. However, there are multiple players in Mexico's data communications, Internet and cable-TV markets. Telcel's control over around three-quarters of the mobile market is likely to be eroded in the coming years, but not by much.

Avantel, Mexico's second-biggest telecoms company, entered the market in the mid-1990s as a long-distance carrier but has become a multiservice provider. It is considered to be vulnerable as a result of the market slowdown; the financial difficulties of Worldcom (US), one of its backers; and legal challenges to another backer, Citigroup (US), over foreign ownership laws. Other challengers to Telmex in the provision of local services include Axtel, Maxcom and Alestra.

After its takeover of Pegaso, Telefónica Móviles (TEM, an affiliate of Spain's Telefónica group) has emerged as the second-largest player in the mobile market. TEM's Móviles México division had around 5.8m subscribers in June 2005, compared with Telcel's 32.3m. In the Internet service provider (ISP) market, rivals to Prodigy (Telmex) include Spain's Terra Networks, Avantel, Alestra and America Online Latin America. In data communications, the market leaders, Telmex, Alestra and Avantel are challenged by Telefónica, MetroRED, GlobalOne-Equant, Convergence and MCM Telecom.

Revenues in the Telecommunications Sector

Revenues in the Industry of telecommunications

(US Million)

Year	Telephone/1	Other services/2	Total
1998	81,317	6,877	88,194
1999	99,524	8,487	108,011
2000	125,258	10,694	135,952
2001	134,747	15,226	149,973
2002	141,980	18,043	160,023
2003	163,237	20,823	184,060
2004/p	187,918	23,243	211,161
2005/p	209,876	25,436	235,312

p/: preliminaries.

e/: estimated data with information of the companies.

1/: Includes companies that bring telephone services wired and wireless, long distance, public and mobile.

2/: Includes companies that bring services of restricted television (Cable, MMDS y DTH), mobile radio localization, specialized radio communication, satellites and value added services

Source: Federal Telecommunications Commission. February 2007: Dirección de

Investment in the Industry of telecommunications
(US Million)

Year	Telephone/1	Other services/2	Total
1998	1,887.6	1,277.4	3,165.0
1999	3,473.9	553.7	4,027.6
2000	4,646.2	582.4	5,228.6
2001	4,846.8	902.6	5,749.4
2002	2,645.2	483.0	3,128.2
2003	2,110.7	473.8	2,584.5
2004/p	3,192.4	423.8	3,463.7
2005/p	2,959.8	503.9	235,312
2006/e	2,943.4	649.4	3,592.8

p/: preliminaries.

e/: estimated data with information of the companies.

1/: Includes companies that bring telephone services wired and wireless, long distance, public and mobile.

2/: Includes companies that bring services of restricted television (Cable, MMDS y DTH), mobile radio localization, specialized radio communication, satellites and value added services

Source: Federal Telecommunications Commission. February 2007: Dirección de Información Estadística de Mercados, COFETEL.

At the end of the 80's the Federal Government established its next ambitious goals for the telecommunications industry:

- Accelerate deployment of basic infrastructure
- Introduce new services and advanced technology
- Develop the Mexican telecommunications market by opening to private investment. In this stage of modernization, the new government's role is to regulate, supervise and promote the telecommunications sector.

With these changes, some policies were established in order to provide certainty to private investment and are reflected in four main events:

- 1990 Teléfonos de México (Telmex) concession title was modified (privatization)
- 1995 The Federal Telecommunications Law was enforced
- 1996 A regulatory entity was created: Federal Telecommunications Commission (Cofetel)

The following regulations were issued:

- Long Distance Services (Jun 96)
- International Long Distance Service (Dec 96)
- Local Service (Oct 96)
- Public Telephony (Dec 96)
- Satellite Communications (Aug 97)
- Pay Television and Audio (Feb 2000)
- Mobile communications
- “The one calling, the one paying” National and International (Nov. 2006)
- Mobile communications
- Portability Resolution (Dec 2006)

Infrastructure of the Telephone companies with Federal Concession

854	Radio Stations AM
719	Radio Stations FM
736	TV. Stations
35	Digital Television Channels

Source: Ministry of Transportation and Communications. February 2006.

These achievements have reached an excellent growth in the sector, which allowed developing the following telecommunication services:

- Local Telephony (Wired and Wireless)
- Long Distance Telephony
- Satellite Communications
- Mobile Telephony
- Pay T.V. and Audio
- Radiocommunications (Trunking, Paging)
- Value Added Services (Internet Access, Audio text, Remote Data

Processing, Electronic Data Exchange, Remote Data Base Access, Voice Mail, Facsimile)

Internet

Year	Computers connected directly to the interconnected system worldwide net per 10,000 inhabitants a	Personal computers per 100 inhabitants
1994	0.7	2.3
1995	1.5	2.6
1996	3.2	2.9
1997	4.4	3.3
1998	11.7	3.6
1999	41.6	4.4
2000	56.6	5.8
2001	92.6	7
2002	110.1	8.3
2003	130.6	8.3
2004	145.2	10.7

Source: Ministry of Transportation and Communications Annual Report, 2004

Chapter 2

Economic Conditions

Mexico in the World Economic Context

- Mexico is the 14th Economy according to Total GDP (2004)*
- Mexico is the 36th Economy according to GDP Per Capita (2004)*
- Mexico is the 12th Economy in line with its Total Trade, 13th to its Total Exports and 12th to its Total Imports (2004) **
- Mexico is the 13th Economy in relation to Crude Oil Proved Reserves (2004)***
- Mexico is the 7th Economy according to how much tourism it receives (2003)****
- Mexico is the 2nd Economy regarding how much Money Transfers it receives (2003)*****
- Mexico is the 3rd Economy, within other Developing Countries, in accordance with Foreign Direct Investment (2004)*****

*Source: International Monetary Fund. World Economic and Financial Surveys. January 2004.

**Source: World Trade Organization. International Trade Statistics 2003. January 2004.

***Source: National Institute of Statistics, Geography and Informatics. March 2004.

****Source: Ministry of Tourism. March 2004.

*****Source: Ministry of Economy. March 2004.

Economy

Mexico in Figures

Non-financial public sector (Ps bn)	2004 4 Qtr	2005 4 Qtr
Revenue	462.9	528.2
Expenditure	559.3	634.7
Balance	-96.4	-106.5
Output		
Industrial production (1993=100)		
General	138.4	142.2
Manufacturing	142.1	145.6
Mining	127.2	131

Employment, wages and prices

	2004 4 Qtr	2005 4 Qtr
Employment ('000)	12,682	13, 247
Employment (% change, year on year)	2	4.5
Unemployment rate (% of the labor force)	3.7	3.1
Real wages (1993=100)	108.4	108.6
Real wages (% change, year on year)	-0.9	0.2
Consumer prices (Jun 16-30 2002=100)	112.1	115.6
Consumer prices (% change, year on year)	5.3	3.1
Producer prices (Dec 2003=100)	108.4	111.3
Producer prices (% change, year on year)	9.5	2.7

Financial indicators

	2004 4 Qtr	2005 4 Qtr
Exchange rate Ps:US\$ (av)	11.33	10.71
Exchange rate Ps:US\$ (end-period)	11.26	10.78
Deposit rate (av; %)	3	3.5
Lending rate (av; %)	8.6	10.1
Money market rate (av; %)	8.5	9
M1 (end-period; Ps bn)	743.2	865.9
M1 (% change, year on year)	8.5	16.5
M2 (end-period; Ps bn)	2, 125.60	2, 337.90
M2 (% change, year on year)	11.5	10
BMV stock market index (1978=0.78)	12, 918	17, 803
BMV stock market index (% change, year on year)	46.9	37.8

Sectoral trends

	2004 4 Qtr	2005 4 Qtr
Crude oil production (m barrels/day)	3.35	3.31
Crude oil production (% change, year on year)	-1.9	-1.2

Foreign trade and payments (US\$ m)

	2004 4 Qtr	2005 4 Qtr
Exports fob	11.33	10.71
Maquila	11.26	10.78
Oil	3	3.5
Imports fob	8.6	10.1
Maquila	8.5	9
Trade balance	743.2	865.9
Services balance	8.5	16.5
Income balance	2, 125.60	2, 337.90
Net transfer payments	11.5	10
Current-account balance	12, 918	17, 803
Reserves excl gold (end-period)	46.9	37.8

Sources: IMF, *International Financial Statistics*; Banco de Mexico, *Indicadores Economicos*; INEGI; STPS.

(c) Economist Intelligence Unit 2007

Current Situation and Perspectives

Mexico's growth remains strongly linked to the US economic cycle, as reflected in an acceleration of GDP growth in 2006, to an estimated 4.7%, driven largely by an upturn in US import demand. Developments in the past few weeks have mixed implications for Mexican growth. Stronger than previously expected US growth in 2007 will ensure, among other things, that inflows of remittances from Mexican migrants in the US (which provide major support to private consumption) will remain firm. However, US manufacturing, which is an important driver of Mexican export growth, is still weakening. Moreover, a softening of oil prices will have a dampening impact on consumption and investment. Ministries and regional governments received oil windfall revenue equivalent to 1% of GDP in 2006, while public companies (mainly Pemex) received around 1.3% of GDP. Consequently, we have made only a slight upward revision to our projection for GDP growth in 2007, to 3.3% (previously 3.1%). There will be a further moderate strengthening in 2008, reflecting a slight rebound in US growth (and import demand). However, although a continued deepening of the credit market will underpin investment, investment levels overall will remain relatively low for an emerging-market economy (at around 21% of GDP), owing to a sluggish pace of structural reform. As a result, growth in domestic demand and exports will continue to be limited by an inefficient and costly physical infrastructure, and by the lack of labor market reform to encourage employment growth in the formal sector.

Source: Economist Intelligence Unit September 2006

Real GDP per Division

(Annual Variation - %)

Concepto	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total	1.7	0.2	1.9	0	1.4	1.4	0.5	-0.2	-0.5	-0.4
Government, General	1.1	-0.1	1.7	1.2	1.9	1.1	-1.2	-0.7	-1.7	-1.6
Central Government	-0.7	-1.3	-4.3	-0.2	0.3	1.3	-3.7	-0.6	-1.5	-5.4
Federal Government	-1.5	-2.3	-6.6	-1.7	-0.1	4.9	-4.9	0.1	-1.2	-6.1
Distrito Federal Government	1.3	2.9	0.9	8.9	1.9	-6.4	-5	-1	-12.1	0.2
De-centralized organisms	1.5	0.4	2	0.3	0.7	-6.6	1.1	-3.1	3.5	-5.5
Local Government	2.3	1.1	6.3	2.3	2.6	1.1		0.8	-2.3	0.6
State Government	2.4	1.1	6.9	2.5	2.5	0.9	0.1	0.6	-2.4	0.6
Municipal Government	1.3	1	1.4	0.5	4	2.1	-0.4	2.3	-0.1	0.1
Social Security	1.5	-1	1.4	0.6	2.9	0.8	0.1	-5.3	0.2	-1.7
Public Companies	2.7	0.7	2.2	-1.7	0.6	1.7	3.4	0.4	1.2	1.5
Of Direct control	2.3	1.5	-0.3	-3.4	-0.2	1.3	0.7	-0.8	1.3	0.3
Of Indirect Control	3.6	-1.2	8.4	2.2	2	2.7	2.7	2.8	1.1	3.7
Non Financial	-0.5	-2.3	11	1.6	-1.5	2.2	8.8	-3	2.6	1.8
Financial	7.2	-0.2	6.4	2.6	4.8	3.1	9.3	7.2	0.2	4.9

Source: INEGI. Sistema de Cuentas Nacionales de México. "Indicadores Macroeconómicos del Sector Público" February 2005

Total Exports and Imports (US Millions)

	2004	2005
Total Exports	187, 999	213, 711
Total Imports	196, 810	221, 270

Source: Ministry of Economy with data from the Central Bank. March 2005

Exchange Rate Policy

The peso has remained largely stable in recent weeks. On January 22nd the exchange rate stood at Ps10.9:US\$1, slightly (0.6%) weaker in nominal terms than at the end of 2006. Our forecasts assume that the peso will depreciate gradually as strong portfolio flows begin to reverse in tandem with tightening international liquidity and oil prices—which underpin Mexico’s largest source of foreign exchange—soften from their recent highs. However, helping contain the rate of depreciation, workers’ remittances and inflows of foreign direct investment (FDI) are forecast to remain firm, while liability management operations will continue to pre-finance public external obligations falling due. By the end of 2008 we forecast an exchange rate of Ps11.63:US\$1. Nevertheless, deteriorating external conditions, a conflictive political environment and (at least in the short term) increased concern about inflation, will be reflected in greater exchange-rate volatility. There remains the risk of a sharp decline in the value of the peso in the event of further turbulence in global financial markets, but we would expect this to prove temporary.

Source: Economist Intelligence Unit September 2006

Exchange Rate

Although the peso has been more volatile in 2006 than in 2005, at Ps11:US\$1 on December 1st, the exchange rate has not weakened much beyond its end-2005 level of Ps10.78:US\$1. Our forecasts assume that high oil prices, continued strong inflows of workers’ remittances and direct investment, and the prefinancing of public external obligations falling due will continue to support the peso. However, we still expect the peso to depreciate gradually from 2007 as some of the factors supporting it, such as strong portfolio flows and high oil prices, begin to reverse. By the end of 2008 we forecast an exchange rate of Ps11.6:US\$1. Moreover, deteriorating external conditions and a still volatile political environment will be reflected in increased exchange-rate volatility.

There remains the risk of a sharp decline in the value of the peso in the event of further turbulence in global financial markets.

Global Exchange Rate Assumptions - Jan 2007

	2006*	2007*	2008*	2009*	2010*
¥ : US\$ (av)	116.2	114.3	99.8	95.8	93.5
US\$: € (av)	1.26	1.34	1.36	1.29	1.27
¥ : € (av)	145.9	153.3	135.9	123.8	118.7

(c) Economist Intelligence Unit 2007
*estimated

Inflation

A spike in food prices in the last few months of 2006 pushed inflation up to 4.1%, slightly above the central bank's 2-4% target range. Although this mainly reflects seasonal price rises for a number of agricultural products, there are other signs of upward pressure on prices: core inflation (which excludes energy and food) has trended upward on the back of rising services prices, particularly housing, to 3.5% in November and 3.6% in December from a low of 2.9% early in the year. At the same time, producer prices rose markedly in 2006, in line with rising commodities prices, peaking at 8.6% in August. Since then, producer price inflation has trended down, ending the year at 7.3%. However, even assuming that pass-through into consumer prices will be limited, the latest producer price inflation data support our expectation that headline inflation will remain outside the central bank's target range of 2-4% for the first half of 2007. However, over the course of this year and into 2008, prices should begin to trend gradually downward once again (to end 2008 at 3.3%), on the assumption that temporary pressures recede and that inflationary expectations remain low.

Source: Economist Intelligence Unit September 2006

Interest Rates

Interest rates (%)	2006*	2007*	2008*	2009*	2010*
US\$ 3-month commercial paper rate	5	5	4.9	5.3	5.3
US\$ 3-month Libor	5.2	5.1	5	5.4	5.4
Yen 2-month private bill rate	0.28	1.09	2.09	2.46	2.46
Euro 3-month interbank	3.1	4	4.1	4.1	4.1

(c) Economist Intelligence Unit 2007
*estimated

Unemployment

Employment, wages and prices	2004	2005
Employment ('000)	12, 682	13, 247
Employment (% change, year on year)	2	4.5
Unemployment rate (% of the labor force)	3.7	3.1
Real wages (1993=100)	108.4	108.6
Real wages (% change, year on year)	-0.9	0.2

Source: Economist Intelligence Unit January 2007

Average Minimum Wage /a

Geographical Zone	2007
A	50.57
B	49.00
C	47.60

A; States: Distrito Federal and Metropolitan Area, Baja California, Baja California Sur
Cities: Acapulco, Guerrero; Ciudad Juárez, Chihuahua; Nogales, Sonora;
Matamoros, Tamaulipas; Coatzacoalcos, Veracruz.

B: Cities: Guadalajara, Jalisco; Monterrey, Nuevo León; Hermosillo, Sonora;
Tampico, Tamaulipas; and Poza Rica de Hidalgo, Veracruz.

C: States: Aguascalientes, Campeche, Coahuila, Colima, Chiapas, Durango, Guanajuato, Hidalgo, Michoacán, Morelos, Nayarit, Oaxaca, Puebla, Querétaro, Quintana Roo, San Luis Potosí, Sinaloa, Tabasco, Talaxcala, Yucatán and Zacatecas. Certain locations of the following states also apply: Chihuahua, Guerrero, Jalisco, Estado de Mexico, Nuevo Leon, Sonora, Tamaulipas and Veracruz.

(Mexican pesos, MXPs - daily basis)

Source: Minimum Wage National Commission. February 2007.

Foreign Direct Investment

(US Millions)

Period	1999	2000	2001	2002	2003	2004	2005
Total	13 696.0	17 772.7	27 141.7	19 044.3	15 256.2	18 940.7	15 993.1
United States of America	7 420.0	12 689.8	21 092.6	12 707.9	9 555.4	7 991.6	9 586.5
United Kingdom	187.5	282.6	131.6	1 246.9	1 056.0	138.3	965
Germany	764.4	347.8	-110.4	595.6	462.6	398.8	341.2
Japan	1 232.7	417.3	187.6	166.2	121.6	363.2	73.7
Switzerland	125.2	151.5	-176.7	461.7	312.4	1 097.0	136.1
France	168.1	-2 483.0	392.5	349.5	529.6	145.4	394.6
Spain	1 042.1	2 112.5	739.2	730.4	1 776.0	6 892.2	1 333.5
Sweden	690.5	- 279.4	- 139	- 48	- 41	71.1	29.3
Canada	625.3	699.7	989.4	221	254.9	497.4	251.2
Holland	1085.8	2 682.5	2 598.1	1 459.7	570.5	713.5	2 198.0
Italy	35.4	36.4	17.6	37.6	9.4	166.4	29.9
Other	694	1 115.0	1 419.2	1 115.8	648.8	465.8	654.1

Source: Secretaría de Economía. Dirección General de Inversión Extranjera.

External Investment Distribution by Sector

(US Millions)

Periodo	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total	10 663.7	8374.6	7847.7	12140.2	8370.4	13696.0	17772.7	27141.7	19044.3	15256.2	18940.7	15993.1
Farming / Agricultural	10.8	11.1	33.4	10	29.1	82.5	91.6	63.8	92.6	10.6	16.3	2.9
Mining and extraction	97.8	79.1	84.1	130.6	49.4	138.1	198.9	21.5	247.8	77.5	146.3	13.6
Manufacture Industry	6209.0	4862.1	4819.3	7290.4	5010.0	9149.2	9911.7	5515.8	8378.8	6641.8	9376.5	8704.6
Water and Electricity	15.2	2.1	1.1	5.2	25.1	150.3	134	333.4	397.7	322.5	187.6	154.2
Construction	259.6	49.2	25.5	110.4	136.3	109.6	172.1	107.9	347.7	80.1	381.6	212.9
Commerce	1251.5	1012.5	752.2	1871.1	1038.5	1408.9	2437.0	2218.2	1758.9	1393.6	1181.9	2582.2
Transport and communications	719.3	876.3	428	681.5	436.6	291	-2083.7	2778.1	824.5	1630.6	1254.1	1170.4
Financial Services a	941.7	1070.1	1215.5	1116.6	732.6	774.6	4859.9	14410.7	5763.0	3330.2	5486.0	890.2
Other services b	1158.8	412.1	488.6	924.4	912.8	1591.8	2051.2	1692.3	1233.3	1769.3	910.4	2262.1

a : Services: financial, administration and lease of properties.

b : Communal and social services; hotels y restaurants; professionals, technical and personal.

Source: Secretaría de Economía. Dirección General de Inversión Extranjera.

Mergers & Acquisitions

The M&A activity in Mexico continued with the positive trend observed in 2004.

The trend continued in both the number of foreign companies looking to enter the Mexican market, or looking to consolidate its actual presence through Mergers and Acquisitions, and in Mexican companies that went shopping to the United States, Europe, South America and Asia with the objective to conquer new markets, bring new products to Mexico, or take Mexican products abroad.

The activity of the M&A market in 2005, compared with 2004, shows an increase of 13.1% in terms of the number of transactions that were carried out (121 vs. 107). On the other hand, the total value of the deals during 2005 was 12.7% lower than the amount registered in 2004. In summary, we observed that the average transaction amount decreased from USD\$197.4MM to USD\$152.4MM or 22.8%.

Source: Global M&A Newsletter 6th bimester 2005

Chapter 3

Labour Relations

Labor relations are regulated by the Federal Labor Law and its Regulations. The law provides minimum working conditions and rights which must be borne by the employer regardless of whether the employees are organized under a union or not. Such provisions cannot be waived by the employee under any circumstances. The law is applicable to all employees in Mexico regardless of their nationality.

The law provides two types of labor relationships: individual and collective. An individual labor relationship is created automatically upon a person being hired to perform a task subject to the control of the employer, whether on a temporary basis or for an indefinite term. Unless the nature of the task is specified or for permanent term as provided in the law, employment may only be terminated without liability to the employer if the employee falls in one of the justified termination causes indicated therein (otherwise severance payments would have to be made). A collective relationship exists when the work force is organized under a labor union and the employer has executed a collective bargaining agreement with such union (see Union's below).

Even if no written agreement exists, the law considers the employee to be under an agreement according to the terms set forth in the mentioned law. It is advisable for the benefit of both parties, to execute a written agreement providing the specific conditions of employment and to avoid problems in the event of a dispute before the Labor Board.

Minimum wage

The law provides a minimum amount which must be paid to all employees in cash for work compensation. This amount is intended to guarantee workers and their families a "living wage." This amount must be given without deductions or withholdings on a weekly basis. Such minimum wage is determined from time to time by the National Minimum Wage Commission integrated by representatives from the Labor, Government and Private Sector.

The minimum wage varies for each of the three economic regions into which the country is divided. A general minimum wage applies to all employees within each economic region, except those that fall within a series of specific job categories. The general minimum wage for the three regions effective as of January 1, 2007 is as follows:

- Zone A (including Mexico City) MXP\$50.57 per day (US\$4.60 - rate of 11)
- Zone B: MXP\$49.00 per day (US\$4.45)
- Zone C: MXP\$47.60 per day (US\$4.32)

The economic situation (based on inflation factors), loss of purchasing power and other similar matters are all taken into consideration to reach a new wage scale.

Work Days, Overtime, Holidays and Vacations

The maximum number of hours which an employer may require its employees to work, without having to pay overtime, is 48 hours per week. For every six days worked, employees are entitled to at least one paid full day of rest per week. However, in practice a 40 or 44 hour workweek is often standard, particularly in offices. An employer may not require its employees to work more than nine hours of mandatory overtime per week. The normal work hours may be distributed throughout the week as necessary.

Since Sunday is usually the day of rest, employees working on that day are compensated with an additional 25 percent premium of their regular wage, regardless of any overtime premium that may apply and even though they receive a day off during the week.

There are three work shifts: day shift (48 hours per week), night shift (42 hours per week) and mixed shift (45 hours per week). Any additional time worked in excess of the above mentioned maximum is deemed as overtime, which is limited to 9 hours per week. The employer must pay the first 9 hours of overtime at 200 percent and overtime exceeding 9 hours at 300 percent of standard pay.

Triple pay is also provided for work on legal holidays and days of rest.

An employee has six days of vacation after one year of work and two additional days of vacation for each subsequent year up to five years. After five years, two vacation days are added for each five years working period.

Vacation time must be paid in full, plus a vacation premium of 25 percent of the regular daily salary times the number of days of vacations granted. The following days are mandatory holidays:

- January 1, New Year's Day
- First Monday of February, commemorating Constitution's Day
- Third Monday of March, commemorating President Juarez's Birthday.
- May 1, Labor Day
- September 16, Independence Day
- Third Monday of November, commemorating Revolution's Day
- December 25, Christmas Day

A holiday is also observed every six years on December 1, when a new president takes office.

Year-end Bonus

Employees and workers are entitled to an annual year end bonus, payable before December 20 of each year, which must equal at least 15 days of salary. If a person ceases to work before such date, he or she must be paid the proportional amount earned up to the moment of separation.

Seniority Premium

This premium, which must be equivalent to 12 days of salary for each work year, is granted as follows:

When separation is voluntary and the employee had worked 15 years or more. In case of death, regardless of the employee's seniority. In case of justified or unjustified dismissal, the years of service shall be computed not earlier than May 1, 1970 (when this premium went into effect), regardless of the actual date on which the employee may have begun to work. The portion of salaries exceeding two minimum wages, are not computed for the payment of this premium.

Severance Payments

Mexican employers may not freely dismiss employees without a justifiable cause. To dismiss an employee without being liable for the severance described below, a Mexican employer must:

- 1) Be able to prove, in labor court, if necessary, that the dismissal was for a statutory “just cause”; and
- 2) Give the employee prompt written notice of the dismissal and the “just cause”; therefore, if the employer fails to prove “just cause” as explained below, the employer is obligated to make the following severance payments:
 - a) 3 months of salary;
 - b) 20 days of salary per each year of services rendered;
 - c) A seniority premium, equal to 12 days of salary per each year of services rendered (with a ceiling twice the minimum wage);
 - d) Unpaid salary from the date of the dismissal up to the date of payment; and
 - e) Accrued benefits.

When the employer fails to prove “just cause,” a dismissed employee is entitled to demand reinstatement in the same position with the company. If the employer wishes to avoid reinstatement, then the aforementioned severance compensation should be paid. Certain employees occupying positions considered of trust or with less than two years of services are not entitled to reinstatement.

Employer’s “Just Cause” for Dismissal

The law provides the specific causes for which an employer may dismiss an employee without being liable for severance payment. These causes include, for example, immoral conduct, repeated absenteeism, unauthorized disclosure of trade secrets and unreasonable refusal to follow directions.

Employee’s “Just Cause” for Resigning

An employee may resign and be entitled to severance payment if his employer commits specified acts against him which are listed in the law. Such acts include, for example, reduction of salary, failure to pay salary when due and causing or allowing unsafe working conditions.

Paid Maternity Leave

All employers must provide their female employees with a fully paid maternity leave of six weeks prior to the approximate delivery date and six weeks thereafter. After this twelve week period employers must offer such employees their former positions back, including any vested rights thereunder such as accrued seniority and vacation premium.

Housing for Workers

Employers are obligated to provide housing for their workers. In compliance with this requirement, the Government has created a national fund to finance housing programs (now in the form of loans to workers for the acquisition or improvement of homes). This fund is known as Instituto del Fondo Nacional para la Vivienda de los Trabajadores (INFONAVIT), the National Workers' Housing Fund Institute.

Employers contribute 5 percent of workers' total compensation, with a maximum base of twenty-five times the minimum wage in force in Mexico City (MXPs50.57 per day), on a monthly basis to INFONAVIT. The INFONAVIT comprises representatives from government, labor and private sectors.

Employee's Profit Sharing

In Mexico, employees are entitled to share in a company's profits. At present, this is 10 percent of an employer's taxable income increased by local dividends, which are not taxable, and some adjustments, such as eliminating the effects of inflation (income or deductions), among others.

Prior year losses (NOLS) are not deductible for computing the profit-sharing base. Therefore, if an employer claims a prior year loss deduction for income tax purposes, these losses must be added back to the declared adjusted tax profit in determining the profit-sharing base. Subject to certain adjustments, the payment of profit sharing will be deductible for income tax purposes beginning in 2006.

Distribution of profits to the employees must be made within 60 days following the date when the annual tax is payable or within five months from the closing date of the fiscal year. Non-payment of profit sharing is considered a justifiable cause for a strike by employees. Employees have the right to object to the returns that serve as the basis for profit distribution filed by a company with the Treasury Ministry. The following procedures must be followed:

- An employer must furnish a copy of its tax return and attached schedules to employees within 10 days after filing the company's annual income tax return.
- Within 30 days the labor union or a majority of employees must file their observations to the Treasury Ministry.
- Employees cannot oppose to the final resolution of the Treasury Ministry. An additional distribution will be made if the Treasury Ministry increases the amount of tax profit.

Employees' rights to share in the profits of a company do not entitle them to intervene in its administration.

The following entities are not required to pay profit sharing:

- Newly organized companies during the first year of operation.
- Newly organized companies engaged in the preparation of a new product during the first two years of operation.
- Mining companies during the exploration period.
- Private welfare institutions recognized by law, that use their own resources to carry out social services and are of a non-profit nature, without individual appointment of beneficiaries.
- The Mexican Social Security Institute (IMSS) and decentralized public, cultural, or welfare institutions.
- Enterprises whose capital and gross income are below certain minimums established by the Labor Authorities.

Directors, administrators and general managers of companies do not participate in the profits. The amount received by employees of employers whose income is derived exclusively from personal services cannot exceed the amount of one month's wages. The same shall apply to persons engaged in looking after income-producing property or collecting debts and interest thereon.

Working mothers before and after the birth of a child and victims of work accidents during the time of temporary disability are considered to be on active service. Temporary employees participate in the profits only if they have worked at least 60 days during the year, whereas domestics do not participate at all.

The profit sharing amount to be distributed is divided in two. The first half is distributed equally among all employees on the basis of the number of days worked by each during the year, regardless of their wages. The second half is divided in proportion to the wages earned for work performed during the year (wages are defined as the amount that each employee receives in cash as daily compensation). Other income and overtime are not included. If wages are not fixed, the daily wage is computed based on the average income obtained during the year.

A commission formed by an equal number of employees and employers representatives determines each employee's share and posts it in a visible place on the company's premises. If the representatives of both groups disagree, a Government labor inspector makes the final decision. Employees may file their observations within 15 days and the commission must respond within another 15 days.

Training and Instruction

All employees are, by law, entitled to receive training from their employer. A training program must be approved by Labor Ministry and its implementation shall be entrusted to a Mixed Commission for Training and Instruction, integrated by an equal number of representatives of the employees and of the employer.

Health and Safety

It is mandatory for the employer to provide a safe and healthy environment for employees to render their services. A Mixed Commission for Health and Safety must also be created to investigate causes of illness and accidents and to pursue the means to avoid them.

Unions

The Federal Labor Law recognizes the association of 20 or more workers for purposes of the studying, improving and defending their interests. Employers may also form unions. In both cases, unions require a certification by the ruling Labor Authorities.

There are various types of unions. The most important are company unions (grouping workers of the same company), industrial unions (grouping workers of two or more companies in the same industry) and national unions (grouping workers who render services in one or several companies of the same industrial field in two or more federal entities).

Only unions may request and enter into collective bargaining agreements for purposes of specifying the terms and conditions of employment for all the company's employees, which may include confidential employees even though they could not belong to the union. Generally speaking, salary provisions are reviewed on an annual basis and the remaining terms are negotiated every two years.

Pension Plans

It is becoming more common to establish pension plans in addition to social security pensions. In order for such pension plans to be deductible for income tax purposes, they are subject to certain requirements:

- The plan must be calculated based on actuarial studies that should be compatible with the nature of the benefits included on the plan.
- The plan must be in the form of an irrevocable trust with a Mexican credit institution, or be administrated by some financial institutions.
- At least 30 percent of the provision set up for the plan must be invested in Federal Government securities, and the remainder must be invested in securities approved by the National Securities Commission.
- The plan must cover all of the employees.

Social Security

In Mexico, social security institutions are the entities that participate in a system aimed at protecting employees, their families and their communities in general, from the risks they are exposed to on a day-to-day basis and as a result of the occupational tasks they carry out.

Social security was initially implemented as a preventive tool against possible workplace risks. In case of an accident, the employee would receive the proper rehabilitation and especially his/her wages, by means of temporary or permanent economic labor benefits, based on the job-related sickness or accident.

By 1942, many favorable factors and circumstances influenced the development of social security in Mexico. President Avila Camacho had shown his interest for labor concerns since the first day he took office when he announced the creation of the Ministry of Labor and Social Welfare and assigned it to Ignacio García Téllez, the Minister of the Interior of the previous government. The first matter of hand that had to be addressed was to iron out and reconcile the employer-employee differences.

In December of that same year, a bill was submitted to Congress. Justifying this bill were the ideals of the Mexican revolution. The bill proposed “to protect the workers and ensure their survival, their wages, their productive capacity and the peacefulness of their families; to contribute to the fulfillment of a legal right, external commitments and government promises.” The bill was passed by the Congress and the Social Security Law came into effect by being published in the Federal Official Gazette on January 19, 1943.

The principal objectives of the Mexican Institute of Social Security are:

- Guaranteeing the human right to health.
- Medical assistance.
- Protection of survival means.
- Welfare services necessary for individual and collective well-being.
- Granting of a pension which, as appropriate and upon meeting the pre-requisites as required by the Social Security Law, enable pensioners and retirees to have a decent standard of living.

This objective will be overseen by a decentralized public entity having legal personality and patrimony of its own, the name of which, as stated earlier, is the Mexican Institute of Social Security. This entity is responsible for providing, administering and organizing the welfare services.

Beginning in 1970, an important turning point took place in the way of understanding the national reality. The necessity of making the fruits of the economic development achieved by the country available to everyone is recognized. The Social Security is understood to be one of the most effective institutions to build the social justice among Mexicans and looks for support to expand and consolidate its operations. In 1972, several studies were prepared and many important additions to the Social Security Law were made and passed by the Congress, and published in March 1973. The new Law increased the benefits from the mandatory insurance regime, extended the social insurance to the organized communal landholders, communal and tenant farmers and small farmers, and implemented the nursery and child day-care centers nationwide.

The most recent economic crises have significantly affected the financial and, consequently, operating situation of the Institution. An in-depth self-examination process was performed throughout 1995 to detect anything that was no longer functional and to look, in conjunction with all those involved and the population at large, for a solution to the underlying problems. Such a process gave rise to a bill for a new Social Security Law, which was passed by the Congress and published by the Federal Official Gazette in December 1996. The New Law, among other things, has radically modified the pension system in order to ensure its economic viability and increased equity in both the medium and the long run.

The current Social Security Law was published in the Federal Official Gazette on November 21, 1996. This law underwent important modifications through the Decree amending a number of provisions of the Law that was published in the Federal Official Gazette on December 20, 2001.

The Social Security Law is intended to guarantee the right to health, medical assistance, protection of the survival means and welfare services necessary for the social and collective well-being of workers and their families.

Registration in the social security system may be made under two insurance regimes, namely:

- Mandatory regime.
- Voluntary regime.

Registration is mandatory for those employees economically depending on an employer either on a permanent or temporary basis, members of production cooperatives and such other individuals as determined by the Federal Executive Branch through issuance of the respective Decrees.

Benefits in cash or in kind specified for each insurance category are provided to employees, and are classified under five insurance types, including occupational risks:

- Sickness and maternity
- Invalidity and life
- Retirement, old age unemployment and old age pension
- Nursery/day-care centers and welfare services
- Occupational risk.

Social Security in Mexico provides for voluntary registration for other individuals. Such registrations are governed by special rules for purposes of contributions by: self-employed individuals, domestic staff, communal farmers and others.

The Mexican Social Security Institute is financed by contributions from employers, workers and federal government.

The proportions in which these contributions are made are as follows:

Employer	70%
Worker	25%
Federal Government	5%
Total	100%

Insurance contributions paid to the Mexican Social Security Institute are determined based on each employee's contributory earnings or that commonly referred to in Mexico as the base contribution salary of each employee, from one minimum wage up to a contribution ceiling amount equal to 25 times the minimum wage in force in Mexico City.

Occupational risks

Employers are liable for 100 percent of contributions or taxes payable for Occupational risk and Nursery/day-care center insurance.

Such costs vary depending on the risk classification assigned to a company, as shown by the table below:

	Average Additional percentages
Commercial, professional, administrative, or sales offices	0.54355
Some commercial, warehousing, very light manufacturing and textiles, etc.	1.13065
Light manufacturing and textiles, etc.	2.59840
High risk industry using metals, chemical heat	4.65325
Maximum risk, including construction, mining, heavy industry.	7.58875

For Occupational Risks or Diseases, the Mexican Social Security Institute provides the benefits in kind such as medical, pharmaceutical, surgical and hospital services, as well as prosthesis and orthopedic apparatus and cash benefits. Such is the case of disability that is paid by the Institute beginning on the fourth day up to 52 weeks following an occurrence. This benefit may be extended for an additional 52 weeks or a pension may be granted for permanent total or partial disability. In case of the death of the insured, orphan pension to children and widow/widower's pension to a spouse may be granted, as appropriate.

Retirement, old-age unemployment, old-age pension

Old-age unemployment (after 60 years of age) or old-age pension (after 65 years of age), are payable by either the Mexican Social Security Institute or the AFORE (Retirement Savings Administrator) to which the employee's individual account was contracted upon meeting the requirement of having made at least 1250 credited weekly contributions. Workers who have not contributed the required 1250 weeks, but to whom at least 750 weekly contributions are recognized, are entitled to in-kind sickness and maternity insurance benefits.

The alternatives to enjoy an old-age pension are as follows:

- a) Contracting a life annuity with a public, social or private insurance company chosen by the worker. The life annuity will be annually updated in February based on the national consumer price index, and
- b) Maintaining the balance of the worker's individual account in an AFORE and making scheduled withdrawals from the account.

The AFORE is voluntarily chosen by the worker to manage his/her individual account in which the employer-employee and government contributions for retirement, old-age unemployment and old-age insurance, as well as returns, will be deposited. This account is made up of retirement, old-age unemployment and old-age insurance, workers' housing and voluntary contribution sub-accounts. At the time a worker is eligible for a pension, the AFORE will determine the aggregate amount and pay a monthly life annuity as appropriate. In the event of an inadequate amount in the individual account, and once the savings account has been exhausted, the Federal Government in conformity with the Law, will grant a guaranteed monthly pension equal to one month's minimum wage in force at the time so requested by the worker.

Contributions paid for disability and life, old-age unemployment and old-age insurance, as well as the contributions to the National Workers' Housing Fund are managed directly by the AFORE, which is responsible for itemizing and appropriating the amounts to proper sub-accounts. The AFORE is also responsible for investing the resources of individual accounts in SIEFORES (Investment Entities Specialized in Retirement Funds), provided it is authorized by the worker to invest his/her savings in other investment companies.

The AFORES are defined as financial entities that exclusively, ordinarily and professionally are engaged in managing investment companies.

In order to increase the level of transparency of the workers' savings, a dual scheme was legislated for the management of the funds: the AFORES are charged with management of individual accounts and the SIEFORES have the function of investing these resources to generate more suitable returns with lower risks and a greater profitability. Both entities will act as communicating vessels between the individual accounts.

The SIEFORES are investment companies specialized in savings funds that are created by the AFORES for the only purpose of investing the resources that are obtained by the individual accounts in the manner and under the terms established by the CONSAR (National Commission of Retirement Savings System) and the internal self-regulation programs.

There are three types of SIEFORES:

- a) Investment,
- b) Debt and
- c) Generic

Just like a worker is entitled to change AFORE, he/she may also request for a change of SIEFORE or indicate how he/she wants his/her individual account resources to be invested in many investment companies of the same group.

There are currently about 20 AFORES in Mexico. The main objective of an AFORE is to gain the greatest possible number of workers as clients, thus allowing more competitive commission rates to be charged for management of the accounts.

Invalidity and Life

This insurance protects against the insured's invalidity and death or a pensioner's invalidity, when not due to an occupational risk, by granting of a pension to the insured/pensioner or the beneficiaries.

Sickness and Maternity

This insurance provides the worker and his/her family with the necessary medical, surgical, pharmaceutical and hospital services. In addition, it provides monetary and in-kind benefits including, among others, subsidies for temporary disability and assistance for nursing mothers.

Nursery/Day-Care Centers and Welfare Benefits

This insurance provides the insured and his/her beneficiaries with nursery/day-care centers for his/her children and general social welfare benefits aimed at improving the quality of life and standard of living of workers and their families.

Social security obligations

An employer's social security obligations include those listed below. Failure to comply with these obligations may result in monetary penalties not only for omission but also for late compliance with such obligations.

- Registration as an employer must be made in the IMSS and INFONAVIT within five (5) business days following the commencement of the first employment relationship.
- In case of non-compliance with the obligation above, the penalty imposed by the Social Security Institute is a fine ranging from 20 to 250 times the general minimum wage for the Federal District.
- Notices for registration of employees must be filed within five (5) business days following the commencement of the employment relationship with the worker in question.
- Failure to comply with the obligation above will result in a fine ranging from 20 to 350 times the general minimum wage for the Federal District.
- Notification of changes in employee salary. Deadlines for filing such notices vary depending on the type of compensation. For fixed salary, notices must be filed within five (5) business days after the date of the salary change. For variable salary, within five (5) business days in January, March, May, June, July, September and November. In case of a mixed salary, the rules for the element in question will be applicable.
- The penalty will be a fine ranging from 20 to 125 times the general minimum wage for the Federal District.
- Notification of employment terminations must be made within five (5) business days following the termination.
- The penalty will consist of continue paying the corresponding contributions through the day following that on which the respective notice is filed.

- Accounting records meeting the established legal requirements must be kept and retained for five years.
- A fine ranging from 20 to 75 times the general minimum wage for the Federal District may be imposed by the Social Security Institute, irrespective of those penalties that might be assessed under other regulations.
- Employer's social security and housing savings fund contributions must be paid within the first 17 days of each month.
- The penalty established by the Social Security Law is a fine ranging from 20 to 75 times the general minimum wage for the Federal District. As for the INFONAVIT, the penalty will range from 301 to 350 times the general minimum wage for the Federal District, taking into consideration also for the assessment of the fine, among other things, the number of affected workers.
- Workers' contributions must be determined, withheld and paid within the first 17 days of each month. In addition, amortization payments of housing credits granted to workers must be filed and paid on a bimonthly basis.
- The Social Security penalty is a fine ranging from 20 to 75 times the general minimum wage for the Federal District, whereas the fine assessed by the INFONAVIT is 301 to 350 times the general minimum wage for the Federal District.
- Supporting documentation evidencing payment of the employer-employee contributions, and the relevant printed forms or magnetic means, must be secured and retained for the regulatory 5-year term.
- Should such evidential matter and documentation not be retained for the regulatory term, and be requested by the tax authorities, non-payment of contributions would be presumed and the applicable penalties would be assessed.

Employer-employee Contributions

Social security contributions are determined on the basis of daily contributory earnings, in conformity with the Law, with the following percentages being applicable:

	Employer's percentage	Insured's percentage	Total
Sickness and maternity			
In-kind benefits			
Fixed contribution	19.75%	0%	19.75%
Excess	1.59%	0.56%	2.15%
Monetary benefits	0.70%	0.25%	0.95%
Medical expenses for pensioners	1.05%	3.075%	1.43%
Invalidity and Life	1.75%	0.625%	2.375%
Nursery/day-care centers and welfare expenses	1.00%	0.00%	1.00%
Retirement	2.00%	0.00%	2.00%
Old-age unemployment and Old-age insurance	3.15%	1.125%	4.275%
INFONAVIT	5.00%	0.00%	5.00%

In the case of invalidity and life, as well as for old-age unemployment and old-age insurance and INFONAVIT, beginning January 1, 2007 through June 30, 2007, the contribution ceiling will be 24 times the general minimum wage for the Federal District.

Beginning July 1, 2007 the ceiling for all Social Security insurance contributions, including INFONAVIT, will be 25 times the general minimum wage for the Federal district, this being the latest change in a series of maximum limits set.

“First Job” Program

In order to encourage the generation of new formal and permanent jobs, beginning on March 1, 2007 a subsidy has been established for employers, which may amount up to 100% of the employer’s social security contributions.

The subsidy will be applicable to the social security contributions payable by employers (whether individuals or legal entities) for those new employees joining the company who have never been previously registered in the Mexican Institute of Social Security (IMSS).

An employee is deemed to be a new employee when, in addition to not having been previously registered in the IMSS, as mentioned above, he/she is hired in addition to those that already were working for the company at January 23, 2007.

The subsidy may amount up to 100% of the first 12-months’ social security contributions payable by the employer for the newly hired employees, based on the table below:

Percentage of subsidized employer’s social security contributions

Base contribution salary	Subsidy percentage
Less than 10	100%
From 10 to 14	60%
More than 14 and up to 20	20%
Over 20	10%

The effective term of this decree will be no longer than November 30, 2012. The deadline for both being registered as an employer and enjoy the benefit under this program and registering the employees for which the subsidy benefit is required will be February 28, 2011.

The following requirements must be met to enjoy this benefit:

- The employer, with certain requirements being met, must have been registered with the IMSS as an employer susceptible to enjoying this benefit.

- The employees must have been registered by the employer in the IMSS.
- Registration of those employees deemed to be eligible for this first job program must have been requested by the employer so that the subsidy benefit may be enjoyed.
- Employees subject to the program must remain insured for at least nine uninterrupted months following the date of registration under the first job program.
- The amount of employer-employee social security contributions for all employees must have been determined and paid.
- The employer must have no unpaid final tax liability assessed by the IMSS.
- The subsidy will be obtainable through refund of the respective employer's social security contributions, via deposit made to the checking account indicated by the employer for that purpose, and will begin after the tenth month following the hiring of a new employee, upon the employer's request, providing the employee is retained through the twenty-first month following his/her registration as newly hired employee.

Appropriateness of the subsidy will be determined by the IMSS, with such determinations being final.

Chapter 4

Foreign Investment

Legal Framework for Foreign Investment

The foreign investment legal framework is ruled mainly by the Foreign Investment Law effective as of December 1993, which opens the possibility to foreign investors to invest in various economic activities that were restricted by the former law. This law provides only 11 areas limited exclusively to the Mexican State and 5 others to Mexican nationals or corporations with a foreign exclusion clause.

Among its purposes, this law promotes the benefits of “neutral investment” and intends to simplify the administrative procedures on this subject.

Participation of Foreign Investment

As a general rule, the law allows foreign investors and Mexican companies controlled by foreign investors, without prior approval from the Mexican Government to own up to 100 percent of equity in Mexican companies, acquire fixed assets, engage in new economic fields, manufacture new lines of products, open and operate establishments and expand or relocate existing ones, as otherwise provided for in such law.

Activities Reserved to the Mexican State

Following Constitutional provisions, this law reserves the following areas, because of their strategic nature, only for the State:

- Oil and other hydrocarbons;
- Basic petrochemical;
- Electricity;
- Generation of nuclear energy;
- Radioactive minerals;
- Telegraph industry;
- Radiotelegraph industry;
- Postal service;
- Issuing of currency;

- Minting coins;
- Control of marine ports, airports and heliports; and
- All other services expressly considered as such by the applicable legal provisions (public services).

Activities Reserved for Mexican Individuals or corporations with a Foreign Exclusion Clause

The areas reserved exclusively for Mexican individuals or corporations with a foreign exclusion clause are as follows:

- Retail gasoline sales and distribution of liquid petroleum gas;
- Broadcasting and repetition of television programs and other radio services, excluding broadcast by T.V. cable stations;
- Credit Unions;
- Development bank institutions pursuant to the related law; and
- The rendering of professional and technical services expressly provided in the applicable legal provisions.

Specifically Regulated Activities and Acquisitions

The law also provides activities where foreign capital may only share in certain proportions that range between 10 percent and 49 percent, such as domestic air transportation and basic telephone services. It also provides areas where foreign investment can participate in excess of 49 percent as is the case of legal services or cellular telephone services, subject to prior authorization of the National Foreign Investment Commission.

Acquisition of Property and Use of Trusts

Under the Mexican Constitution, foreign individuals and entities may not hold legal title to real estate in Mexico located within 100 kilometers along the borders or 50 kilometers along the coastlines (Restricted Zone). However, foreign investors may hold the beneficial interest in such real estate under a trust. Real Estate Trusts have a maximum term of 50 years, which term may be extended and the trustee must be a Mexican bank. The law however, allows Mexican companies with foreign equity participation to hold direct title to real estate located in the Restricted Zone, if they engage in non-residential activities and if their by-laws include the agreement executed with the Foreign Affairs Department provided in Article 27 of the Mexican Constitution.

This article provides, among others, that a foreign investor must agree to be deemed a Mexican national with regard to the investment in question, and should not seek the protection of its Government in the event of a dispute, under penalty of forfeiting its interests in favor of the Mexican nation, if it seeks such protection. If foreign investors engage in residential activities they may hold real estate through a trust.

Organization and Modification of Corporations

As to the incorporation of a business entity, the law first requires obtaining an authorization from the Ministry of Foreign Affairs. In addition, such entity's bylaws must include the foreign exclusion clause or the agreement provided in Article 27 of the Mexican Constitution.

Branches

The law provides that in order for foreign business entities to operate in Mexico through a branch, they must first obtain a permit from the National Foreign Investment Commission of the Ministry of Economy. To obtain a permit from such Ministry, foreign business entities must agree with the provisions of Article 27 of the Mexican Constitution.

The law simplifies the approval process by considering an application as authorized within 15 days after such application is filed. Subsequently, the branch must be registered with the National Registry of Foreign Investments and with the Public Registry of Commerce.

All incorporations and opening processes require formalization before a Mexican Notary Public.

Neutral Investment

This investment is available for Mexican Corporations or authorized Trusts to obtain external funds and financing from the public. The corresponding shares will not have voting rights but will have preferential treatment with respect to dividend payments.

Through this investment, corporations may conduct expansion or financial restructuring projects without Mexican investors losing control of corporations while allowing participation of foreign capital.

It is worth noting that this investment is not only available for large companies, but for small and medium size industries too, and this investment is not considered when determining the amount of foreign investment in the capital stock of Mexican corporations.

National Foreign Investment Commission

The law provides the powers of such Commission and determines that it must dictate the policies on foreign investment and establish the terms and conditions applicable to participation of foreign investment. The law provides that the Commission must resolve applications within 45 business days; otherwise, applications will be deemed approved. Accordingly, the law sets forth the criteria under which such Commission must perform its evaluations. .

National Foreign Investment Registry

The law establishes this Registry for Mexican entities, foreign entities and trusts. A significant matter is that a Notary Public may request foreign investors or their representatives to prove their registration at such Registry, and if such registration is in process, they must prove the existence of such filing. Otherwise, the Notary Public may authorize the transaction under disclaimer, but will inform the Registry of such omission.

Penalties

On failing to comply with the provisions of this law, the Ministry of Economy may impose fines that range from one hundred to five thousand times the minimum daily wage in force in Mexico City, and if acts are simulated to allow the use of properties within the Restricted Zone, the penalty will be equivalent to the amount of the transaction.

Another significant aspect of the law is that foreign investors may submit to the consideration of the Office of the General Director of Foreign Investments, the release from compliance with programs, requirements and commitments previously agreed with such Direction. The Director should resolve within 45 business days from the date the application is filed. There are also provisions that allow foreign participation in certain economic areas up to 100 percent of the capital stock of Mexican corporations as from a certain date, there being no need to obtain a favorable resolution from the National Foreign Investment Commission.

Indirect Foreign Investment

Foreign investors may combine direct and indirect investment. Income from indirect investments may be subject to lower tax rates since a parent company's charges to its Mexican affiliate represent tax-deductible expenses (such as technical service fees, royalties, interest and rental payments).

However, foreigners may have to choose indirect investment because of the aforementioned restrictions, existing competition, or other market conditions. The National Foreign Investment Commission is interested in activities that will result in training Mexican technical personnel.

Intellectual Property

In Mexico, there are two different laws regarding intellectual property.

- Industrial Property Law, mainly for inventions, trademarks, industrial designs, and appellations of origin; and
- Copyright Law, primarily for literary, musical, artistic, photographic and audiovisual works.

Both laws were developed from international standards by the World Intellectual Property Organization (WIPO) and are similar to the ones applied by the most important countries.

The most relevant provisions are the following:

- Patents are protected for a 20-year term as of the filing date. Patented foreign inventions that have not yet been produced in or imported to Mexico qualify for a national patent. The patent will be granted to the original applicant abroad, provided that he or she files an application in Mexico within a year of the date of enactment of this law. Such patent protection is available for chemical, pharmaceutical and biotechnological products and processes.
- Industrial and trade secrets are protected. Unauthorized disclosure by any person previously warned as to the confidentiality of the information constitutes a criminal offence.
- Minor inventions qualify for legal protection as utility models for a period of 10 years from the filing date. Also, industrial designs are protected against unauthorized imitation for 15 years.
- Registration of three-dimensional and collective trademarks is permitted.

- The term of protection for a trademark is 10 years from the filing date. An affidavit stating that use had been interrupted for periods greater than three years must be filed when applying for renewal of registration.
- Commercial notices can be protected on nation wide basis for a renewable period of 10 years.
- Appellations of origin are protected in the terms of the Treaty of Lisbon.
- Administrative procedures have been simplified to expedite the granting of patents and the registration of trademarks.

The Mexican Patent and Trademark Office will cooperate with its counterparts in other countries to reduce the local examination process for patents that have already been registered in other countries. Penalties, sanctions and damages can also be claimed.

This law replaces the Law on Inventions and Trademarks, as well as the Law for the Control and Registration of Transfer of Technology and the Use and Exploitation of Patents and Trademarks and its derivative statutes. Consequently, any agreements related to technical assistance, transfer of technology (know-how), royalties or others to which the replaced law makes reference shall no longer be required to be recorded before the extinct National Registry for the Transfer of Technology.

The subject matter of copyright is usually described as “literary and artistic works,” that is, original creations in the fields of literature and arts. The form in which such works are expressed may be words, symbols, music, pictures, three-dimensional objects, or combinations thereof (as in the case of an opera or a motion picture). The law provides for the protection of computer programs as literary works.

The most important provisions of the Copyright Law are the following:

- Copyright protection generally means that certain uses of the work are lawful only if they are done with the authorization of the owner of the copyright.

In Mexican Copyright Law, these rights which together are referred to as “economic rights,” are not exclusive rights of authorization but, in certain specific cases, merely rights to remuneration. In addition to economic rights, authors (whether they own the economic rights or not) enjoy “moral rights” on the basis of which authors are entitled to claim their authorship and require that their names be indicated on the copies of the work.

An exception for this right is in those works of publicity, where the name of the author is not included; the author has the right to oppose to the mutilation or deformation of his/her works.

- The owner of a copyright may generally transfer his/her right or may license certain use of his/her work. This transfer always is for an economic fee, and in every case is temporary. Moral rights are, however, generally inalienable although their exercise may be waived by the author.
- Copyright generally vests in the author of the work. The law provides for exceptions and, for example, regards the employer as the original owner of copyright if the author was, when the work was created, an employee and was employed for the very purpose of creating the work.
- The law provides that protection is independent of any formalities, that is, copyright protection starts as soon as the work is created.
- Copyright protection is limited in time. As a general rule, the term of protection starts at the time of the creation of the work and ends 75 years after the death of the author.
- This law concerns only acts performed in Mexico. Consequently, the law cannot provide for the protection of the citizens of Mexico in another Country.

Antitrust Law (Federal Law of Economic Competition)

This law became effective in June 1993. The ultimate meaning and significance of the Federal Law of Economic Competition will depend on the regulations, decisions and opinions issued by the Federal Commission of Competition, which is a decentralized administrative entity of the Ministry of Economy.

The law forbids monopolies, cartels and activities that, under certain terms, diminish or obstruct the competition and free markets in the production, processing, distribution and commercialization of goods and services. Also, the absolute monopolistic activities are provided in this law and are declared void and are subject to penalties in addition to criminal liability under other laws. Regarding these activities, the law forbids agreements, arrangements or combinations of economic agents that are competing amongst them, whose purpose or effect is to fix, raise, coordinate or manipulate prices.

Acts, agreements, arrangements or combinations whose purpose or effect is to

displace other market agents, substantially obstruct their access to the markets or establish exclusive advantages in favor of one or various persons, under certain circumstances, shall be considered monopolistic activities by this law.

The law provides that the above mentioned Commission should be notified of certain concentrations before they are created, for example, if the transaction's value exceeds an amount equal to 12 million times the minimum daily wage (currently this amount is approximately 55 million dollars); when the transaction implies the accumulation of 35 percent or more of the assets or stock of an economic agent whose assets or annual sales exceed an amount equal to 12 million times the minimum daily wage or when the agents participating in the transaction, individually or jointly, have assets or annual sales for an amount exceeding 48 million times the minimum daily wage (approximately 220.6 million dollars) and if such transaction implies an additional accumulation of assets or capital stock equivalent to 22 million dollars.

Railways Industry Law

This law regulates the construction, operation, exploitation and maintenance of railroads, as well as public railroad transportation and auxiliary services. The mentioned law became effective in May 1995, and allows foreign corporations to participate up to 49 percent and in some cases allows exceeding the mentioned percentage with a favorable resolution from the National Foreign Investment Commission.

Telecommunications Federal Law

It is an important legal instrument, which has improved the telecommunications services, as well as allow an efficient exchange of information between Mexico and other nations.

Radiotelegraphy and telegraphy services are still reserved to the Mexican Government. Foreign investment may participate up to 49 percent in the telecommunications industry. It is possible to participate with higher percentage in the telecommunications industry with a favorable resolution from the National Foreign Investment Commission.

Reporting

Article 35 of the Foreign Investment Law provides that every company or branch registered before the Foreign Investment Registry must annually renew its registration by filing a report at said Registry. For such purposes, a calendar is established based on the first letter of the entity's name, as follows:

- From A to D, during April.
- From E to J, during May.
- From K to P, during June.
- From Q to Z, during July.

In the event the company or branch did not have activities during the previous fiscal year, it is exempted from the referred filing to the extent that it notifies the Ministry of Economy of this situation by filing a copy of the tax return for the previous fiscal year.

The second paragraph of Article 38 of the Regulations to the Foreign Investment Law provides that all foreign individuals or entities, as well as Mexican Companies with foreign participation in their capital stock, shall file an income and expense report at the Foreign Investment Registry on a quarterly basis, in order to keep their registration with this agency updated. Such reports shall be filed in the formats that the Foreign Investment Registry provides for such purposes.

However, the mentioned article provides that this quarterly report shall be filed only when the total quarterly income or expenses are higher than an amount equal to 3,000 times the minimum wage in force in Mexico City, provided that such income or expenses arise from any of the following:

- New contributions or withdrawals made by foreign Shareholders to or from the company, not affecting the capital stock, i.e., contributions to reserve funds or withdrawals from said funds.
- Withholding of gains from last fiscal year or use of accumulated withheld gains.
- Loans to be paid or collected from subsidiaries resident abroad, the main office abroad, to foreign investors residing abroad who participate in the company's capital as Partners or Shareholders, and foreign investors abroad that are part of the same corporate group as the foreign individual or entity or the Mexican company filing the report.

Loans and Equity contributions

Due to a FTC modification, if a company receives a Loan or Equity contributions for more than \$600,000 mxp (55,000 USD) the company that receives such amount must inform tax authorities about this funding 15 days after the reception of the money, if there is a failure in the inform, such amount will be considered as accruable income.

Chapter 5

Conducting Business in Mexico

There are several ways in which a foreign corporation or individual can do business in Mexico, either through an agent or representative, through a branch of a foreign company or through a subsidiary company organized in Mexico.

Mexican Partnerships and corporations

Legal entities may be organized in various forms under Mexican law:

- Sociedad en Nombre Colectivo - The usual general partnership form.
- Sociedad en Comandita Simple - A limited partnership with some general partners (having unlimited liability) and some limited liability partners; its capital is represented by social interests.
- Sociedad en Comandita por Acciones - A limited liability stock partnership with some general partners (having unlimited liability) and some limited liability partners; its capital is represented by shares.
- Sociedad de Responsabilidad Limitada or "S. de R.L." - A partnership with limited liability for all its members, in which the capital is represented by social interests.
- Sociedad Anónima or "S.A." - Entity similar to the US Corporation, in which all its members have limited liability and its capital is represented by common shares.
- Sociedad Anónima Promotora de Inversión or "SAPI" - as of June 2006, this new type of entity is eligible to investors. This entity is organized in general terms as an S.A. but it is exempt from certain obligations resulting on the ability to give to its shareholders further corporate and economical rights. The SAPI is recommendable for Joint Venture projects or for entities which may become Publicly Held Companies.
- Sociedad Anónima Búrsatil or "SAB" entities that issue shares listed in the Mexican stock Exchange (BMV)

General partnerships are not typically used by foreign investors due to their lack of limitation on the liability of the partners.

Although for tax purposes in Mexico an S de R.L. is treated exactly as any other mercantile entity, for tax purposes in the US, it may be considered as an eligible entity for partnership status. In this regard, if the partners of an S. de R.L. are from the US, either a corporation or an individual, they will benefit from the pass-through taxation rules.

The S.A. is by far the most common business entity used by foreign investors in Mexico. Further discussion in this chapter is focused on this type of corporation. On the other hand, both an S.A. and an S. de R.L. may be incorporated under the mode of variable capital ("de capital variable"), in which case the capital of the company may be increased or decreased by simple shareholders' or partners' resolution, as the case may be, without the need for further formalities. The shareholders may reimburse their contributions to the variable capital without any special formalities; however, they cannot reimburse the portion of the fixed capital, which has to remain at the minimum mandatory amount.

Organizing a Mexican corporation

An S.A. must have fully subscribed capital of at least MXP\$50,000 pesos. One fifth of the share capital is payable at the time of subscription, when the subscription is for cash. However, if the capital contribution is in kind, the capital must be fully paid. The company may be formed by incorporation or by public subscription, but in either case it must be registered at the Public Registry of Commerce.

Shareholders' liability is limited to the amount of their contributions. When shares are issued for property ("Treasury Shares"), they must remain in escrow for two years as protection against property of little value being exchanged for shares.

Any outstanding balance on shares must be paid within five years. Other factors that apply to stock ownership include the following:

- Different classes of shares may be issued and shares may or may not carry par value; all shares within a certain class have equal rights and value; shares cannot be issued at a discount; a company cannot own its shares; all shares must be issued and subscribed, except those of an S.A. de C.V.
- The capital may be increased or decreased by the shareholders of a fixed stock capital corporation. A fixed stock capital corporation or a variable stock capital corporation may have only registered shares.

Number of Shareholders

There must be at least two shareholders to organize an S.A. The General Corporations Law does not require a specific number of the shareholders to be Mexican individuals or entities other than as required under the Foreign Investment Law described earlier since the restrictions of the law focus on the type of activity developed by the corporation. Consequently, all of the shareholders of corporations that qualify to be totally foreign owned may be formed by foreign investors that could be individuals or corporations.

Shareholders' meeting

The most important governing body of the company is the shareholders' meeting, which must be held at least once a year within three months of the close of the company's fiscal calendar year. This meeting approves, rejects or modifies financial statements, elects the sole administrator or board of directors and also elects the statutory examiner (comisario). Extraordinary shareholders' meetings must be held to rule on increases or decreases in fixed capital, liquidations, mergers and other items of a special nature which implies a modification of the by-laws of the corporation.

Ordinary shareholders' meetings require a quorum representing 50 percent of the company's capital stock, and resolutions are passed by a majority vote of the shares represented. On the other hand, special shareholders' meetings require a quorum of 75 percent of the capital stock unless the by-laws require a higher percentage. Resolutions must have a favorable vote of at least 50 percent of the share capital. All shareholders' meetings must be held at the company's legal address. The sole administrator, directors and statutory examiner cannot hold proxies for voting.

The Shareholders' Meeting minutes must be summarized with at least fifteen days prior to the execution of the Meeting, but if all shareholders are represented at the Meeting, this summary is not necessary.

The minutes of Extraordinary shareholders' meetings must be notarized and registered before the Public Registry of Commerce. Directors may not vote in connection with the approval of financial statements.

The by-laws may provide that resolutions taken outside the shareholders' meeting and approved unanimously by the shareholders representing the total of the voting shares or of the special category they belong to, as the case may be, will have, for all legal purposes, the same force as if taken within the shareholder's meeting, as long as resolutions adopted are confirmed in writing. A corporation is required to keep Corporate Books in order to keep record of the Shareholders' minutes.

Voting trusts between shareholders are not permitted, and shareholders must have full freedom to vote their stock. Thirty-three percent of shares is enough to call a shareholders' meeting for a particular reason or to postpone voting for three days on any matter discussed at a shareholders' meeting.

Thus, a minority shareholder holding 33 percent of the shares can cause procedural problems. Any shareholders who oppose proposed changes in the corporate purpose, corporate nationality or reorganization of the company can request reimbursement of their shares at the book value listed on the last balance sheet approved by the shareholders' meeting. This reimbursement must be requested within 15 days after the corporate change was agreed.

Management Structure

In a general meeting, the shareholders may appoint a sole administrator or a board of directors (depending on what the deed of incorporation provides). These administrators or directors may or may not be shareholders. The quorum for a board meeting is at least 50 percent of the directors, and resolutions are passed by a majority vote of those present. However, the chairman of the board has the deciding vote.

The by-laws or the general shareholders' meeting, as the case may be, may establish the obligation for administrators and managers to grant a guarantee to cover any liability that may arise while performing their duties.

Shareholders representing 25 percent of the share capital have the right to elect one director. Directors may be foreigners who live abroad and directors' meetings may be held anywhere. Where a quorum is not present the statutory examiner has the right to appoint provisional directors. The resolutions of the Board of Directors must be recorded in a Corporate Book that must be kept by the corporation.

Legal Representatives

Legal representatives of corporations can be Mexican nationals or foreigners. In both cases they should have a Mexican taxpayer registration number (tax I.D. number).

However, the legal representation of the corporation corresponds to the Sole Administrator or the Board of Directors, and their faculties commonly are granted in the by-laws of the corporation

Year-End

The fiscal year of corporations organized within the calendar year will run from the day in which they were incorporated through December 31. Any subsequent fiscal year shall run from the first to the last day of every calendar year, except in the case of the corporation's liquidation or winding-up.

Accounts

Corporations must prepare the following financial information within three months of the close of the year-end: a balance sheet, an income statement, a statement of shareholders' equity, a statement of changes in financial position, and the necessary footnote disclosures. A management report containing all the foregoing information should be delivered to the statutory examiner at least one month before the shareholders' meeting. Within 15 days of receiving this information, the statutory examiner should prepare an opinion and any proposals for change. Although this is a tight schedule, in practice the financial statements are usually ready for the audit in plenty of time to issue an opinion, as required by law.

The financial information and the statutory examiner's report must be in the hands of the Sole Administrator or the Board of Directors and available for inspection by the shareholders at least 15 days prior to the shareholders' meeting. Fifteen days after approval by the shareholders, the financial statements, footnote disclosures and statutory examiner's report should be published in the Official Gazette of the jurisdiction where the company has its address, and a copy must be delivered at the Public Registry of Commerce. If there are any votes against approval, these must also be published and registered. If the financial information and statutory examiner's report are not ready in time, the shareholders may dismiss and take action against both the directors and the statutory examiner.

Duties of the Statutory Examiner

All companies must appoint one or more statutory examiners at the annual general shareholders' meeting. Shareholders owning 25 percent of the capital stock can appoint a statutory examiner.

Statutory examiners must not be employees of the company or blood relatives of any board member. However, they may own shares in the company and are required to guarantee the performance of their duties by a bond or a nominal cash deposit.

In addition to reporting on the company's year-end financial information, statutory examiners should examine the books and records, as well as the monthly balance sheet and income statement at least once a month. They have the right to modify the agenda for shareholders' and directors' meetings and can call shareholders' meetings whenever considered necessary. Although they must attend all shareholders meetings and board of directors meetings, they have no voting rights at such meetings.

Statutory examiners must be informed in advance of all meetings. In addition, if a shareholder advises a statutory examiner of any irregularity, the statutory examiner must report on this, with recommendations at the shareholders' meeting. Statutory examiners are held jointly responsible with the company for any legal violation.

Although the duties and obligations of statutory examiners are fully detailed in corporate law, no mention is made of the qualifications they must have.

Environment

The General Law of Ecological Equilibrium and Environmental Protection (the "Environment Law"), enacted in 1988, is the primary Mexican environmental statute. It contains specific chapters concerning air, water, soil, hazardous waste, noise, vibration, thermal energy, lighting, odor and visual pollution. It also sets out enforcement procedures and other provisions concerning the respective responsibilities of the Federal and State Governments.

SEMARNAT

The Ministry of Environment and Natural Resources (SEMARNAT) is the federal body which oversees the enforcement of the Environment Law and sets national policy procedures through the frequent issuance of technical standards to control the allowable level of emission of pollutants. Although several of Mexico's 31 States and the Federal District have also enacted environmental laws, SEMARNAT is the only Governmental entity actively engaged at present in enforcement and the only entity empowered to enact and enforce laws regarding hazardous wastes. Nevertheless, all activities conducted in Mexico must comply with the Federal and State laws.

The Environment Law provides a licensing system based upon media-specific discharge limitations for air emissions and wastewater discharges and for the generation, transportation, handling and disposal of hazardous waste. All companies operating in Mexico must limit the amount of pollutants that they release or discharge within the specific ranges issued by SEMARNAT. In addition to establishing technical standards applicable to all wastewater discharges, the wastewater regulations specify the allowable discharge level for specific contaminants. For example, the specific industry discharge limitations apply to glass, textile, petroleum, construction, synthetic rubber, tire, upholstery, sealant, sugar cane, carbonated beverage, lumber, meat packing, leather, fertilizer, plastic, synthetic polymer, beer, milk, metal, paper, food packing, iron and steel industries.

All companies must comply with the licensing system provided by the Environment Law. Depending on the nature of its activities, a company may be required to file for an operating license; file an environmental impact statement; file for a residual water discharge license; file for an air discharge license; and register, file and maintain documents concerning hazardous wastes.

Environmental Impact Statement

Environmental impact statements must be filed for a wide range of proposed activities, generally whenever the activity may cause ecological imbalance or exceeds the limits and conditions provided for in the ecological technical standards and regulations issued by the Federal Government.

The Environment Law defines the term “ecological imbalance” as “alteration of the independent relationships between natural elements which form the environment, and which negatively affects the existence, transformation and development of man and other beings.”

SEMARNAT has taken the informal position that the best way for a company currently operating or contemplating future operations to ensure compliance with the Environment Law is to file an environmental impact statement. Upon receipt of the statement, the Government may fully authorize the activity, authorize the activity on the condition that changes must be made, or deny a license for the activity.

Operating License

All “fixed sources” which emit odors, gases, solid particles or liquid particles into the air, i.e. all manufacturing plants, including those plants which were operating prior to the enactment of the Environment Law, must obtain an operating license from SEMARNAT. SEMARNAT may grant or deny the license or require changes to be made.

Chapter 6

International Trade

Import and Export Duties

All individuals or corporations importing goods into Mexico must pay import duties, which are determined based on the customs value of the goods. This value generally includes the purchase price at the date of importation, plus expenses incurred by the buyer for its delivery, including freight and package charges between the exporting place and the port of entry into Mexico. The duty rate is applied to the aforementioned value, in accordance to the tariff classification number of the goods, as provided in the General Importation and Exportation Duty Law.

In general terms, duties are payable on the importation of goods intended to remain in the country for an undetermined period. Goods imported into Mexican territory during 2006 were subject to an import duty mean of 11.0%.

With some exceptions, the vast majority of goods that qualify as originating in accordance with the North American Free Trade Agreement, the Mexican European Union Free Trade Agreement and other trade treaties entered into by Mexico with other countries, are either duty free or handled with a preferential duty. Furthermore, it is worth noting that such trade treaties have a scheduled gradual phase-out of the current import duties applicable.

On the other hand, all exportations of products manufactured in Mexico are exempt from Mexican export duties.

Mexico's Trading Partners

During the last 10 years, Mexico's Foreign Trade Policy has strategically focused on establishing strong commercial alliances with other countries. Such alliances have placed Mexico as a major player in many foreign markets. The Mexican government has negotiated twelve free trade agreements, which provide preferential entry to 43 foreign markets on three continents. Through these commercial treaties, Mexican exporters have access to over 860 million consumers, thus resulting in an enormous advantage to the exporting industry.

These free trade agreements are:

1. North American Free Trade Agreement - NAFTA (Canada and the United States of America)
2. Mexico - European Union Free Trade Agreement (Austria, Belgium, Denmark, Finland, France, Luxembourg, the Netherlands, Portugal, Spain, Germany, Greece, Italy, Ireland, Sweden, the United Kingdom, Poland, Estonia, Lithuania, Slovenia, Slovakia, Malta, Hungary, the Czech Republic and Cyprus.)
3. Mexico's Free Trade Agreement with the European Free Enterprise Association (Norway, Iceland, Liechtenstein, Switzerland).
4. Free Trade Agreement with Japan.
5. Northern Triangle Free Trade Agreement (El Salvador, Guatemala, Honduras)
6. Mexico and Chile Free Trade Agreement
7. Mexico, Colombia and Venezuela Free Trade Agreement. (Venezuela opted out from this agreement in 2006).
8. Mexico and Costa Rica Free Trade Agreement
9. Mexico and Bolivia Free Trade Agreement
10. Mexico and Nicaragua Free Trade Agreement
11. Mexico and Uruguay Free Trade Agreement
12. Mexico and Israel Free Trade Agreement

In addition to the abovementioned international trade treaties, Mexico also participates in a number of trade organizations, such as the Latin American Association for Integration (ALADI), the Organization for Economic Cooperation and Development (OECD), the Asia-Pacific Economic Cooperation Mechanism (APEC), and though not a member, holds strong commercial links with the member countries of the Common Market of the Southern Hemisphere (MERCOSUR). Mexico's numerous trade alliances and strategic geographical position have placed the country among the world's major trading powers.

North American Free Trade Agreement (NAFTA)

NAFTA became effective in January 1994. Its approval has created one of the largest trade zones in the world with more than 360 million consumers within its borders. The main purpose of NAFTA is to gradually reduce and eliminate import duties between the United States of America, Canada and Mexico.

Currently, 99% of all imports are duty-free, and by January 2009, all NAFTA imports into Mexico will be duty-free. In addition, it intends to eliminate technical barriers, such as import permits and other non-tariff barriers. On the other hand, it seeks to develop fair and expedite procedures for the resolution of controversies and disputes.

NAFTA also intends to increase international competitiveness and regional trade between the three participating countries, as well as to protect the environment and provide better labor conditions. NAFTA's main goals are:

- To phase-out qualitative and quantitative barriers;
- To avoid dumping practices;
- To increase investment opportunities;
- To protect intellectual property rights; and
- To promote trilateral cooperation.

Mexican European Union Free Trade Agreement

The European Union, as Mexico's second largest trading partner, was one of the driving forces for creating a common market. Consequently, the Mexican European Union Free Trade Agreement became effective in July 2000. Since then, European investment and trade relations with Mexico have increased.

Among its main objectives, the treaty seeks to gradually phase out import duties, administrative and customs barriers, protect intellectual property rights, promote fair market competition and foster cross-Atlantic business ventures and employment opportunities. Though the new trade relations stemming from the agreement are relatively young, the commercial ties that have been established have notably increased foreign investment into Mexico and permitted the entry of Mexican goods in European markets.

In accordance with the treaty, all Mexican manufactured products had duty-free access to the European Union since 2003, while only approximately 52 percent of the European Union industrialized products had duty-free access to the Mexican market. However, beginning in 2007, all European Union manufactured products will also enjoy a duty-free entry into Mexico.

Export Promotion Programs

Mexico's foreign trade policy has emphasized the promotion of exports, particularly non-oil exports, mainly through the creation of export programs. Such programs are regulated by the Ministry of Economy and grant additional tax and administrative advantages to the exporting industry. The main exporting programs promoted by the Ministry of Economy are:

- Manufacturing, Maquiladora and Export Service Decree (DIMMEX)
- Highly Exporting Company Program (ALTEX)
- International Trade Enterprises (ECEX)
- Sector Promotion Programs (PROSEC)
- Drawback

Manufacturing, Maquiladora and Export Service Decree (DIMMEX Program)

Since November 13, 2006, the DIMMEX program has consolidated both the Maquila and PITEX Decrees into one single export promotion instrument. Such program allows industrial or service operations aimed at assembling, transforming, manufacturing or repairing goods originating abroad, which are imported on a temporary basis, to be subsequently exported. Additionally, it entails services that are destined for export.

In general terms, the goods, raw materials and components imported under the DIMMEX program enter Mexico on a temporary basis, duty-free and value-added tax (VAT) free, provided that said goods are exported back within the timeframes established in the DIMMEX Decree. On the other hand, foreign machinery and equipment imported under the DIMMEX scheme will be subject to the corresponding import duties, but will benefit from a VAT free entry.

Mexican corporations may apply to participate in this program, regardless of how their capital stock is structured. Such corporations may establish their facilities anywhere in Mexico, and their purpose must be to export their production (although they may sell a certain percentage of the total production on the Mexican market). Likewise, already established companies may become engaged in this kind of operation, if they compete with their products in the domestic market and desire to use their production capacity to export.

This program also offers opportunities to companies engaged in export projects through foreign companies that provide technology and raw materials but not involved in managing such projects.

To qualify for the DIMMEX (see chapter 2) program the exporting entity must annually export a minimum of US\$500,000, or export at least 10% of the company's total annual sales.

The modalities of DIMMEX in which authorized entities may operate are as follows:

- a) Industrial: engage exclusively in elaboration, transformation and repair processes upon temporarily imported goods destined exclusively for export.
- b) Controlling: consolidate the production of manufacturing activities performed by two or more industrial DIMMEX entities.
- c) Service: perform services upon goods imported on a temporary basis, such as storage, distribution, packaging, recycling and minor processes that may not be deemed elaboration, transformation or repair, call centers, logistics, customer service, etc. (It should be noted that an exhaustive list of activities that may be rendered by the aforementioned entities are included in an Annex of Foreign Trade Rules issued by the Ministry of Economy.
- d) Shelter: Provide administrative and technical services related to the operations inherent to its authorized activities, such as accounting, payroll services and product supervision.
- e) Outsourcing: Enables certified enterprises to subcontract manufacturing entities in Mexico that perform manufacturing activities on their behalf.

Highly Exporting Company Program (ALTEX)

Through the main purpose of this certificate is to obtain preferential treatment and simplify paperwork. For such purposes, the Ministry of Economy coordinates with the Tax Administration Service (SAT), the granting of the following benefits to the ALTEX certified companies:

- Refunds originating from a VAT credit balance are processed in five working days (ordinary processing time is forty business days);
- Preferential and simplified customs treatment during export operations;
- Free access to the Ministry of Economy's commercial information system.

Individuals or corporations that manufacture non-oil goods can apply for this program, if they can prove that they sell at least 2 million US dollars abroad yearly, or 40 percent of their total annual sales. If they are indirect exporters, they will have to prove indirect export sales of at least 50 percent of their total annual sales.

International Trade Enterprises (ECEX)

The main purpose of these corporations is to promote the trade of Mexican products to be exported by:

- Integrating and consolidating export offers, in accordance with the international market requirements;
- Identifying and satisfying demands of Mexican goods abroad;
- Developing international distribution channels;
- Promoting exports of middle and small-sized companies; and
- Integrating national spare parts and components to export goods.

These corporations perform market research, develop strategies and marketing programs, analyze traffic operations and logistic problems of goods, including freight, insurance, customs handling and documentation, amongst other activities.

ECEX corporations will enjoy the following benefits:

- Preferential filing process for obtaining the ALTEX certificate;
- Preferential filing process for obtaining the PITEX program;
- Free commercial information service; and
- Access to the financial incentives program established for these corporations by the Foreign Trade Bank (Bancomext).

Sectorial Promotion Programs (PROSEC)

Since a wide number of Mexican enterprises heavily depend on foreign sourced goods and components, the Mexican government, through the Ministry of Economy, decided to reduce the tariff impact on the importation of goods and inputs utilized by manufacturing entities by creating the Sectorial Promotion Programs. Said program is intended to reduce import duties of goods and inputs that cannot be sourced within Mexican territory, with the only requirement that these are utilized to elaborate a final product in Mexico, regardless of final destination. Currently, the program covers over twenty-two important industrial sectors, such as electric, electronic, chemical, automotive, capital assets, textile and pharmaceutical, among others.

To qualify for this program, prior to the importation, the company must consult the sectorial listings to verify which goods may be imported under the PROSEC scheme, meet certain terms and file for the program's authorization with the Ministry of Economy.

Drawback

Manufacturers that import under a permanent import regime and later incorporate the imported goods to an export-oriented finished product or return said foreign goods in the same physical state as they were imported, may take advantage of the drawback program, which allows the refund of the import duties paid at the time of entry of such goods.

To benefit from this program, said imported goods must be incorporated into finished export-oriented products, or returned in the same physical state within a year from the date they were initially imported. The program will likewise benefit the entities that sell such goods to companies with DIMMEX and/or ECX programs, provided that the sale was performed within the aforementioned timeframe. In any case, the drawback refund application must also be filed within the mentioned period.

Import License

All import (and export) operations must be conducted by a previously appointed customs broker. Nonetheless, importers must be registered with the National Importers' Registry to be allowed to import goods into Mexico; in specific cases, importers of certain specific goods may need an additional license to import the goods.

Customs Account

Importers may also elect to deposit import duties, countervailing duties and value added tax incurred due to their import operations by depositing the corresponding amounts in a Customs Account opened in any authorized bank. This option is applicable if the goods imported under this scheme are exported in the same physical state within a year following the date of importation. Nevertheless, contingent upon the filing of the corresponding notices, said period may be extended to a maximum of two additional years.

The importers that opt to abide by this procedure will be entitled to the corresponding refund of the funds deposited along with earned interests, prorated by the number of days the goods stayed in the country with respect to the number of days allowed for their depreciation in accordance to the Mexican Income Tax Law, if and only if the previously imported goods have been duly exported.

On the other hand, if the importer were to decide not to export the aforementioned merchandise, a notice must be given to the bank or brokerage firm so that the deposited funds along with the accrued interest can be transferred to the Federal Treasury. In this manner the import duties, countervailing duties and value-added taxes arising from the import operation will be considered as duly paid.

Enterprise Customs Certification

As of 2003, Mexican corporations regularly engaged in import and export operations may file for a customs certificate with the SAT. This certificate, which must be renewed on an annual basis, will benefit the holder's import and export operations in the following administrative incentives:

- The certified company may conduct import-export operations through any customs broker, including those that otherwise prohibit the entry or dispatch of certain types of goods.
- Preferential treatment and simplification of customs and administrative procedures.
- Filing preference for specific import licenses of goods found listed under certain sectors.
- Preference in the reduction of certain fines and sanctions.

To qualify for such certificate, among other requirements, the company must be a Mexican incorporated entity, up to date with its tax obligations and have the financial statements of the last five tax years certified by an independent auditor. If the company is newly incorporated and has not operated for five tax year, the auditor's certification will be required for the years it has been in operation.

Strategic Private Bonded Warehouses

In July 2003, the Strategic Private Bonded Warehouses (SPBW) concept came into effect in Mexico, but it was in August 2004 that the defining administrative regulations regarding documentation and procedures were released by the SAT, which in Mexico also oversees customs activities. The SPBW is a new legal import regime under which foreign or domestic goods may be stored in confined spaces that are managed by private Mexican companies. The principal innovation of the SPBW is, unlike imports made into traditional bonded warehouses (bonded warehouses owned in Mexico by the financial system) where only warehousing, display, sale, labeling, packaging or sampling activities are permitted under the operating control of the bonded warehouse, at an SPBW private companies are authorized to manufacture and transform the raw materials entered in the SPBW into finished products.

Goods imported into Mexico and housed in an SPBW may remain in the SPBW for two years. Machinery, administrative equipment, furniture and general fixed assets may remain in the SPBW for as long as they are depreciated for income tax purposes, which generally is a 10-year term. It should also be noted that companies storing goods in a SPBW are not required to be authorized under a DIMMEX program that entails complicated administrative controls on the part of the companies

Tax Issues and Import Permits

There are two principal tax and administrative advantages to companies that house goods in a SPBW:

1. Foreign goods are not liable for import tariffs or countervailing duties (except when rules of Trade Agreements are applicable regarding the restrictions on refund of customs duties on export products or tariff deferment programs), and
2. They are not subject to VAT on importation or general excise tax (imposed on imported beverages, alcohol, cigarettes, soft drinks, etc.) for as long as they are not removed from the SPBW for definite importation into Mexico.

Furthermore, goods entered in a SPBW are not required to comply with nontariff regulations and restrictions (i.e., previous import permits, quotas, country of origin marking, etc.) or Mexican official standards, other than sanitary, environmental or national security standards.

Shrinkage, is not subject to import tariffs or foreign trade taxes, whereas waste must be destroyed in conformity with administrative controls.

Chapter 7

Important Tax Provisions

Tax Legislation

Mexico's tax legislation is comprised of several laws containing provisions regarding each specific tax. Taxes are usually levied on income, capital and certain transactions. The fundamental legal structure of taxation is defined by the Mexican Constitution, which establishes procedures whereby Congress enacts tax laws.

In addition to special tax laws there are some basic laws that relate to general tax administration, such as the Annual Revenue Law and the Federal Tax Code. Most of the laws have a series of regulations issued by the tax authority, which provide some procedures and interpretations.

Annual Revenue Law

Effective January 1 of each year, the Annual Revenue Law establishes the federal taxes, duties, fees and all other types of internal revenue payable to the federal government during that calendar year. However, tax administration is in accordance with the applicable tax laws for each specific tax.

Federal Tax Code

The Federal Tax Code (FTC) provides the basic tax administration procedures applicable to federal tax laws, unless specific provisions are contained in these laws.

Generally speaking, it provides definitions for taxes, taxpayers, domicile, resident status, and exemptions, as well as rules relating to administrative procedures, litigation before tax courts, penalties, statutes of limitation, reimbursements and others. The major provisions of the FTC are summarized in the following paragraphs.

Domicile

The domicile of an individual engaged in business activities is considered to be his or her main place of business. For individuals rendering independent personal services, it is the permanent base from which such services are rendered. If an individual does not have a domicile through which he or she carries out business activities or a permanent base in which independent services are rendered, the domicile is considered to be his or her permanent home.

The domicile of a corporation is considered to be the place of the business's main administration.

Residence

Individuals are considered Mexican residents (solely for tax purposes) when they establish their place of abode in the country. If such persons have their place of abode in another country, they would be considered Mexican tax residents if they have their vital centre of interest in Mexico.

For these purposes, the vital centre of interest is in Mexico when:

- a) 50% of the revenue is derived from Mexican sources.
- b) Main place of activity is situated in Mexico.

Mexican individuals who change their residence to a country considered as a preferential tax regime would be still considered residents in Mexico for four years from the date in which new residence is established, unless that country has entered into an information exchange agreement with Mexico.

Legal entities are deemed Mexican residents when the principal business administration or effective control is established in Mexico.

In this respect, the Treasury's criteria contained in the current Miscellaneous Resolution considers that such situations arise when the shareholders' or board of directors' meetings are held in Mexico; the persons making the day-to-day decisions dealing with the control, direction or management of the legal entity incorporated abroad are Mexican tax residents or have offices in Mexico; there is an office in Mexico in which the management or control of the legal entity incorporated abroad is carried out; or the accounting books are kept in Mexico.

Taxpayers' Registry and Advanced Electronic Signature Certificate

The federal tax authority maintains a registry where all taxpayers must apply for a registration number and an Advanced Electronic Signature Certificate.

Failure to have a taxpayer registration number generates penalties. Most of the states also have their own registries for local tax purposes.

Non-resident partners, shareholders or associates participating in companies or joint ventures are not required to register in the Taxpayers' Registry, provided that the Mexican company or joint venture files a listing of these partners, shareholders and associates, indicating their domicile, tax residence and foreign tax identification number during the three months following the closing of each period.

Examination of Returns and Statute of Limitations

Tax authority is entitled to examine and assess additional taxes for any year at any time within a five-year period commencing on the day following the day taxes were due or tax returns were filed, including amended returns: if the taxpayer has deducted tax losses from the tax profits, the tax authority is entitled to examine and assess the information related to such tax loss, regardless of the exercise in which it was generated up to 5 years after the amortization off the loss. For this purpose, the tax authority may audit the taxpayer's operations or third parties' operations related to those of the taxpayer. The same five-year period applies to taxpayers' claims for refund of tax overpayments.

A special ten-year statute of limitations applies to cases in which the taxpayer has incurred major irregularities such as no having tax ID number, failing to file a return, or not properly maintaining accounting records.

Fiscal Period

The fiscal period must be twelve months for legal entities and individuals, coinciding with the calendar year, except for the initial and liquidation periods. Therefore, the start and closing dates must always be January 1 and December 31, respectively. This period does not apply in settlement or liquidation of an entity.

Updating (Restating for Inflation)

Late tax payments will be restated using inflation indices from their due date to the actual date of payment. Interest for late payment and penalties are computed on the updated taxes.

Tax and related items authorized for extension will also be updated with inflation indices.

All balances in favor of taxpayers that should be refunded by the tax authority will also be updated with inflation indices from the date of filing the return that shows the balance in favor or the payment was made to the date of actual refund. The term for making the refund is forty business days. If the taxpayer files tax reports, the refund period should not exceed 25 business days.

Interest for late payment will be applied on updated tax payments at a rate determined annually by Congress. Generally speaking, surcharges are limited up to five years and in certain cases of major irregularities are limited up to ten years.

The same rules for late interest payments are applicable to interest payable by the authority for untimely refund of taxpayers' favorable balances.

Offsetting

Balances in favor may be offset by taxpayers and will also be updated with inflation indices from the month in which the amount is in favor, to that in which the offsetting is effected.

Favorable balances derived from federal taxes may be offset according to the requirements established by the tax authority through general rules that must be fulfilled by the taxpayers.

Amended Returns

Taxpayers may only file three amended returns to modify the original one, provided that the tax authority has not initiated an audit. This limitation will not apply when there is an increase in taxable income or in the value of taxed activities (VAT); there are less deductions or net operating losses or creditable taxes and/or offset amounts; and when the taxpayer has its financial statements audited for tax purposes, and may correct his original tax return as a result of the audit tax report.

Verification powers

The authorities are authorized to require from the taxpayers the documentations or vouchers that prove the legal stay, property and importation of goods.

In exercising their verification powers, and ascertaining compliance with tax obligations with respect to taxes and periods already reviewed, the tax authorities may only do so when dealing with different events and many base their review on the documentation supplied by the taxpayers with the defense means filed by the latter.

Audited Years

Where the authorities determine omitted taxes corresponding to a year that has already been reviewed but that arise from different events, such determination should be supported by information supplied by third parties.

Likewise, the determination should rely on specific concepts not previously reviewed and also on information that taxpayers have already contributed through the defense means filed and not produced before the tax authorities during the exercise of their verification powers.

Presumptive determination

As of 2008, it shall be deemed that deposits in bank accounts during a given fiscal year, of persons who are not registered in the Federal Taxpayer's Registry (RFC) or not required to keep books in excess of \$1,000,000 are income on which taxes should be paid.

Appeal Procedures against Tax Assessments

Taxpayers are granted a period of 45 business days in which to file with the Ministry of Treasury an appeal for reversal at the administrative level resolution or to elect to initiate legal proceedings against the federal tax court as a result of an assessment derived from a review of taxpayer returns.

Accountants and attorneys often take part in preparing such appeal and may be in charge of handling the appeal. The appeal must be filed in writing and must state the grievances caused by the decision, with evidence offered. A copy of the Ministry of Treasury's decision must be attached to the appeal.

The authority in charge of deciding for or against the appeal issues a decision within three months of the filing date.

Collection of tax assessment is suspended at the taxpayer's request during the handling of appeals or legal proceedings, provided that the amount of taxes involved and surcharges thereon is guaranteed. Generally, this guarantee is given by means of a bond.

Court and Legal Recourses Available to Taxpayers After Administrative Relief is Exhausted

If an unfavorable decision is issued and administrative relief has been exhausted, the decision may be appealed at the federal tax court within 45 business days. Legal proceedings are handled by attorneys, usually with assistance from accountants as expert witnesses in accounting matters. The federal tax court's decisions may be appealed at the circuit court, and its decision is definitive.

Statutory Tax Reports

As of January 1, 2007, taxpayers with income obtained in 2006 exceeding MXP\$30,471 million or with total assets exceeding MXP\$60,942 million or with at least 300 employees working in each month of the previous year are required to engage an independent public accountant to perform an annual tax audit and issue a statutory tax report. Penalties for not complying with these provision, range from MXP\$8,570 to MXP\$85,740. Taxpayers not included in these situations may elect to file this report. One of the advantages of filing such report is that any review by the authority is conducted through the public accountant who issues the report instead of making a direct review at the taxpayer's premises.

Loans and Equity contributions

Due to a FTC modification, if a company receives a Loan or Equity contributions for more than \$600,000 mxp (55,000 USD) the company that receives such amount must inform tax authorities about this funding 15 days after the reception of the money, if there is a failure in the inform, such amount will be considered as accruable income.

Chapter 8

Individuals

The taxable income of individuals includes all income obtained, except the income specifically excluded by the law. The tax authority is empowered to verify if individuals have made expenses or investments exceeding the reported income. If the expenses and investments exceed the reported income, the authority must notify the taxpayer, who will have the opportunity to explain the origin of such excess.

If the excess is not adequately explained and supported, it will be considered as taxable income, and the corresponding taxes will be assessed. In arriving at taxable income, individuals are granted the following deductions:

- Medical and dental fees and hospital expenses paid in Mexico by the taxpayer or the economic dependents (spouse, children, and parents, provided that their annual income is less than the annual general minimum wage), without any limitation, after deducting amounts reimbursed by insurance companies.
- Funeral expenses made by the taxpayer or by the economic dependents mentioned above, limited to the annual general minimum wage paid in Mexico, after deducting amounts reimbursed by third parties.
- Donations approved by the tax authority, the maximum deduction on such item is limited to 7% of the taxable income for the immediately preceding fiscal year.
- Interest paid during the fiscal year derived from mortgage credits.
- Premiums paid for medical insurance.
- School bus expenses for children, provided that such transportation is obligatory according to the legal provisions of the school's area.
- Contributions to authorized retirement saving funds up to the maximum amount provided by law.
- Local income tax if imposed by the State in which the taxpayer resides as long as the local income tax rate does not exceed 5%.
- Itemized deductions (with certain adjustments) relating to rental income, independent services and business activities.

The law classifies the income obtained by individuals as follows:

- Personal services
- Business and professional activities
- Leasing of real property
- Sale of property
- Acquisition of property
- Interest
- Prizes
- Dividends
- Other income

The following paragraphs discuss the most important provisions relating to exemptions, deductions, and the tax treatment for each kind of income.

Income from Personal Services

In general, individuals who are paid as employees, directors, managers, or statutory examiners are taxed on all amounts received as salaries, wages, or fees for personal services. Also taxable are amounts received by employees as profit sharing, severance pay, and allowances of all types, including housing, living expenses, education, overseas services, and tax reimbursements. However, there are some exceptions to certain benefits obtained by workers with salaries of up to one minimum wage and provided that such benefits do not exceed the amounts permitted by the Federal Labor Law. From January 1, 2007, the minimum wage by geographic area is:

- Zone A \$50.57
- Zone B \$49.00
- Zone C \$47.60

In addition, social welfare benefits are tax-exempt, including social security payments, such as pensions and retirement payments for disability, unemployment, old age and dead, up to nine times the general minimum wage; income from scholarships to workers or their children; disability payments; daycare nurseries; cultural and sporting activities; reimbursements for medical, hospital, and funeral expenses; and other social welfare benefits, when granted in accordance with the law or labor contracts.

There is one exception stipulated for certain revenues derived from social welfare benefits. When the amount of salary and social welfare benefits exceeds seven times the annual minimum wage of the corresponding economic zone, the exemption is decreased to only the amount of the annual minimum wage; the remainder is subject to tax and is to be withheld by the employer.

This limitation affects benefits arising from subsidies for disability, educational scholarships for workers or their children, daycare nurseries, cultural and sporting activities, or other similar activities. However, benefits of savings funds and reimbursements of medical and funeral expenses are not considered for the determination of this limitation. Therefore, if the benefits comply with the requirements established by law, they remain as non-taxable income for individuals.

In addition, annual bonuses that do not exceed 30 days of the general minimum wage are tax-exempt, as are indemnities for occupational accidents or illness, contributions to saving funds (if they are tax deductible for the employer), employees' social security taxes absorbed by their employers, and properly documented reimbursements of travel and entertainment expenses incurred in the service of the employer.

Employees with salaries exceeding the general minimum wage are not liable for income tax on 50% of overtime income, if the overtime income does not exceed the limit established by the Labor Law and five times the general minimum wage for each week of service.

The law establishes an exemption for employees equivalent to 15 days of the minimum wage on vacation premiums and profit sharing received. In addition, an exemption is established for income obtained from Sunday work premiums, equivalent to one minimum wage for each Sunday worked.

Income obtained by individuals for exercising an option granted by the employer, or any related party thereof, to acquire, even by subscription, shares or securities representing property, without cost or at a price below or equal to the market price of such shares or securities at the time the option is exercised, regardless of whether the shares or securities are issued by the employer or a related party thereof, is deemed to be salary.

The difference between the market value of the shares or securities subject to the option at the time such option is exercised by the taxpayer and the price established when the option is granted is taxable income.

Withholding tax is calculated by multiplying the rates provided by law by gross salary, less tax-exempt income.

The annual tax is determined by applying an integrated table. This table allows for a creditable subsidy of 86% and increases the scale from 5 to 8; with a maximum rate remaining at 28% for 2008. This table is changed every year to reflect the inflationary effect on salaries. The annual tax should be calculated and paid by the employee.

Employees must file an annual return by April 30 of the following year if they:

- Communicate in writing to their employers that they will file a Mexican annual tax return;
- Cease to provide services as employees before December 31 of the year in question;
- Have rendered services as employees to more than one employer simultaneously during the year;
- Obtain salary income from foreign employers or from persons or entities that are not required to withhold income taxes;
- Obtain taxable income other than salary;
- Receive salary income in excess of MXPs400,000 annually.

In all cases, the Mexican employer is obligated to make withholdings on a monthly basis on behalf of each employee when salaries are borne by such Mexican employer. If not, the individual is obligated to file monthly personal tax returns.

A subsidy referred to as Employment Subsidy which is calculated by applying a graduated table, is granted to workers and employees with salary income not exceeding MXP's 7,383. This credit may be up to MXP's 407 for the monthly estimated payments. This subsidy can also be applied at the annual calculation.

In the case that the employee works for two employers at the same time, the subsidy shall be applied just by one.

A salary credit, which is calculated by applying a graduated table, is granted to workers and employees with salary income not exceeding MXPs7,383. This credit may be up to MXPs407 for the monthly estimated payments. For the calculation of the annual tax there is no salary credit.

Business Organizations and Professional Services

Income obtained by individuals from business activities, the rendering of professional services, artistic and the rendering of independent services are subject to tax as discussed below. Individuals residing abroad with a permanent establishment in Mexico are subject to tax on income derived from personal services attributable to such establishment.

In calculating taxable income, these taxpayers may deduct all ordinary and necessary expenses, including depreciation and amortization, as well as payment of the local tax on income obtained from business activities or professional services, if applicable.

The deductions must be effectively disbursed and strictly indispensable for carrying out the trade or business, amongst other requirements, in order to be claimed. Taxpayers referred to herein must make monthly estimated tax payments by the 17th day of the following month.

The taxable amount received less the above mentioned authorized deductions, deductions for medical expenses, funeral expenses and authorized donations results in the basis for determining taxable annual income for business activities and independent personal services. The annual return must be filed by April 30 of the following year. A tax loss is incurred when the year's taxable income is less than the authorized deductions. This loss may be offset against profits derived from the same activities in the following ten tax years.

When taxpayers render professional services to Mexican legal entities, the entities must withhold as provisional payment, 10% of the amount paid, with no deduction allowed and must provide evidence of this withholding to the taxpayer. This tax may be credited towards the monthly estimated tax payment.

Individuals obtaining sporadic income from the rendering of professional services and obtaining no other income from business activities in the fiscal year shall pay within fifteen days of obtaining such income, 20% of the revenues, with no deduction allowed, as provisional payment on account of annual tax.

Leasing of Real Property

All income derived from granting the use of real property, except frozen rents, is taxed as described below. To calculate the taxable income, taxpayers may choose between deducting 35 percent of all real property rental income real property Tax and the following authorized deductions:

- Maintenance expenses and water consumption taxes.
- Interest on loans used for the acquisition or improvement of leased property.
- Salaries, commissions, and fees paid which are necessary for obtaining rental income.
- Premiums on insurance policies covering leased property.
- Depreciation at an annual fixed rate of 5% on buildings and improvements, adjusted by Mexican inflation.

In the case of sub-leasing, taxpayers may only deduct the actual rent paid to the lessor.

Taxpayers who receive rental income shall make monthly estimated tax payments by the 17th day of the following month. Taxpayers who only receive income from the leasing of real property will not be obligated to make monthly estimated tax payments if the monthly income is less than 10 minimum wages of Mexico City. A graduated rate scale with a maximum of 28% is applied to the actual income received, less deductions for expenses incurred in the same period. Income from the leasing of real property must be included in the individual's annual income tax return. The final tax is calculated by applying the annual rates.

When the lease payments are made by a Mexican legal entity, 10% of the amount paid must be withheld by the entity with no deduction, as provisional tax payment, and evidence must be provided to the taxpayer. The taxpayer may credit this amount in its monthly estimated tax payments.

Sale of Property

In general, profit from the sale or transfer of property is taxable. However, certain exemptions are considered, as follows:

- The gain obtained from the sale of the taxpayer's personal residence, provided that the sale price does not exceed 1,500,000 UDIs (Invest Units-Inflation Units approximately MXPs5,695,000) and the transaction is formalized using a Notary Public. If the sale price exceeds the above limitation, the taxable gain is the excess over the limitation less the authorized deductions allowed under the Mexican income tax law. In order to calculate the allowed deductions applicable to the excess, the total deductions should be multiplied by the result of dividing the excess by the total sale price. The limitation does not apply if the taxpayer can prove that he or she lived in the property for the last five years preceding the date of the sale.
- Transfers of ownership due to death or donation, mergers of entities, and the sales of bonds, securities and credit instruments when such income is considered as interest income pursuant to the Mexican income tax law.
- Gains obtained from the sale of certain securities when the transaction is carried out through the Mexican Stock Exchange or recognized markets according to the general rules issued by the Mexican Treasury.
- Profits on sales of personal property other than shares, partnership interests, securities and investments of the taxpayer when in the tax year the difference between the total sales and the cost of acquisition of the alienated property does not exceed three times the annual general minimum wage.
- Sales of properties made by taxpayers as payment or judicial award by complying with certain requirements provided by law.

Expenses incurred by taxpayers regarding the acquisition and/or sale of assets, including acquisition cost; construction, improvements and additions; notary expenses; taxes and fees; and commissions, brokerage and appraisal fees, among others, are considered authorized deductions.

The annual taxable income is determined by adding to all other taxable income (other than earnings from the disposal of property), the amount resulting from dividing the taxable gain by the number of years elapsed between the dates of acquisition and sale, up to a maximum of 20 years.

In calculating the tax payable on non-accruable gains, the portion of the profit not added to taxable income shall be multiplied by either the effective tax rate corresponding to income accruable during the year or the average of effective rates payable in the last five years, at the taxpayers election. If there is any loss on the sale of real estate and shares, the amount that results from dividing the loss by the years elapsed between the dates of acquisition and sale, up to a maximum of ten years, may be deducted from any accruable income of the same period, except from salaries, business activities or personal services, or earnings obtained from the sale of other property during the three following calendar years.

The portion of the loss not deducted according to the preceding paragraph generates a tax credit against the tax payable on earnings from the sale of similar property, which may be obtained during the taxable year or the following three years. The tax credit is determined by applying to the non-deducted portion either the effective tax rate of the year when the loss was sustained or the rate of any of the three years following the date in which the tax is payable.

If the loss is not deducted or the tax is not credited in a calendar year in which the taxpayer was entitled to do so, the taxpayer forfeit the right to deduct or apply the amount in subsequent years.

An estimated tax payment must be made with respect to each operation. In the case of a sale of non-movable assets, the tax should be calculated by applying the monthly tax table to the result of dividing the total gain by the number of years elapsed from the acquisition to the sale of the asset. The result should be multiplied by the number of years elapsed from the acquisition to the sale of the asset, and this amount should be the total tax to be paid by filing an estimated tax return. If the sale is formalized by a notary public, such entity should withhold and remit the tax determined as explained above.

In the case of a sale of other assets, a 20% withholding tax as provisional payment must be made by the acquirer (Mexican resident or permanent establishment) to the aggregate amount of the operation on the alienation of other property. If the acquirer is not a Mexican resident or permanent establishment the seller should pay a 20% withholding tax through a return filed within fifteen days of obtaining the revenue.

No withholding tax is required on the sale of personal property (other than securities) when the amount involved in each transaction is less than MXP\$227,400.

Acquisition of Property

The appraised value of any property obtained as a result of a donation (unless otherwise excluded), and treasures, as well as constructions, installations and permanent improvements to real property when the lesser becomes the owner of such improvements upon expiration of the agreement, is considered taxable income from the acquisition of property.

Estimated tax payments are calculated by applying a rate of 20% on the gross income and are payable within 15 days following the date of the transaction. In the calculation of the annual tax, deductions for expenses directly related to this income, such as local and federal taxes (except income tax), notary and legal expenses, appraisals, commissions, and brokerage fees, are permitted.

Interest

The Income Tax Law defines interest to be, among others, yields for any kind of credits: yields from public debt, bonds and debentures, including discounts, premiums or prizes; premiums paid on loans of securities; discounts for the placement of securities, bonds or obligations; commissions or payments made to open or guaranteed loans (regardless of such loans being contingent); payments made to third parties for the acceptance of a guarantor; the authorization of a guarantee or the assumption of responsibilities of all types; and earnings obtained from the sale of credit instruments placed among the general investing public.

Taxable interest (real interest) is the difference between the interest obtained less the inflation adjustment computed according to the provisions established by the law.

Real interest should be accrued as other taxable income on the annual tax return. If the inflation adjustment exceeds the interest obtained, the difference may be offset against other taxable income, except for income from personal services and business activities.

If real interest is the only income obtained by the taxpayer and it is less than MXP\$100,000, no annual return is required to be filed. In this case, the withholding made by the interest payer is considered as final tax payment. If real interest and income from personal services exceeds MXP\$400,000, the taxpayer should file an annual tax return.

Payers of the interest should withhold tax at a rate of 0.85% on the amount of capital that gave rise to the interest payment, which may be offset against the annual tax.

There are several provisions regarding the taxation of investments made in debt instrument investment companies and variable yield investment companies.

Prizes

Revenues derived from lotteries, raffles, drawings, betting games and competitions are deemed income from prizes.

In general, the tax must be withheld by the payer of the prize and is levied according to the following rates:

- 1% of the prize value with no deduction allowed, if the local government does not levy local tax or if said tax does not exceed 6%.
- 21% if the local government entity levies a local tax at a rate exceeding 6%.
- 1% of the aggregate amount distributable among all winning tickets for betting games.

This tax is deemed final provided the taxpayer reports in its annual return the prize obtained in the year, or if the sum of loans obtained, donations received and prizes received exceeds MXP\$ 600,000.

Dividends

Revenues obtained from dividends should be accrued on the annual return of the taxpayer. Likewise, individuals may credit against the income tax determined on the annual return, the income tax paid by the company that distributed the dividends.

Both the dividend and the amount of income tax paid by the company are deemed accruable income. Additionally, the company must provide evidence of the payments made as dividends and the amount of tax paid thereon in order for the taxpayer to be allowed to credit the income tax paid.

For this purpose, a rate of 28% is applied by the company to the amount resulting from multiplying the dividend by the factor of 1.3889 for 2008.

Furthermore, the following are deemed dividends:

- Interest from shares with right to interest
- Profits paid to debenture holders or other parties by corporations residing in Mexico or by domestic credit institutions.
- Loans to shareholders if they are granted for one year or more, are not a normal consequence of the company's operations or if the agreed monthly interest rate is less than 0.75% for 2008.
- Non-deductible expenses made for the benefit of the shareholders.
- Omissions of income.
- Estimated tax profit by the authority.
- Taxable profits estimated by the tax authority in transactions carried out between related parties.

Other Income

The following income, among others, must be accrued by the taxpayer in the fiscal year in which it is deemed to be obtained:

- Amount of debt forgiveness
- Revenues from investments in foreign companies
- Dividends received from a company residing abroad
- Income estimated by the tax authority
- Revenues from royalty agreements

Non-resident Taxpayers Who Obtain Income from Mexican Sources

Non-residents are required to pay tax on income obtained from sources of wealth located in Mexico when they do not have a permanent establishment (PE) in Mexico or when having a PE, the income received is not attributable to that PE. Tax rates, method and time of tax payment, and exemptions are defined for each type of income obtained from sources of wealth located in Mexico.

Taxable income also includes any payments made for acts or activities generating revenue that benefits those residing in a foreign country. Such payments includes avoidance of expenses and the tax corresponding to the foreign resident paid by a Mexican resident, on his or her behalf, except the VAT passed on by such a resident under terms of the respective law. This also includes income determined by the tax authority in the hypothesis provided by the law (transfer prices). Except for certain cases, the tax base is the total amount of gross income without any deduction.

The person making the related payment, provided it is a resident of Mexico for tax purposes or a resident abroad with a PE in Mexico, must withhold the required tax when the consideration is due or paid, whichever occurs first. For these purposes, payment is deemed to be any act whereby a debtor complies with an obligation or extinguishes it by any means.

In general, the tax withheld is considered the final tax payment. In the case of an individual taxpayer who acquires Mexican residency during the calendar year, withholding taxes paid during the period of non residence will be considered final payments. Tax on income obtained as from the date of acquisition of tax residence shall be computed according to the rules provided for resident individuals.

When payments to a resident abroad are made in foreign currency, the related withholding tax must be paid in Mexican currency (pesos), by converting it at the exchange rate that the Bank of Mexico publishes in the Official Gazette of the Federation prevailing on the date immediately preceding the date on which payment is due.

Personal Services

As a general rule, wages, salaries and income obtained from rendering personal services in a subordinate or independent capacity are considered to be Mexican source income when the related services are carried out in Mexico.

The tax on payments made for the rendering of personal services in a subordinate capacity is determined by applying the following rates to the income obtained during the calendar year:

- Up to MXPs125,900 Exempt
- From MXPs125,900 to MXPs1,000,000 15%
- Over MXPs1,000,000 30%

Payments for independent personal services are taxable at 25% on the gross revenue obtained.

The corresponding Mexican income tax derived from dependent and independent services shall be withheld by the payer if it is a resident of Mexico or a resident abroad with a Mexican PE when the services are related to such establishment. In other cases, the taxpayer must pay the corresponding tax by filing a tax return within 15 business days of receiving the income.

It is assumed that services rendered in an independent capacity are rendered entirely in Mexico, unless the person rendering such services can prove that the services were partially rendered abroad. In this latter case, the tax is computed on the portion corresponding to services rendered in Mexico. Additionally in the rendering of independent personal services, it is assumed that the services are rendered in Mexico, unless proven otherwise, if the payment is made by a Mexican resident, or a foreign resident with a PE therein, who is a related party of the resident abroad.

Persons obtaining income from the rendering of personal services in an independent capacity are required to issue tax receipts which must be printed by authorized establishments and contain the name, tax address and tax identification number of the issuer, among other requirements.

Salaries and income obtained by non-residents rendering personal services are exempt, provided that the following conditions are met: a) the stay of the person rendering the services is less than 183 days in a twelve-month period; and b) the related payments are made by residents abroad that do not have a PE in Mexico or if they do have such an establishment, the services carried out are not related to activities of that establishment.

The exemption does not apply when the payer of the services has an establishment in Mexico, even if it does not qualify as a permanent one, and the services carried out are related to such establishment, as well as when the person rendering the services to such establishment receives supplementary payments from residents abroad for the services rendered in Mexico.

Fees paid to board members are considered Mexican source when a company that is a resident of Mexico pays such fees. The income tax payable is 25% on the gross payment with no deductions and shall be withheld by the Mexican company making the payment.

Stock Purchase Options

In dealing with options granted to a foreign resident, income from salaries applies in the same terms as for a resident of Mexico and the tax is due upon the exercise of the option to purchase the shares.

According to the definition of source of wealth for subordinated personal services, this provision should have specified that the tax payment shall be made for options granted and exercised on services rendered in Mexico.

Pension Income

Income from retirement, annuities or other forms of retirement is considered Mexican source when the payments are made by residents of Mexico or by a PE in Mexico or when the contributions to the plan relate to a subordinated service rendered in Mexico.

The applicable withholding tax rates are as follows:

- Up to MXPs125,900 Exempt
- From MXPs125,900 to MXPs1,000,000 15%
- Over MXPs1,000,000 30%

The person making the above mentioned payments must withhold and remit the corresponding tax. If the person making the payments is a resident abroad or does not have a PE in Mexico, the taxpayer must pay the corresponding income tax within the 15 business days after receiving the income by filing a tax return.

Temporary Use or Enjoyment of Property

In the case of temporary use or enjoyment of real property and time sharing, the source of wealth is considered to be located in Mexico when the property in question is located there. The applicable tax rate is 25% of gross income for real property without any deduction.

For time sharing, the applicable tax rate is 25% of gross income without any deduction. Optionally, if the resident abroad has an authorized representative in Mexico and certain requirements are met, it may pay income tax at the rate of 28% on the net income. In both cases, the attributable taxable base must be determined considering the factor that results from dividing the value of the real properties of the taxpayer and its related parties located in Mexico by the value of the all real properties worldwide of the tax payer and its related parties, multiplied by the worldwide pre-tax income or profit of the taxpayer. The value of the real property for purposes of the tax base calculation is the value reported on the audited financial statements.

Receipts, which must be issued by persons obtaining this income, must meet all legal requirements. When income is obtained through a trust, the trust institution should issue the receipts, make the required withholding and remit the tax to the tax authority.

With respect to the temporary use or enjoyment of movable property used in business activities, the source of wealth is considered to be located in Mexico when the property is used or enjoyed in Mexico. Unless proven otherwise, it is assumed that such property is for business activities carried out in the country if it is leased to residents of Mexico or residents abroad having a PE in Mexico.

If the related property is used for activities other than business activities, the source of income is considered to be Mexican when such property is delivered in Mexico.

In both of the above cases, the applicable withholding tax rate is 25% on the gross revenue obtained without any deduction. A 5% withholding rate applies to lease payments of containers, as well as airplanes and vessels having a federal concession to be commercially exploited by the lessee.

In no case will the aforementioned provisions be applied to payments made in connection with financial leasing, royalties, technical assistance or advertising. These payments are subject to specific provisions of the law

Income from Freight Services

Income derived from freight charter services is deemed to be of Mexican source when vessels are used to undertake charter services in Mexico. The corresponding tax is determined by applying a 10% rate to the gross income obtained with no deduction allowed.

Sale of Property

Income from the sale of real property is considered to be of Mexican source when such property is located therein. The following options are established for the payment of this tax:

- First option - Applying a 25% withholding tax rate to the total amount of the sales price and considering this tax payment as final. The purchaser must withhold the tax if he or she is a resident of Mexico or a resident abroad with a PE in Mexico. Otherwise, the vendor must pay the tax no later than 15 business days after the income is obtained by filing a tax return.
- Second option - Applying a rate of 28% forward on the excess of the revenue obtained over the authorized deductions to resident individuals who sell real property. Such deductions must include the inflationary adjustment to the acquisition cost but must not include losses incurred on the sale of such property, shares, or partnership interest. For this purpose, the person residing abroad must have a legal representative in Mexico. When the sale is duly notarized, it is not necessary to have a legal representative.

The notary public shall calculate and pay the tax no later than 15 business days after the income is obtained. For this purpose a tax return must be filed at the corresponding tax collection office. Returns must be filed for each transaction even if no tax is payable.

If installment sales are duly notarized, the law permits the tax to be paid proportionally on each installment amount when the term of payment exceeds 18 months. The tax shall be paid on the 15th day of the month following that in which each payment is due.

Sale of Shares

Income derived from the sale of shares or securities representing the ownership of goods are considered to be Mexican source when the issuing company is resident for Mexican tax purposes or when more than 50% of the book value of the shares is derived directly or indirectly from real property located in Mexico. The same aforementioned options available for paying the tax on the sale of real property apply in this case; that is, 25% on the gross sale price or 28% on the net gain derived by computing in the same manner indicated for the sale of shares by Mexican resident business organizations, as long as the vendor does not reside in a country considered to be a territory with a preferential tax regime ("tax haven") or a country with a territorial tax system.

Additionally, transactions whereby shareholders of Mexican entities residing abroad organize a usufruct over shares, as well as assignments of beneficial ownership, are deemed sales of shares. Furthermore, there is a deemed sale of shares derived from legal acts whose purpose is to partially or fully transfer the rights to receive the return on shares. It is important to comment that in the event of a sale of shares, the taxpayers exercising the option to pay tax at the rate of 28% on the corresponding gain must appoint a legal representative, who must be a resident of Mexico for tax purposes or a Mexican permanent establishment of a non-resident, and file with the tax authority, a tax report (dictamen) issued by Mexican public accountant stating that the tax was computed in accordance with applicable tax provisions.

For sales of shares or securities representing the ownership of goods to a related party, the public accountant must disclose in the tax report the book value of such shares or securities and the following elements of the issuer company in determining the sale price of the shares or securities: restated book value of the equity, projected profits or cash flows or last quotation on the stock exchange in the case of publicly-traded shares.

The disposition of shares exempted from tax under the rules applicable to resident individuals (i.e., shares of Mexican or foreign companies publicly traded on the Mexican Stock Exchange) is also exempt when sold by a foreign resident. Also exempt are sales of shares when sold on a stock exchange located in a market of wide trade marketability in a country with which Mexico has a double taxation treaty in force at the time of sale.

Dispositions of shares, which are considered by the SAT to be available to the general public, made through an authorized stock exchange or recognized market determined by the SAT, are subject to a 5% final withholding tax regardless of the vendor in question. The foreign resident may elect to pay a 20% withholding tax on the net gain. The tax must be withheld by the broker and remitted to the authorized tax office no later than the 17th day of the month immediately following the month in which the disposition was made.

The tax authority may authorize the deferral of the income tax derived from capital gains on the disposition of shares in group reorganizations. Tax must be paid when the shares of the reorganized Mexican company are transferred to a party outside the group. The deferred tax should be adjusted for inflation from the date of the restructuring to the date of sale of the shares. The value of the shares transferred at the time of the reorganization should be the fair market value or the value appraised by the tax authority. In such reorganizations, the authorization to defer the payment of the tax will only be granted when the agreed-upon consideration consists of the exchange of shares issued by the party purchasing the shares being transferred

Swaps of Public Debt for Investment

Swap transactions to substitute Mexican public debt for investment are considered Mexican source income. The tax is payable at a 25% withholding rate applicable on the amount of payment made by the resident of Mexico to the resident abroad, or at a 40% withholding tax on the profit obtained from the transaction if the resident abroad appoints a legal representative who is a resident of Mexico for tax purposes and does not reside in a tax haven or a country with a territorial tax system.

Dividends

Dividends and, in general, distributions of retained earnings by business organizations and income obtained by non-profit organizations are not subject to any withholding tax. Nevertheless, dividends paid by Mexican entities are taxed at the corporate level on a grossed-up basis considering the factor 1.3889 when the dividends paid out do not originate from the CUFIN balance. Such tax is payable by the distributing entity.

Interest

Interest is considered to be Mexican source when the capital is placed or invested in Mexico or when the party paying the interest is a Mexican resident or a non-resident with a PE.

The term “interest” includes yields from any kind of loans, whether or not secured by a mortgage and whether or not entitled to participate in the profits; yields from public debt, bonds and debentures, including premiums or prizes; discounts for the placement of securities, bonds or debentures; commissions or payments made to open or guaranteed loans; payments made to third parties for the acceptance of a guarantor; the authorization of a guarantee or the assumption of responsibilities of all types; gains obtained from the sale of credit instruments placed among the general investing public; gains on the transfer or shares issued by investment; funds in debt instruments and adjustments made to the principal based on the application of inflationary index factors or any other form, including adjustments to the principal when the debt or operations are denominated in investment units (Unidades de Inversión or UDIS).

In the transfer of credit instruments payable by Mexican residents acquired by residents of Mexico from residents abroad, any gains obtained are deemed interest subject to tax.

Additionally, in dealing with the gain on the transfer of loans, where the purchaser is a resident of Mexico or a resident abroad with a PE therein, a procedure is established for determining the gain on which to apply the withholding rate applicable to the beneficial owner of the interest.

Withholding tax rates applicable to interest paid vary according to the foreign beneficiary, the borrower domiciled in Mexico and the purpose of the loan.

The applicable withholding rates are shown below:

- 4.9% Foreign finance entities in which the federal government, through the Mexican Treasury Ministry or Banco de Mexico (Central Bank), holds capital stock, provided that such entities are the effective beneficiaries of the interest, are registered for that purpose with the SAT and have filed with the SAT the information required by general rules on financing granted to borrowers located in Mexico.
- 4.9% Interest from publicly traded credit instruments, and gains from the alienation thereof; interest received from certificates, acceptances, credit instruments, loans, or other credit payable by Mexican financial institutions, as well as those placed through banks or stockbrokers in a country with which Mexico has a double taxation treaty, if and when for the documents in which the financial transaction is stated a notification is filed before the Security and Exchange Commission (Comisión Nacional Bancaria y de Valores, CNBV) describing the main characteristics of the bid and adhering to the general provisions issued by such Commission and the information required by general rules on financing granted to borrowers domiciled in Mexico(1).
- 10% Finance entities owned by foreign governments and foreign banks including foreign investment banks and non-bank banks, provided that they are the effective beneficiaries of the interest, are registered with the SAT, and have filed the same information required by general rules on financing granted to borrowers domiciled in Mexico. Non-bank banks should also comply with the requirements established by the SAT related to placement percentages and deposits received (2)
- 10% Entities that place or invest in Mexico, capital derived from the placement abroad of securities with the general public according to the general rules issued by the SAT.

- 10% Securities available to the general public placed abroad through banks or stock brokerage houses in non-tax treaty countries, provided that for the documents in which the financial transaction is stated a notification is filed before the CNBV describing the main characteristics of the bid and adhering to the general provisions issued by such Commission.
- 10% Excess of face value over sale value of credit rights transferred by a Mexican resident creditor or a foreign resident creditor with a PE in Mexico.
- 15% Foreign reinsurers.
- 21% Interest other than those indicated above, paid by Mexican banking institutions.
- 21% Foreign suppliers who sell machinery and equipment forming part of the acquirer's fixed assets.
- 21% Financing to acquire machinery and equipment and in general to furnish working capital, if these circumstances are mentioned in the agreement and such creditors are registered for this purpose with the SAT.
- 28% Interest other than that stipulated above.

(1) In the event of non-compliance with the above stated requisites, the applicable rate will increase to: 10%

(2) In 2007, the interest paid to foreign banks, including foreign investment banks, and non-bank banks, provided that the actual beneficiary of the interest resides in a country with which Mexico has a double taxation treaty and complies with the requirements established in said treaty, is subject to a withholding tax rate of: 4.9%

The aforementioned registries for the reduced withholding tax rates should be renewed annually.

No tax is imposed on interest from loans granted to the federal government and Banco de Mexico (Central Bank) or on interest derived from bonds issued by them, provided such bonds are acquired and paid abroad. In addition, no tax is levied on interest derived from loans with a minimum 3-year term that are granted or secured on preferential conditions by financial entities engaged in promoting exports,

provided they are registered for this purpose with the SAT. Furthermore, no tax is charged on interest derived from loans granted or secured on preferential conditions by financial entities to institutions authorized to receive donations, provided such entities are registered with the SAT.

Reinsurance

In the case of premiums paid or transferred to foreign reinsurers by a resident for Mexican tax purposes or by a non-resident with a PE in Mexico, the tax rate is 2%. The tax must be withheld and paid by the person making the payments.

Financial Leasing

The source of wealth for financial leasing is considered to be located in Mexico when the associated goods are used in Mexico or when a Mexican PE deducts the interest payments fully or partially, even if another establishment located outside Mexico makes the payments. Unless proven otherwise, it is construed that the goods are used in Mexico when those who use or enjoy the related goods are tax residents of Mexico or have a PE in Mexico.

The income tax rate is 15% on the amount agreed to as interest in the agreement. The persons making the payments must withhold the tax.

Financial Derivative Transactions (FDTs)

The Income Tax Law recognizes capital FDTs and debt FDTs and provides a different tax treatment for each type of transaction.

a) Capital FDTs.

The source of income is considered to be in Mexico when one of the parties undertaking the capital FDT is a resident of Mexico or non-resident with a PE in Mexico and the transactions refer to shares or securities issued by Mexican companies or by foreign companies which hold real property located in Mexico that represents more than 50% of the value of the foreign company's total assets.

Non residents realizing gains on capital-related financial derivative transactions linked to stock exchange listed shares and indexes related to such shares are exempted from Income Tax, provided that the requirements established for individuals for tax exemption of listed shares are met.

The income tax from such transactions is calculated as 25% on the gain obtained by the non-resident. The tax should be withheld by the Mexican resident or Mexican PE, except when the transactions are carried out through a resident bank or stock brokerage institution, in which case these latter entities must withhold and remit the corresponding tax.

Foreign residents that do not reside in a tax haven and appoint a representative in Mexico can elect to pay the tax on the net gain obtained in capital FDTs carried out during the month. This election is also available even when the foreign resident does not have a representative in Mexico as long as the Mexican resident counterpart accepts to pay the tax and obtains, the related information to compute the taxable base from the foreign resident. The net gain is determined by subtracting from the gains obtained during the month, the losses suffered in the same period for transactions undertaken with the same entity or person. The tax is 28% computed on the net gain and must be remitted by the representative or by the Mexican resident no later than the 17th day of the following month.

b) Debt FDTs

Gains resulting from financial derivative operations of debt are deemed to be interest and the source of income is considered to be in Mexico when one of the parties undertaking the debt FDT is a resident of Mexico or a non-resident with a PE in Mexico and the transaction is attributable to such PE.

Additionally, it is deemed that the source of income is located in Mexico when a debt FDT carried on between non-residents is liquidated by the delivery of the property titles of debt instruments issued by resident entities. The income tax is calculated on the gain resulting from the debt FDT, and the applicable withholding tax rate is the one corresponding to interest income and depends on the type of entity obtaining the gain (for rates, see the above table shown in the section discussing interest). Debt FDTs liquidated in kind are subject to a 10% withholding tax rate. The person making the payment is responsible for withholding the applicable tax.

Other Financial Income

In order to increase revenue collections, as of January 1999 several items previously included in the term “interest” have been recharacterized by the tax authority as “other income” with the intention of not applying the reduced tax rates provided in the tax treaties. Such items of income are considered to be located in Mexico when the capital is placed or invested in the country or when the parties paying them reside or have a permanent establishment or fixed base there.

These items of other income include debt derivative transactions; gains from securities placed among the general public; factoring transactions and an adjustment to the principal, for operations denominated in investment units.

The withholding tax rate applicable to these items of other income is the one applicable to the effective beneficiary of such income provided in the above referred heading of “interest.”

With respect to factoring transactions the amount subject to tax is the difference between the face value of the credit right increased by any yields on which no withholding tax has been made and the purchase price. The applicable withholding tax rate is 10 percent.

A 10% withholding rate applies to gains from securities placed among the general investing public and debt derivative transactions settled in kind.

Royalties, Technical Assistance and Advertising

Income from royalties, technical assistance and advertising is considered to be Mexican source when the goods or rights on which royalties and technical assistance are paid are used or enjoyed in Mexico or when the person making the related payment is a tax resident of Mexico or has PE in Mexico.

The tax rate on royalties varies, depending upon the goods or rights used or enjoyed. The applicable withholding tax rates for royalties are as follows:

Goods or rights used or enjoyed: Tax Rate

- Railcars: 5 %
- Technical assistance: 25 %
- For the temporary use or enjoyment of patents or certificates of invention or improvement, trademarks or brand names, and for advertising: 28% for 2008.

When the same agreement involves royalty payments for different items subject to the 25% or the 28% rate, then the corresponding tax rate should be applied to payments for each type of item. If it is not possible to identify the portion of payment corresponding to each type of item, the payment is subject to the 28% tax rate.

Revenue from the sale of property or rights such as patents trademarks, literary, artistic or scientific rights, among others, is characterized as royalty income and the above rates, depending on the type of property or right sold, shall be applied to the revenue obtained by the foreign resident with no deduction allowed.

Construction and Other Services

For income from construction, installation, maintenance or assembly of works on real property or related inspections or supervision, it is considered that the source of wealth is in Mexico when the respective services are carried out in Mexico.

The following options are established for payment of the tax:

- Application of a 25% final withholding tax on the gross income obtained without any deduction, which should be withheld by the Mexican resident paying for the services, or
- Application of a 28% rate to the gross income obtained less authorized deductions to be taken by business organizations that affect said income, regardless of where the expenses are incurred.
- For the second option, the taxpayer must appoint an authorized representative who should calculate and pay the resulting tax by filing a return at the authorized SAT office corresponding to the location where the related work is carried out.

This return must be filed within one month after work is completed. Tax payments made during the first tax period shall amount to 25% of the gross income obtained in each payment, unless the foreign resident taxpayer chooses to pay 28 % tax on the net profit. However, if the resident abroad spends more than 183 calendar days in Mexico, consecutive or not, within any given 12-month period and carries out the aforementioned services, the foreign resident is deemed to have a PE in Mexico. In such case, the income tax is payable in accordance with the provisions that apply to business organizations.

If, before the services are rendered, it is planned that the work or services will last for more than 183 days within any given 12-month period, a PE is deemed to exist from the first day that the services are rendered. It is important to keep in mind that the number of days in which services are rendered through subcontractors is taken into account to compute such 183 day term.

Athletes and Public Entertainment

Income received for artistic and sporting activities, or for the realization or presentation of shows to the public is deemed to be of Mexican source when the performance, show or sporting event takes place in Mexico.

Such income includes promotional services for the presentation of the show and activities conducted in Mexico as a result of the reputation of the artist or athlete. It also includes the income obtained by foreign residents from the rendering of services, temporary use or enjoyment and sale of goods related to the presentation of shows, artistic or sporting events. Unless proven otherwise, it is assumed that the artists, athletes or persons presenting the shows have a participation in the profits obtained by the provider of such services, the grantor of the temporary use or the vendor of such goods.

The following options are established for payment of the tax:

- The payer, if it is a resident of Mexico or a resident abroad with a Mexican PE, must apply a 25% withholding rate to the total income obtained without any deduction. In all other cases, any persons receiving income should pay the corresponding tax at the SAT office corresponding to the place where the performance or show took place, on the first business day immediately following the day when the income was obtained.
- As a second alternative, a tax rate of 28% rate in 2008 is applicable to the income obtained less authorized expenses, regardless of where such expenses are incurred. In this second option, the taxpayer must: a) appoint an authorized representative who calculates and pays the resulting tax by filing a return at the SAT office corresponding to the location where the related show, artistic or sporting event took place.

This tax return must be filed within one month after the performance is concluded, and b) grant the tax authorities a guarantee equivalent to the corresponding tax by applying the 25% rate on the gross income on the first business day immediately following the day when the income was obtained. In this situation, the withholding agent is relieved of its withholding obligation.

Goodwill

Income obtained by residents abroad from the sale of goodwill is deemed to be of Mexican source if the goodwill is attributable to a resident of Mexico or to a Mexican PE of a foreign resident. To this effect, the source of income is also deemed to be located in Mexico when a resident abroad sells assets used by a resident of Mexico or by a Mexican PE of a non-resident and the price paid exceeds the market value of the goods sold. In this case and unless otherwise demonstrated, it is assumed that the resident abroad receives income from the sale of goodwill for the amount that exceeds the fair market value of the assets.

In this situation, the SAT is empowered to carry out an appraisal to determine the market value of the goods in question. In the event that the appraised value exceeds the fair market value used by the taxpayer for the sale by more than 10%, the difference is deemed to be income from the sale of goodwill. The tax is assessed by applying a rate of 28% in 2008 to the total compensation. The tax must be withheld by the resident of Mexico or by the resident abroad with a PE in Mexico who made the payment. In all other cases, the taxpayer must pay the tax by means of filing a tax return at the SAT office within 15 days following that in which the income was received. These provisions are not applicable to gains on the sale of shares.

Prizes

Income from prizes is considered to be of Mexican source when the lottery, raffle, drawing or betting game is held in Mexico. Unless proven otherwise, it is construed that any of these events takes place in Mexico when the prizes awarded are paid in Mexico. Income from prizes is taxed at a federal income tax rate of 1% on the value of the prize, as long as no state tax on prizes is imposed or if so, it does not exceed 6%. If the state tax exceeds 6%, then the applicable federal income tax rate is 21%.

The payer of the prize must withhold the tax if it is a resident of or a nonresident with a PE in Mexico. Otherwise, the tax should be paid by the nonresident payer of the prize through a tax return that must be filed within 15 days following receipt of the income. Both are considered final tax payments.

Other Income

The source of income is considered located in Mexico in the following cases:

- Forgiveness of debt granted by a Mexican resident or a nonresident with a PE in Mexico to a resident abroad.
- Payments for the right to participate in a business deal, investment or any payment to participate in any legal act taking place in Mexico, except for capital stock contributions.
- Payment of indemnities for damages or income derived from conventional or criminal clauses paid by a resident of Mexico or a nonresident with a PE in Mexico to a resident abroad.

In the foregoing cases, the withholding rate is 28% for 2008 on the gross income obtained.

Definition of Income

It is established that income of foreign residents is not deemed income from business activities. We believe that it is the intention of the tax authority to limit the application of the tax treaties to which Mexico is a party, in relation to income deemed by such treaties as "Business Profits".

Payments to Preferential tax regimes - Withholding Tax Rates

In the case of payments for commissions, brokerage, agency fees, among others, made by a Mexican resident or Mexican PE to foreign residents of a tax haven or payments to preferential tax regimes, a 40% withholding tax automatically applies on the gross amount of such payments without any deduction.

In the case of interest payments to foreign banks located in a tax haven, the withholding rate is 10%. If the payment is to a financial institution in which the federal government, through the Mexican Treasury Ministry or Banco de México, holds capital stock, the withholding tax rate is 4.9% provided that in both situations,

those entities (a) are the actual beneficiaries of the interest and are registered with the SAT as foreign banks or financial institutions; and (b) file the same information required by the general rules on financing granted to Mexican residents.

Dividend payments to residents of a tax haven are also exempt from Mexican income tax at the shareholder level.

Legal Representatives

The representatives of a Mexican non-resident must be residents of Mexico or a permanent establishment in Mexico of a non-resident, and must keep all the documentation supporting tax payments made on behalf of the non-resident for at least five years following the date in which the tax return was filed.

Foreign Retirement Funds

A foreign retirement fund with investments (interest, leasing and capital gains income) in Mexico will not be taxed on its earnings derived from such investments, provided that the fund is organized according to the respective laws of the country of origin, is the beneficial owner of such income, is exempt from income tax in the country in question and is registered with the SAT.

Tax Treaty Benefits

In order to enjoy the benefits of tax treaties, the resident of a treaty country must provide evidence that it is a bona fide resident of the particular treaty country for income tax purposes. In addition, the foreign resident must comply with certain formal requirements provided by the Income Tax Law, such as registration of foreign banks and certain types of interest with the SAT, the filing of a certified public accountant's report (dictamen) when applicable and the designation of a legal representative when allowed to pay income tax on a net basis. Otherwise, relief under the treaty will not be granted and the rates provided in the Income Tax Law will apply.

In the case that the withholding party applies income tax rates greater than the rates indicated in a tax treaty, the foreign resident will have to request a refund for the difference between the reduced treaty rates and the income tax rate applied.

Anti-Tax Haven Provisions

Mexico, as well as other countries throughout the world, has established anti-tax haven provisions. The Mexican government determined that such laws were needed to close the loophole that both Mexican and foreign investors were using to allocate income to tax havens, thus reducing their Mexican taxable income.

In 1997, Mexico enacted anti-tax haven legislation. Mexico has modified its original legislation to serve a two-fold purpose. One is to discourage the use of tax haven investment mechanisms by Mexican residents, and the other is to penalize through high withholding rates, the foreign investors that use tax haven countries.

The legislation was designed to preclude Mexican taxpayers from deferring Mexican income taxes through the use of the preferential tax regimes or tax havens. Currently, the Income Tax Law's anti-tax haven provisions encompass all types of investments by a Mexican resident, either directly or indirectly.

The definition of tax haven or preferential tax regime states that jurisdictions are deemed to be preferential tax regimes when taxes paid are less than 75% of the amount that would be paid in México.

To determine whether an income is derived from a preferential tax regime each of the relevant generating transactions must be taken into consideration. Up until December 31, 2007 such computations could be made at Company or legal entity, country or territory level.

This treatment apply to legal entities incorporated abroad that are not taxpayers or are deemed transparent for tax purposes even do its incomes does not come from a preferential tax regime.

The Definition of tax transparent entities include those that are not regarded as tax payers in the country where their principal or actual management headquarters are based and their revenues are attributable to members, partners or stockholders.

Mexican investors, either through direct or indirect ownership, in preferential tax regimes are forced to recognize the income on a current basis and to file an annual information return on the business and the investment activities, undertaken in such jurisdictions.

Payments made to entities or individuals in a preferential tax regime are subject to greater withholding rates. Such high withholding rates apply, among others, to commissions, royalties, technical assistance, transfer of technology and services.

Income from royalties, patents or industrial secret is not subject to a preferential tax regime when the intangible has been developed in the country of residence of the foreign legal entity, the royalty payment is made of market values.

Additionally, payments made to residents of preferential tax regimes are deemed not to be at arm's length, regardless of the fact that the parties may be unrelated. Therefore, companies must carry out a transfer pricing study to demonstrate that the transaction is carried out using fair market values.

Tax authorities may authorize Mexican payers participating in financing entities not apply the regulations related to preferential tax regimes providing certain requirements are met.

Requirements are established that income are derived from a sale of shares within the same group as a result of international restructurings, including mergers and spin-offs, is not regarded as subject to preferential tax regimes. The law defines group as a number of companies whose voting stock is 51% or more held directly by the same legal entity.

Simulation of acts

As of 2008, the authorities have the power to determine whether simulation of legal acts in connection with related-party transactions has taken place for tax purposes. It is established that the taxable event will be that actually performed.

The authorities resolutions must establish:

- Identification of the simulated act.
- Quantification of the relevant tax benefit obtained.
- Specification of the elements that served as a basis for the authorities to determinate the existence of simulation.

The authorities may base their resolutions on any other presumption elements as they may think fit.

Withholding Rates

Generally, payments made by a Mexican resident to tax haven countries as defined in the Mexican Income Tax Law, are subject to a 40% withholding rate.

Nevertheless, dividends paid to a tax haven country are not subject to any withholding tax.

Additionally, exceptions may apply to interest payments made to a tax haven. A 10% withholding rate may apply to certain types of interest paid to banks registered at the Mexican Treasury Ministry and on interest arising from bonds offered to the general investing public. In addition, interest that is exempt from withholding tax under the Mexican Income Tax Law is also exempt from withholding tax even though the payment is made to a tax haven.

Business Flat Tax (IETU for the Spanish abbreviation)

This new tax will become effective on January 1, 2008.

Subjects liable to IETU

This tax will be assessed on individuals and legal entities residing in Mexico, as well as non-residents having a permanent establishment in Mexico as a result of performing the following activities:

- Alienation of goods
- Rendering of independent services
- Granting of temporary use or enjoyment of goods

For definition of the abovementioned concepts, reference is made to the provisions of the Value-Added Tax Law (VAT Law).

Tax rate

Tax will be computed by applying the rate of 17.5% to the amount resulting from deducting the expenses authorized by the law from total income earned in the year. A transitional provision establishes that the rate for 2008 will be 16.5% and 17% for 2009.

If deductions should exceed income a tax credit will be determined by applying the tax rate to the amount in excess. Such tax credit may be applied against the tax for the year or estimated taxes over the ten following years, until exhausted.

For taxpayers with a concession for exploitation of public property or provision of public services, the term for application of the tax credit will be the same as the concession term.

Taxpayers who fail to use a tax credit for a year when entitled to it will forfeit the right to use it in subsequent years up to the amount that could have been credited.

In order to promote new investments, it is provided that the tax credit generated in one year may also be applied against the Income Tax (IT) for the year in which such tax credit was generated, but this procedure does not generate a right to any refund whatsoever.

Once the aforementioned tax credit has been applied, an additional amount may be deducted. This amount will be determined by applying a 0.175 factor to the aggregate of salary payments subject to IT and social security contributions paid in the year, which is aimed at offsetting the effect of not being able to deduct salaries in determining the base for IETU purposes. The factor applicable for 2008 will be 0.165 and 0.17 for 2009.

An amount equal to the IT for the year and estimated IETU payments made may be deducted against the tax determined after applying the tax credit and additional credit.

IT paid on dividends in 2006 and 2007 may be applied against IETU for 2008; the term of three years established by the IT Law for applying the credit is recognized. However, IT paid on dividends in and after 2008 will only be creditable against IETU for the year.

Taxable Income

The calculation of the IETU should be considered as taxable income, in addition to price, any other amount that may be collected, including advances, received deposits, taxes and fees, interest and contractual penalties.

Additionally, the allowances or discounts received, as well as the advances or deposits refunded are also considered as income, when the original transactions were subject to the tax payment.

Taxes to be transferred such as VAT will not be regarded as income.

Income on exportation of goods or services is regarded as actually collected after twelve months have elapsed following exportation. In such cases, bad debts may be deducted for IETU purposes if the requirements established by the IT Law are met.

In those instances where goods are maintained abroad, and such goods are subsequently sold or leased, the related income will be subject to IETU at the same date such income is taxable for IT purposes.

By being a tax based on cash flows, provisions are established for determining the income when the price or the consideration is not in cash or by check. So, if collection is in goods or services, the market value or appraisal value will be regarded as income; this is also applicable if there is no agreed-upon consideration.

Income not subject to IETU

The following income is not subject to this tax:

- Payments for temporary use or enjoyment of assets between related parties regarded as royalties (taxable when use of tangibles is granted).
- Income from financing or bailment transactions giving rise to interest payment not considered in the price of the assets, or derivative financial transactions, when the underlying asset is not subject to the IETU.
- Income from sale of owners' equity interests, notes receivable and negotiable instruments, except for certificates of deposits and certificates of investment in a real estate trust not subject to amortization or other instruments granting the holder rights over real property.
- Income from sale of Mexican and foreign currencies.

- Income realized by individual on a sporadic basis, if not taxed under the IT Law.
- In those instances where foreign pension funds are exempt for IT purposes in their country of residence, participate as stockholders in entities where at least 90% of income is derived from sale or lease of real property located in Mexico.
- Legal entities not subject to IT, with certain exemptions.
- Donees authorized to receive tax-deductible donations, if income so received is used for their business purpose and no benefits are granted on any distributable remainder, except if such benefit is granted to another authorized recipient.
- Individuals and legal entities engaged in agricultural, stock-breeding, forestry or fishery activities, provided that such taxpayers are registered in the Federal Taxpayer Registry.

Deductions

Taxpayers will be entitled to take the following deductions:

- Expenses incurred for acquisition of goods, independent services or temporary use or enjoyment of goods, indispensable either for performing the taxed activities or for their management or production.
- Returns of goods received, discounts or allowances granted and deposits or advances refunded.
- Compensation for damages and losses and contractual penalties, except when arising from fault attributable to the taxpayer.
- Set-up or increase in mathematical reserve or disaster reserve related to life, pension or disaster risk insurance, as appropriate.
- Set-up or increase in the special mathematical reserve and other reserves required by the General Law for Mutual Insurance Institutions and Companies.
- Payments for covered risks made by insurance companies, as well as payments for claims by bonding companies.
- Lottery, raffle and draw prizes paid in cash.
- Non-monetary donations (same conditions as they are deductible for IT purposes)
- Uncollectible credits. Debt relieves, discharges and losses on sales related to the interest-bearing portfolio are also tax deductible.

The deductions must meet the requirement of being strictly indispensable for performance of the activities subject to this new tax, having actually been paid and satisfy the requirements for deductibility as established by the IT Law.

Deduction of wages and salaries or fringe benefits related to an employment relationship, the most important of which are social welfare provisions, is not permissible.

Since royalties for use of intangibles between related parties are not regarded as an activity subject to IETU, such royalty payments will not be tax deductible. Taxes paid by taxpayers in Mexico, incurred beginning January 2008 will be considered as deductions, except for IETU, IT, Tax on cash deposits, contributions to Social Security and transferable taxes, unless there is no right to the related tax credit.

Estimated tax payments

Estimated IETU payments must be made towards the annual tax liability on the same dates as those established for estimated IT payments. Estimated tax payments will be determined by applying the tax rate applicable to the year to the difference resulting from subtracting the deductions expended in the same period from the income collected from the beginning of the year.

The tax credit and additional credit, as well as the estimated IT payments for the same period and estimated IETU payments made previously may be applied against the tax determined for the estimated IETU payment.

Tax consolidation

Entities that consolidate for tax purposes (holding company and subsidiaries) are required to calculate individually their annual and estimated IETU payments.

Subsidiaries may credit both the IT delivered to the holding company and IT paid to the authorized offices against the IETU.

It is important to mention that the IETU Law provides that a holding company may apply only the corresponding individual IT.

Trusts

Whenever activities subject to IETU are performed through a trust, the trustees are required to compute the tax and comply on behalf of the trustors or beneficiaries with all formal obligations established, and make the estimated tax payments.

Trust beneficiaries or trustors must add to their income subject to IETU the relevant portion of the results of the trust activities for the year or credit the tax, if any, in conformity with their participation in the trust.

Based on the foregoing procedure, the trust would be a tax transparent entity; therefore, the trustors and beneficiaries will determine their IETU as they would if they had performed the activities directly.

Taxpayers' obligations

Taxpayers subject to IETU will be required to:

- Keep accounting records in accordance with the Federal Fiscal Code.
- Issue supporting documentation for the activities performed.
- For related-party transactions, income and deductions must be determined by considering compensation on an arm's-length basis.

Asset Tax

With the enactment of this new tax, the Asset Tax Law is repealed. However, the procedure to recover asset tax paid in prior years remains in force.

Refund of asset tax is also limited to the difference resulting between the IT actually paid in the year, with no credit for the tax on cash deposits, and the asset tax paid for 2005 through 2007, whichever is lower. The difference will be the limit to be used in subsequent years.

Whenever IETU exceeds IT for a year, any recoverable asset tax pending refund may be offset against the IETU. If asset tax is not offset or the respective refund is not reclaimed when entitled to do so, the right for offsetting or refund in subsequent years will be forfeited.

Transition

It is established that IETU will only be payable on activities carried out after the effective date of the IETU Law. Therefore, additional controls must be set up so as not to consider collection and payments for activities performed prior to the effective date.

In order to prevent discouraging new investments as a result of the enactment of this new tax, an additional deduction is authorized on investment acquisitions effected and incurred from September through December 2007.

The deduction will be taken at a rate of one third per year beginning 2008. For estimated tax purposes, the deduction to be taken will be a twelfth portion of the deduction corresponding to the year multiplied by the number of months from the beginning of the year though the month of the tax payment.

For investments acquired from January 1, 1998 through December 31, 2007, which are deductible under the IETU Law, a tax credit may be applied against the tax for the year and against estimated tax payments. Such tax credit consist of applying a 0.175 factor to the balance pending deduction as of January 1, 2008, adjusted at December 2007, and 5% of the results so arrived at will be credited to each fiscal year over ten years beginning 2008. Therefore, 50% of the tax value of the assets held at December 2007 cannot be considered.

The factor for fiscal 2008 will be 0.165 and 0.17 for fiscal 2009.

If investments are alienated prior to fiscal year 2018 or are no longer generating income, the tax credit pending to be credited is not applicable.

In case of a merger, the surviving entity will continue to apply the tax credits on investments under the same terms. For spin-offs, both the divided and new company may divide the tax credits on the referred-to investments.

Law for Tax on cash deposits (IDE for the spanish abbreviation)

This new tax will become effective July 1, 2008.

The new tax on cash deposits (IDE for its Spanish acronym) is defined as a control tax in nature, taxing those earnings that are not supported by an activity registered in the Federal Taxpayers Registry.

Subjects, taxable base and rate

Under the IDE Law, monthly cash deposits exceeding the amount of \$25,000 made by individuals or entities in a calendar month in any type of account with financial institutions, will be taxed at a rate of 2% which would be withheld by this institutions at the end of the month.

It will be understood that the deposit belongs to the account holder; however, the financial institution may be requested to allocate the tax among all of the account co-holders.

The \$25,000 limit would be determined by considering all cash deposits made by the taxpayer in one or more accounts with the same financial institution. Deposits made via electronic transfers, account transfers, negotiable instruments or any other document will not be liable for IDE because it is assumed a control exists and, therefore, oversight of the origin of the funds is possible.

Tax exemption

The Federation, Federal Entities, Municipalities, State-owned public administration entities, legal entities or institutions no subject to Income Tax, financial institutions on deposits made as a result of their financial intermediation and foreign individuals making cash deposits received as remuneration for diplomatic or consular services or in their capacity as employees of embassies and official delegations, would be exempt from the IDE.

Recovery or Credit

IDE could be credited against Income Tax paid by the taxpayers when filing estimated and annual income tax returns, except when previously credited against taxes withheld from third parties or offset against other federal taxes. It is established that any IDE that is not credited in a year when entitled to do so will not be creditable at a later date.

Whenever there is a recoverable difference on estimated tax payments after the aforementioned crediting and offsetting procedures, a refund may be requested through a tax certificate issued by a public accountant (auditor for tax purposes).

Tax consolidation regime

Under the tax consolidation regime, controlled entities may credit the IDE against the Income Tax that is to be delivered to the holding company and the tax payable to the authorized offices. Holding companies may credit both their individual IDE and the IDE credited by the controlled entities for their respective participation subject to consolidation against their consolidation Income Tax payable.

Obligations on financial institutions

This tax imposes new obligations on the financial institutions such as:

- Collecting the tax on the last day of the month in question, except for time deposits in excess of \$25,000, where the tax will be collected at the time the deposits are received. The IDE will be remitted to the Federal Treasury within the following three days.
- Financial institutions will be jointly and severally liable for failure to collect the tax and inform the tax authorities when funds are insufficient for tax collection.
- The tax authorities must be informed of both IDE collected and IDE pending collection due to insufficient funds, on a monthly basis.
- Financial institutions are also required to issue monthly and annual documentation to taxpayers evidencing the tax withheld, and file an annual information return no later than February 15th of the next year. Based on the information so received, the tax authorities may assess a tax liability that must be notified to the taxpayer which will have a 10 day term to disprove the facts.

Chapter 9

Other Taxes

Value-added Tax

Effective January 1, 1980, the value-added tax (VAT) replaced the gross receipts tax, the stamp tax and several other special federal taxes.

While the gross receipts tax was paid on the transfer of a good at each step of the production and distribution chain, VAT is levied on the value added to goods and services at each stage of the production and distribution process and is paid once by the final consumer on the total value added at each level.

The general VAT rate is 15 percent; however, the following special rates apply:

- Zero percent rate generally for sales of patented medicines and food products. The importation of such products is not subject to the payment of tax. Also, this rate applies to exports.
- 10 percent when the operations for which the tax is due are carried out within the border zone, except for transactions involving real estate.

On the other hand, the federal government established a special tax treatment for a significant number of products and services to promote their use and decrease their importation. This treatment consists of applying the rate of zero percent to activities carried out by taxpayers, mainly those relating to the sale and importation of basic food products in their natural state, the importation of farm machinery and equipment, the services rendered to farmers and cattle raisers, the exportation of goods and services such as those rendered by in-bond processing plants, commissions and mediations for exportation, technical assistance, publicity and professional services totally enjoyed abroad, financing, insurance, bonding and call center services.

Taxpayers carrying out these activities are entitled to a credit or to request a refund of taxes that have been transferred by their suppliers of goods or services, and thereby obtain the benefit of their recovery. Obviously, this treatment was designed to avoid raising the prices of products and services (without this treatment the tax would be absorbed as an additional cost, increasing the price).

VAT should be withheld in the following cases:

- a) When business entities agree with individuals on a fee basis or make lease payments to individuals, or acquire waste or scrap to be used as raw materials in industrial activities or for its trading.
- b) When individuals or business entities acquire tangible goods or make lease payments to residents abroad that do not have a permanent establishment in Mexico.
- c) When banks acquire goods by means of payment in kind or court awards.
- d) Overland motor vehicle transportation services for goods rendered by individuals or legal entities.
- e) Commission services rendered by individuals.
- f) When business entities that are in a temporary importation program in order to produce goods to be exported, acquire goods authorized by their programs from national suppliers.

VAT is imposed on gross income derived from the sale or disposal of property, including conditional sales, the rendering of independent services, the granting of temporary use or enjoyment of property and the importation of goods or services (technical assistance, fees, commissions, royalties and certain interest paid abroad), including taxes, duties, interest, and reimbursements.

Inventory shortages are also taxable unless the taxpayer can substantiate that such shortages do not involve any transfer or disposal of property.

Since 2002, VAT is paid on a cash flow basis. Certain exceptions are established as mentioned in following paragraphs.

Any person carrying out taxable transactions is subject to this tax. However, as previously indicated, the final consumer is the payer of the tax. The law requires that this tax be passed on to each operation regardless of the status of the consumer, whether a tax-exempt organization or federal and local governments.

The invoice issued to support such operations must expressly indicate the amount of both the operation and the tax transferred. In sales to final consumers not entitled to credit or deduct this tax, its transfer is not mandatory and should be included in the sale's price.

The taxpayer pays the difference between the tax passed on to the consumer and the tax already passed on or paid by the taxpayer on the purchase or importation of goods and services. The amount of creditable taxes must relate to goods or services strictly indispensable for carrying out the taxable operation, provided that such goods or services are deductible for income tax purposes.

In the case of sales, the rendering of services, the granting of temporary use or enjoyment of goods and the importation of intangible goods, the tax is payable at the time when the price is actually collected. In addition, when tax withholding is required, it should be made at the time of payment. The tax base is the gross income and no credits are allowed against the withholding.

Accordingly, with the taxing on a cash flow basis, the crediting of tax will only be possible when the tax transferred to the taxpayers is actually paid. In order to regulate the time when the actual payment is made, it is necessary to verify the date on which checks are honored because a credit may only be claimed until that time checks bank.

In the event that credit instruments are issued in favor of the taxpayer, they only constitute a guarantee of payment until they are actually collected or the documents pending to be collected are transferred to a third party, except when they are transferred for collection purposes. There is a specific procedure provided in the law for determining the tax when documents pending collection are transferred to debt collecting agencies.

The only acts or activities not giving rise to tax under the cash flow system are interest derived from credits granted by financial institutions through the use of credit cards and financial leasing operations where the tax on interest arises as it accrues.

Advances or deposits received by the vendor, the renderer of a service or the person granting temporary use or enjoyment of an asset, form part of the agreed price or consideration, regardless of the name given thereto. Below is the procedure to be followed for the determination of the creditable tax for the calculation of monthly payments.

Determination of creditable VAT

The VAT transferred to taxpayers and VAT paid on imports related to expenses for the acquisition of goods, services or temporary use or enjoyment of goods, used exclusively for performing taxable activities, which are deductible for income tax purposes, may be credited.

Tax shall not be creditable when these expenses are used exclusively for performing exempt activities and activities that are not subject to VAT. In cases where the taxpayer is only liable for tax on a portion of its activities, the crediting of VAT shall apply in the proportion of the value of taxable activities to total value of the activities performed during the month in question.

A specific treatment is provided for the crediting of taxes transferred to a taxpayer on the acquisition or importation of investments (fixed assets), with such taxes being fully creditable when such investments are exclusively intended for performance of taxable activities.

When the investments are used exclusively to perform exempt activities and activities not subject to tax, the VAT paid shall not be creditable. For investments used to carry out taxable or exempt activities, and activities not subject to tax, the tax paid shall be creditable in the proportion of the value of the taxable activities to the total value of the activities performed during the month in question.

Taking into account that such proportion may change subsequently, an adjustment procedure is provided to either refund or increase the credit originally applied to the extent the proportion of the taxable activities to total activities decreases or increases as compared to the proportion of the month in which the good was acquired.

The adjustment shall be made when there is a variation greater than 3% in the months subsequent to that in which the crediting of the tax on the investment in question was first applied. The adjustment procedure must be performed for the period in which the investment is deducted for tax purposes, based on maximum rates established by the applicable law, with control being required for each investment separately.

Taxpayers have an election with taxed or exempt activities and activities not subject to VAT for determination of creditable VAT, considering the proportion of taxed activities to total activities of the taxpayer during the calendar year preceding the month for which the tax is being computed. This procedure must be maintained for at least sixty months. Making such election entails that the taxpayer continue to determine the creditable VAT based on rules similar to those in force through 2004.

To determine the proportion of taxable activities with respect to total activities of the taxpayer, exempt activities and the activities not subject to VAT should be included in the total activities carried out, excluding from the proportion computation practically the same items as in 2004, except that beginning in 2005, exported goods and services must be included.

Determination of the tax

Tax is determined monthly and considered as final payment. Should a credit balance be obtained in any month, the refund of this can be requested in full or credited in subsequent months.

In view of the aforesaid, the previous annual return and adjustment will no longer be filed, which would appear to reduce the taxpayers' administrative burden. However, any omission of information will result in the filing of amended returns when previously such items were corrected in the annual or adjusted return.

In addition, the creditable taxes must be supported by invoices complying with tax requirements showing the amount of taxes passed on. For the purposes of this law, disposal of property means any transfer of property, regardless of how it is made, whether through a direct sale or through conditional sales, financial leases or other forms provided by law.

As mentioned previously there are important exceptions for which no VAT is payable. The most significant of these are land, construction projects destined for housing; books and newspapers, as well as certain other rights; used personal property, except that sold by businesses; partners' interests and credit titles; and local and foreign currencies and pieces of gold or silver, including troy ounces. Certain services are exempt from the payment of this tax. The most important of these are services rendered directly by the federal and state governments, including the Federal District, and municipalities that give rise to the payment of duties except in the case of service, use, supply, or exploitation of water.

Taxes transferred to the federal government, the Federal District, states and municipalities, as well as their decentralized entities and public social security institutions, may only be compensated when they are identified with activities that are subject to the payment of taxes pursuant to the law.

Other tax exempt services are those rendered by public institutions for social security; education rendered by accredited institutions; insurance against agricultural risks and life insurance, as well as the related commissions paid to agents and underwriters; medical services rendered by a recognized physician; commission obtained by pension funds administrators, interest on loans granted or paid by credit institutions, except for those from credit cards and the ones paid by individuals not engaged in business activities; the rendering of independent personal services or leasing of real property; and derivative financial transactions.

In the case of interest from loans granted by financial institutions, current accounts in the use of credit cards, installment sales and financial leasing, the tax will be paid on the difference between the nominal interest and the inflation following a procedure provided by law.

No tax is payable for the temporary use or enjoyment of real estate destined for housing or farms used for agricultural purposes or cattle raising. The granting of temporary use or enjoyment of property is understood to be any act regardless of the juridical form employed for carrying it out by which permission is given for the temporary use of tangible goods in exchange for some consideration.

Every importation of goods or services is subject to the payment of VAT, with the exceptions mentioned below. In the case of the importation of tangible goods, tax is payable as soon as the goods are available for the importer at the customs or tax building; in the case of temporary importation, the tax is payable when they become final.

For any of the above taxable transactions, taxpayers must file a VAT return by electronic means and should pay the VAT within seventeen days following the month during which the taxable transactions are carried out.

VAT cannot be paid on a consolidated basis, when such treatment has been elected for income and asset tax purposes. On the other hand, parties withholding the tax must issue the required certificates of withholding, and file an informative tax return in February of each year.

Taxpayers with exempt transactions or taxable transactions that are taxable at different tax rates must record those transactions separately in their accounting records. The taxpayer must issue an invoice that supports the taxable transactions and show separately the amounts of the transactions and the tax passed on.

Commission agents must distinguish between and record separately in their books, those transactions performed on behalf of their principals and those performed for their own account.

Exportation of goods

Beginning July 1st, 2006, foreign tourists who leave the country by air or sea may opt for the refund of the tax paid on goods acquired, provided the amount purchased is at least 1,200 pesos per establishment.

Minor taxpayers

The tax calculation procedure for those who pay taxes under the minor taxpayers' regime established that their tax liability shall be determined in the general terms of the subject Law. The payment based on the estimated value of the taxpayer's activities is optional for these minor taxpayers.

Invoices

Invoices supporting acts or activities on which VAT is due shall indicate expressly whether the consideration is payable in a single payment or by installments.

When the consideration is due in a single payment, the invoice should indicate the total amount of the operation and the equivalent of the tax being transferred.

If the consideration is payable by installments, the invoice issued to support the transaction should indicate the amount of the installment being paid and the tax thereon being transferred.

When the consideration is payable by installments, taxpayers shall issue simplified vouchers for each installment payable after the date of issuance of the invoice.

Also, taxpayers shall enter thereon the amount of the installment supported by it, the form of payment thereof, the amount of tax being transferred, the amount of tax withheld, if applicable, and the number and date of the document issued, to support the relative sale or granting of temporary use or enjoyment of assets or rendering of services

Special Tax on Production and Services

In accordance with the Special Tax on Production and Services Law, entities or individuals carrying out the following activities are liable for the tax:

- Alienation of alcoholic beverages, beer, tobacco, gasoline and diesel fuel.
- Rendering of services such as commissions, mediation, agency, representation, consignment or distribution derived from the alienation of the products mentioned above.

Applicable Rates

The tax is determined by applying the following rates on the activities carried out:

Alcohol, Fermented Alcoholic Beverages and Beer

- From 0 to 14 degrees G. L. 25%
- More than 14 degrees, until 20 degrees G.L. 30%
- More than 20 degrees G.L. 50%
- Alcohol, denaturalized alcohol 50%

Tobacco

- Cigarettes 150% (2008), 160% (2009)
- Cigars and other tobacco 150% (2008), 160% (2009)
- Cigars and other tobacco handily made 28.5% (2008), 30.4 (2009).

Gasoline and diesel

The rate applicable to gasoline and diesel fuel will be the one resulting for each agency of Petroleos Mexicanos and its subsidiaries. Also, the law establishes a special treatment for the sale of these products.

Beginning 2008, a surtax is charged on the sale of diesel or gasoline in Mexican territory at the rate of 5.5% on revenues earned from final sales of gasoline or diesel to the general public in Mexico, which are not subject to value added tax but included in the selling price of these fuels.

This surtax shall be applied gradually, starting by a 1.5% increase in the month this provision takes effect, then 1% increases in the months of February, April, June and August 2008 to complete the 5.5%.

The tax at the rate of 5.5% shall not be levied where the Mexican States establish local taxes on final gasoline and diesel sales.

Exemption from the 5.5% surtax is afforded to sales between subsidiary organisms or to sales made o service stations that are not the general public.

- Gambling and betting 20%.

Creditable Tax

Taxpayers can credit the transferred tax for the acquisition of alcoholic beverages, beer and alcohol and also, for importing alcoholic beverages, tobacco, gasoline and diesel.

Taxpayers will lose this right when the transferred tax is not credited against the payable tax within the month when the payment must be made or within the following two months.

Monthly Payment

The due date for tax payment is the 17th day of the month following that in which the payment must be made. The payment is considered made when the payment is collected.

Taxable Base

In order to calculate the tax for the sale of products, the taxable base will be the payment made for such products. The monthly payment will be calculated by subtracting the tax paid on the importation of the goods and the creditable tax; from the amount obtained from the application of the corresponding rate.

Taxpayers who sell or import cigarettes must consider as taxable base the price at which they sell the products to retailers. Beginning 2006, with a view to encouraging the reuse of containers by beer makers and importers, the calculation of the tax is amended so that the taxpayer ultimately pays the greater tax between that of the current procedure or the amount that results from applying a 3 peso rate to each liter sold or imported. In this last case, the rate noted may be reduced by 1.26 pesos when the container is used again.

Importation of goods

In accordance with the law, the tax is triggered when the petition (pedimento) is filed with customs, when the temporary importation became definitive or when the goods are illegally introduced in Mexico and this is detected by the tax authorities.

Taxable Base

The taxable base for importation of goods is the value declared for general import tax purposes increased by the amount of contributions and rights that must be paid for the importation, except the VAT.

Rendering of services

To calculate the tax for the rendering of services, the amount paid for such services will be considered the taxable base. In this case, the tax will be triggered when the payment is collected.

Gambling and betting

The tax is calculated by considering the total value of the amounts actually received from participants of said gambling and betting. In the case of games or betting where bets are placed, the value of the total bet amount shall be deemed as the base, while in games or betting where the bet is made using devices used in betting instead of cash amounts, the base shall be the total value of the equivalent amounts in Mexican currency supported by such means. Prizes and the amounts returned to participants may be deducted from the base amount.

No tax shall be levied on said activities when performed by non-for-profit organizations authorized to receive deductible donations for Mexican Income Tax purposes, provided they use the totality of the funds obtained for the purposes for which they were created, after discounting the prizes actually paid.

In like manner, exemption from this tax shall apply where betting participants acquire such capacity without being subject to the payment, the acquisition of a good or the engagement of a service or acquire such capacity gratuitously for the mere fact of having acquired a good or engaging a service and provided the betting organizer does not obtain more than 10 permits to hold betting in any given calendar year and that the total amount of prizes offered in a given calendar year does not exceed 3% of revenues earned in the immediately preceding year.

Obligations

The law establishes, among others, the following obligations:

- Taxpayers should keep the accounts and issue vouchers or invoices in which the transferred tax is specified when alcoholic beverages and beer are sold when it is required by the buyer.
- Producers and importers of alcoholic beverages and cigarettes are obligated to label and seal their products.
- Taxpayers engaged in sale of table wines shall be obligated to inform on a semi-annual basis of the selling and the volume of products sold.
- Taxpayers must file annual informative returns of the goods produced, sold or imported during the year.

Information on tags or seals

For verifying the proper use of tags or seals the tax authorities may require from the taxpayers information or documentation thereon. Such documentation should be provided within 10 business days of such request.

Real Estate Acquisition Tax

This is a local tax which substituted the stamp tax and is imposed on transfers of real estate or similar operations by which property or rights thereto are transferred, including donations for cause of death and contributions to an association or company, as well as conditional sales, promises to buy, assignment of rights or mergers and spin-offs of companies.

Likewise, foreclosed assets and payment in kind with real estate (liquidation, capital redemptions, profits or dividends of civil associations or mercantile companies) and the transmission of usufruct or the bare property, as well as the extinction of usufruct, unless it is extinguished by death of the usufructuary, regardless of whether the usufruct has been constituted for a certain time or for life, are acts subject to this tax.

Also, certain acts carried out through trusts are subject to this tax.

The tax is payable on the greater of the acquisition price, the determined cadastral value by application of the unitary values of the land, constructions adhered to it, special facilities of common type, accessory elements or complementary works or the appraisal value determined by the tax authorities, applying the rates in force

in the law of the state where the property is located. For instance, in the Federal District, the rates range from 3.163 to 4.565 percent for real estate values ranging from pesos MXPs61,718.70 to those in excess of MXPs1,481,246.80, respectively.

Generally speaking, in the Federal District, the tax must be paid during the first 15 days of the month following that in which the agreement is formalized. The notary public that notarizes the operation is held jointly responsible with the purchaser for the payment of the tax.

Tax on New Automobiles

Sales of new automobiles manufactured in Mexico, the importation of new automobiles or models not more than ten years old are subject to this tax. The seller or importer is responsible for paying the tax.

For the importation of vehicles by manufacturers and dealers, the tax will be due and payable at the time the vehicle is sold to the consumer and not upon its importation. This procedure eliminates the current financial burden.

The tax basis is the automobile manufacturer's sales price offered to the consumer or its dealers, including its accessories, or the value used to compute the general import tax, including optional equipment, but does not include the VAT included in such sales. The tax rate ranges from 2 to 17 percent for automobiles with a sales price up to MXPs302,751 and more than MXPs290,297 up to 464,444, respectively. For values greater than MXPs464,444 the tax will be reduced to a 7% rate on the difference between the total price of the automobile and this upper amount. The tax is calculated by fiscal year, except in the case of certain imports. Taxpayers must make provisional payments at the latest by the 17th day of each one of the months of the fiscal year, by means of filing a return by electronic means.

The annual tax, reduced by the provisional payments, must be paid by means of a return filed at the authorized offices within the three months following the closing of the same tax year.

This tax is not payable in the following cases:

- On the definitive export of automobiles, in terms of the customs legislation.
- On the sale to the general public of compact automobiles of popular consumption.
- On the import of tax exempt vehicles in accordance with the law, or with treaties or international agreements rendered by Mexico, whenever one fulfils the requirements and conditions indicated by the Mexican treasury and by means of general rules.

Chapter 10

Mining

Before engaging in mining activities, a company must first obtain a concession from the federal government for exploring and exploiting a mine. These concessions are granted to companies incorporated under Mexican laws or to Mexican individuals, not directly to a foreign company branch. According to the Mexican Foreign Investment Law in force, there is no limit on the participation in the capital stock of a Mexican company that carries out mining activities.

Hydrocarbon exploration and development are activities reserved exclusively for the Mexico, as well as the development of nuclear minerals.

Concessions

There are two different types of concessions: exploration and exploitation. An exploration concession may only be granted for a non-renewable six-year period with no limit on the number of hectares. This concession may be substituted by one or more exploitation concessions which are granted for a fifty-year period and may be renewed.

An exploitation concession must meet minimum annual expenses incurred in its operation. Every year, the concessionaire must prove that the operation program is carried out as approved, that development expenses were actually incurred and that the plant is properly working.

Taxes

The following are the semi-annual rights applicable to the mining industry:

Mexican pesos

For each hectare assigned to exploration of mines:

During the first and second year	4.60
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During third and fourth year	6.88
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During fifth and sixth year	14.24
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During seventh and eight year	28.64
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During ninth and ten year	57.26
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From ten year on	100.79
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The tax should be paid every six months on January and July of each year.

Income Tax

Exploration costs, including the cost of acquiring exploration rights, may be deducted over a 10-year period (i.e. at 10% per year as a general rule). If mine development commences during the 10-year period, a residual deduction may be applied in respect of 100% of any undeducted exploration costs. Initial costs that are not related to exploration activities may be deducted in the year in which they were incurred.

Nevertheless, taxpayers engaged in exploitation of mineral deposits may elect to deduct disbursements made in pre-operating periods (exploration costs) in the income year in which they are made. This option is required to be applied for all pre-operating expenses corresponding to each mineral deposit in the income year concerned.

Accelerated depreciation is available in respect of new fixed assets subject to certain rules and other financial analysis.

It is important to consider, that certain requirements must be met to deduct such expenses against income.

Chapter 11

Maquiladoras

Maquiladora program (commonly known as maquila) is an industrial or service process aimed at transforming, manufacturing or repairing goods originated abroad, imported duty-free on a temporary basis, to be subsequently exported back and to provide services that could qualify as exportation of services such as: inventory management, calling centers, data processing, among others.

Up to the end of 2006, maquilas were operating under the Maquila Decree which was merged with the PITEX program (another export program similar to the maquila), generating a new Decree denominated "Decree for the Maquiladora Industry, Manufacturing and Services for the Exportation." This new Decree maintains all benefits previously granted to maquilas and was intended to simplify the operation of the two programs mentioned. Currently this new Decree is commonly referred to as "DIMMEX".

One important change incorporated in this new Decree is that it recognizes the rendering of export services. It includes a complete list of services that could be considered as exported through this program.

Mexican corporations may apply to participate in this program, regardless of how their capital stock is structured. Such corporations may establish their facilities anywhere in Mexico, and their purpose must be to export the majority of their production or services (although they can sell their products in the Mexican market).

Likewise, already established companies may become engaged in this kind of operations, if they compete with their products in the domestic market and desire to use their production capacity to export. This program also offers good opportunities to companies engaged in export projects through foreign companies that provide technology and raw materials but are not involved in managing such projects (shelter maquiladora).

In order to operate as a maquila, it is necessary to obtain a permit from the Ministry of Economy. The permit is granted once the entity has been duly incorporated in Mexico and a federal tax identification number has been obtained (Registro Federal de Contribuyentes).

The relationship between the Mexican maquila and its foreign related party or parties is managed through a maquila agreement, in which the terms and conditions of the services to be provided, including the foreign entities use of machinery and equipment, is established.

It is important to mention that through the years, different types of maquilas have been developed, such as service maquilas, manufacturing maquilas, maquilas operating under manufacturing agreements or shelter operations, involving the use of equipment provided by foreign residents or owned by the maquila, and transforming raw materials owned by foreign residents or by the maquila. The options available for the use of this program are several and the program could be adjusted to almost all types of agreements to manufacture goods in Mexico, taking advantage of specialized labor, proximity to the United States and an extensive commercial treaties' network developed by Mexico, including, among others, the North American Free Trade Agreement (NAFTA), the European Community Treaty, and the Economic Cooperation Trade Agreement with Japan.

One important issue to consider is that the Mexican Government has developed a complete legislation to allow maquilas to operate in Mexico in a very competitive way. For these purposes, Mexican legislation in connection with transfer pricing compliance, customs and VAT has been adjusted through the years in order to eliminate or reduce negative consequences, taking into consideration the way in which global businesses are handled from different perspectives such as tax generation, delivery and destination of the goods.

Tax legislation - specific issues applicable to maquiladoras

Income tax

Maquiladoras are subject to Mexican taxes, as any other Mexican entity, notwithstanding the type of legal entity (i.e., corporation, partnership, etc.) There is no specific treatment for them. The income tax rate applicable to Mexican entities is currently 28%.

Estimated tax payments must be made every month, taking into consideration the previous years taxable income.

There are three important issues that should be taken into consideration in connection with maquilas:

- Constitution of a permanent establishment for the foreign resident to whom maquilas services are provided. In general terms, a maquila may give rise to a PE for its foreign principal (company that provides goods to be manufactured by the maquila using assets provided by such company) or to hire the Mexican entity to perform export services. Under the Mexican Income Tax Law in force, a PE is not deemed to exist if the following requirements are met:
 - i) The foreign parent company is a resident of a treaty country (please refer to the list of tax treaties signed by Mexico at the end of this book), if the requirements established in the treaty are complied with and the treaty states that no permanent establishment is triggered in connection with the maquila operation carried out by the maquila in Mexico and,
 - ii) The maquila complies with the transfer pricing rules, which are mentioned in the transfer pricing section below.
- Tax on assets for the foreign goods (machinery and equipment and inventories) used in Mexico but owned by the foreign principal. Assets, such as machinery and equipment and raw material provided to the maquila in order to be used in the maquila activity are subject to Tax on Assets. However, if the maquila complies with the transfer pricing rules applicable to maquilas, an exemption is granted to such assets as long as the assets are not used to manufacture goods to be sold in the Mexican market. If goods manufactured in a maquila are sold in the Mexican market, this tax is triggered considering only on the percentage of the total production destined for the Mexican market.
- Income Tax Exemption. As of October 2003, the Mexican government issued a decree which allows the maquilas to reduce or eliminate their income tax, at both the annual and the estimated payments level. This decree is currently in effect and there is no termination date. However, the Mexican government has the right to repeal it. The main reason for the issuance of the decree was to promote foreign investment in Mexico and avoid the exit of maquila activities to other countries such as China and to Central America.

Value-added tax (VAT)

Maquila services provided by maquiladoras are considered as exportation of services for VAT purposes, subject to the 0% tax rate. This rate is also applicable to the submaquila services provided by other maquilas if the goods are exported.

Generally, maquiladoras generate VAT balances in their favor that can be refunded or used as a credit against other federal taxes. The favorable VAT balance is generated from the tax paid to their local suppliers of goods and services. There is a specific treatment applicable to maquilas that allow them to consider all the VAT paid related to the export operation, (providing that the supporting documentation complies with the tax requirements), creditable and subject to refund.

When maquilas acquire goods authorized in their maquila program from Mexican suppliers, they are required to withhold the VAT charged by the local supplier. Even when by Law this withholding is mandatory, currently through miscellaneous rules it is established that this it is not mandatory until a national supplier program has been developed.

The benefit of the withholding scheme allows the maquilas the immediate reimbursement of the VAT charged by the suppliers.

One important issue to take into consideration is the acquisition or sale of products in Mexican territory carried out by non-residents when the goods are delivered to or by maquilas. In general terms, any sale of goods performed in Mexico (when the physical delivery is made in Mexico) is subject to VAT. For these purposes, the Mexican tax authorities have established mechanisms in the law and in the foreign trade rules, to avoid the payment of this tax when the goods are transferred between maquilas, sold between non-residents or sold by Mexican vendors to the foreign principal, but physically delivered to the maquila, if the goods continue to be imported on a temporary basis. Customs mechanisms have been established for these purposes.

Transfer pricing rules

Maquilas have been subject to specific transfer pricing rules since 1995, and such rules have changed through out the years. New rules were introduced in 2003 and are the following:

There are two options in order to comply with the transfer pricing rules:

1) Safe Harbor

The new rules, as of 2003, provide that in order to meet the safe harbor and avoid the PE issue, the taxable income of the maquiladora should be the greater of:

- 6.9 percent of the value of the assets owned by the maquiladora and the foreign principal used in the maquila activity; or
- 6.5 percent of the operating costs and expenses incurred in Mexico in the maquiladora operation, including certain costs and expenses of the foreign principal.

Companies that elect this option must file with the Mexican tax authorities, within the first three months of the following year in which the option was applied, a statement that indicates the result of the above comparison.

2) Transfer Pricing Study

Alternatively, the maquiladora may prepare a transfer pricing analysis for Mexican purposes, under the guidelines of the Organization for Economic Cooperation and Development, which must consider either:

- The maquiladora operation in Mexico, plus 1% of the net book value of the foreign owned machinery and equipment located in Mexico and used in the activity, or
- The return of investment expected from the maquiladora operation in Mexico in comparable transactions, considering any foreign-owned assets in addition to the assets owned by the Mexican company.

As mentioned above, these rules are only applicable to maquilas operating with a company resident in a country which has signed a double taxation treaty with Mexico.

Payments abroad

Generally, there are no payments by the maquila to its foreign parent company because the use of the machinery and equipment is provided on free of charge through bailment agreements, and there is no charge for technical assistance provided by the foreign entity. However, there are no restrictions on charging the maquilas for such concepts or for any other of similar nature such as management fees.

It is important to take into consideration that most maquilas are operated under a cost-plus basis (all the expenses incurred by the maquila plus a markup profit margin, determined to comply with the transfer pricing rules, are charged to its customer). Therefore, any charge to the maquila for the above concepts would be invoiced back, increased by the maquila profit.

Payments to non-residents are subject to Mexican income tax withholding, which varies depending on payment in question and the country of residence of the recipient.

Chapter 12

Transfer Pricing

Transfer pricing has become a very important topic in the tax arena. Mexico's tax authorities are increasingly issuing more rules and requirements related to transfer pricing. Also, the number of transfer pricing inspectors within the tax authority, as well as the number of transfer pricing audits, have increased dramatically, compared to previous years.

A couple of decades ago, transfer pricing was not an issue for Mexican tax authorities, mainly because Mexico's borders were closed to international transactions. However, once Mexico joined the former GATT, cross-border transactions started to increase. Due to this fact, in 1992, some transfer pricing rules were incorporated into Mexico's tax legislation. These rules allowed the tax authority to restate a taxpayer's profit or loss, using what might be considered the traditional transaction methods (comparable profit method, cost plus, and resale price). However, there is no evidence that these rules were ever enforced.

In 1994, Mexico joined the OECD and signed the NAFTA. Based on these developments, Mexico was encouraged to include in its legislation, the principles issued by the OECD regarding transfer pricing, among other issues.

The first legislation regarding transfer pricing was enacted in 1995 and was intended for the maquiladora industry (in-bond agreement manufacturing regime), which operates under specific rules for tax and custom purposes. This new legislation established that maquiladoras were considered to comply with transfer pricing if they obtained a safe harbor equivalent to a taxable profit representing at least a 5% of the total assets. If a maquiladora did not apply for a safe harbor, it could request an advanced pricing agreement from the tax authorities.

Maquiladora rules have gone through several changes, mainly for them not to be considered a permanent establishment of the foreign resident. As of 2007, they still may apply a safe harbor, which must be the greater of a 6.9% on assets or a 6.5% on costs and expenses. If they do not apply for a safe harbor, they need to prepare transfer pricing documentation, taking into account the assets used that belong to the foreign resident. An APA is no longer necessary for a maquiladora to comply with transfer pricing, but maquiladoras still have the option to request one.

Based on the revenue increase from the maquiladora industry, and after several years of dealing with transfer pricing, Mexico's tax authority, in 1997, incorporated, transfer pricing rules that apply to all taxpayers into the Income Tax Law. These rules have undergone some changes since they were first introduced.

Under Mexican domestic tax legislation, all taxpayers are required to price their transactions with related parties on an arm's-length basis. When transactions are carried out with foreign-based related parties, taxpayers are also required to prepare and maintain documentation that supports the arm length price by identifying related parties and disclosing information regarding the functions, risks, and assets associated with each type of transaction performed with related parties.

Also, the use of a transfer pricing methodology, including the information of the comparables used, is required for each type of transaction carried out with related parties. The methodologies provided by Mexican legislation are the following:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Profit split method
- Residual profit split method
- Transactional operating margin method

If the transactions are carried out with a Mexican related party, they should be priced at arm's length, and one of the transfer pricing methodologies mentioned above, may be applied to support that the values used in the transactions represent local market values.

Generally speaking, the Mexican tax authorities follow the OECD guidelines, and there is a regular exchange of information with the OECD tax specialists to ensure the tax authorities are kept up to date with developments.

All the transfer pricing methods included in Mexico's legislation are contained in the OECD guidelines and are acceptable to the authorities. However, starting in 2006, taxpayers must apply in first term the Comparable Uncontrolled Price Method, and will only be allowed to use another method contained in the tax legislation when the Comparable Uncontrolled Price Method is not the adequate method to determine that the transaction carried out with related parties is arm's-length.

Additionally, in order to consider that the methodology is correct when applying the Resale Price Method, the Cost Plus Method or the Transactional Net Margin Method, the taxpayer has to demonstrate that the costs and the sales price are arm's-length. Finally, the taxpayer has to demonstrate that the applied method is the most adequate according to the information available, having to prioritize the Resale Price Method and the Cost Plus Method.

Taxpayers undertaking related party transactions with overseas affiliates are required to file an informative return with the tax authorities regarding transactions carried out with said related parties during the previous year. The information to be filed consists of the name, country of residence and tax ID number of the related party, the type and amount of transaction carried out, as well as the profit margin obtained from the transaction and the transfer pricing methodology used to test its arm's length nature. This informative return is due along with the annual income tax return.

If the tax authority considers a taxpayer to have underpaid taxes as a result of an unacceptable transfer pricing policy, it is likely that the taxpayer will suffer a penalty that may range from 75 percent to 100 percent of any additional taxes due. If, however, the taxpayer has maintained adequate supporting documentation, the penalty imposed may be reduced by 50 percent. Also, if a taxpayer declared a loss for tax purposes due to an unacceptable transfer pricing policy for the tax authorities, it is likely that the taxpayer will suffer a penalty that may range between 30 percent and 40 percent of the over reported loss. However, if the taxpayer has transfer pricing documentation, this penalty may also be reduced by 50 percent.

There is no specific penalty for failing to maintain contemporaneous transfer pricing documentation, although a minor penalty may be levied in such cases owing to a failure to comply with a tax obligation. However, there is a penalty for not filing the informative return, which ranges from USD 4,000 to 8,000.

Also, if the informative return is not filed, payments made to foreign based related parties may be considered as non-deductible. Recently, the tax court issued a rule stating that in order to deduct payments made to related parties for tax purposes, the transfer pricing documentation supporting the arm's length nature of said transactions must be in place by the time the tax return is filed.

Recently, the tax authorities have been performing several transfer pricing audits.

One of the criteria followed in these reviews is that if the taxpayer does not have transfer pricing documentation in place, then it failed to comply with its obligation of maintaining transfer pricing documentation, and therefore, all payments to related parties may be considered as non-deductible. This criterion has been recently confirmed by the tax court, since it issued a rule stating that in order to deduct payments made to related parties for tax purposes, the transfer pricing documentation supporting the arm's length nature of said transactions must be in place by the time the tax return is filed.

Tax authorities have been very aggressive while performing transfer pricing audits. They have challenged the nature of related party transactions, as well as the fact that documentation has to be in place for the specific year in which the related party transaction was performed, and testing said transactions.

APAs may be negotiated with the Mexican tax authorities. The majority of APAs already concluded have been unilateral agreements issued to maquiladoras. APAs may either be unilateral or bilateral, and have a period of five years. This five-year period includes the year of request, the following three years, and the year prior to the request.

Chapter 13

Accounting Requirements and Practices

Statutory Requirements for Books and Records

The Mexican Commercial Code and Income Tax Law require that certain summary accounting records be maintained in the form of bound books; however, mechanized and electronic data processing systems are acceptable.

The principal books of account are the general journal and the general ledger. Loose-leaf or any other type of subsidiary records may be maintained. The principal and subsidiary records of a company must be written in Mexican pesos and in the Spanish language. They should be kept at the official domicile of the company.

Accounting Principles and Practices

Through mid 2004, the Accounting Principles Commission, a branch of the Mexican Institute of Public Accountants (MIPA), was responsible for issuing formal statements on generally accepted accounting principles, which differ in certain significant respects from those applied in the United States (U.S. GAAP). On June 1, 2004, this responsibility was transferred to a new entity (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera -CINIF), independent from the MIPA. The standards issued by this entity are known as financial reporting standards (FRS), and are intended to achieve convergence with International Financial Reporting Standards (IFRS).

Through December 31, 2006, CINIF has issued nine FRS effective for fiscal years beginning after December 31, 2005, and four effective for fiscal years beginning after December 31, 2006, mainly replacing statements issued by the Accounting Principles Commission. Those statements not specifically superseded by FRS continue to be mandatory and, thus, considered FRS. One of the FRS in force establishes the supplementary application of IFRS and, in limited circumstances, other country standards, in the absence of international standards in the case of events or transactions not dealt with by existing FRS.

The principal changes introduced by FRS are:

- Donations received are reported in the results of operations, instead of as contributed capital.
- Income statement items are split into ordinary and non-ordinary, thus eliminating special and extraordinary items.
- Employee statutory profit sharing is reported under ordinary expenses, as a component of other income and expenses, instead of as a separate line item after income (loss) from continuing operations.
- Disclosure of the officer or body authorizing issuance of the financial statements, as well as the date on which such authorization was granted.
- Retroactive recognition of the effects of changes in standards used.
- Beginning January 1, 2007, long-term liabilities callable by the creditor because of a breach of covenants at the balance sheet date should be classified as short-term even if a waiver is obtained from the creditor prior to issuance of the financial statements. This requirement is the same as that established by IFRS, but departs from U. S. GAAP.
- Disclosure of the possibility that owners or others modify the financial statements after issuance.
- Disclosure of the name of the direct parent company, as well as the ultimate parent, when different.
- Disclosure of total benefits for key management personnel or relevant officers, in the aggregate, broken down in four categories.
- Mandatory capitalization of comprehensive financial results (CFR) directly attributable to the acquisition of qualifying assets which acquisition period begins after December 31, 2006. Previously, capitalization was discretionary. CFR includes interest, foreign exchange gains and losses, changes in the fair value of financial assets and liabilities, and gains and losses on monetary position.

The FRS in force cover:

- Structure of financial reporting standards
- Basic postulates
- Users' needs and objectives of financial statements
- Qualitative characteristics of financial statements

- Basic elements of financial statements
- Recognition and valuation
- Presentation and disclosure
- Supplementary application of international financial reporting standards
- Accounting changes and correction of errors
- Statement of income
- Comprehensive income
- Segment information
- Business acquisitions
- Consolidation and valuation of permanent investments
- Interim financial information
- Recognition of the effects of inflation on the financial information
- Statement of changes in financial position
- Subsequent events
- Earnings per share
- Foreign currency transactions and translation of financial statements of foreign operations
- Financial statements of not-for-profit entities
- Cash
- Financial instruments
- Accounts receivable
- Inventories
- Prepaid expenses
- Property, plant and equipment
- Intangibles
- Liabilities, accruals, contingent assets and contingent liabilities, and commitments
- Derivative financial instruments and hedge transactions
- Shareholders' equity
- Financial instruments with characteristics of liabilities, equity, or both
- Related parties
- Impairment of long-lived assets

- Accounting for personnel costs (including pensions, severance and seniority compensation)
- Accounting for income tax, tax on assets and employee statutory profit sharing
- Leases
- Capitalization of comprehensive financial results
- Construction-type contracts
- Agriculture
- Revenue and contributions received by not-for-profit entities, as well as contributions made by them.

In addition to the statements, the Accounting Principles Commission used to issue interpretive circulars on the application of the statements to special events and/or transactions. CINIF has continued with this practice when necessary.

Inflation Accounting

Of paramount importance is the requirement that, to comply with FRS, the basic financial statements must recognize the effects of inflation on the financial information. This recognition includes the following:

- Current year income statement must be stated in pesos of constant purchasing power as of the date of the most recent balance sheet presented, by applying the National Consumer Price Index (NCPI) published by Banco de Mexico (the Central Bank), from the month in which income, costs and expenses occurred to year-end, except when specific costs are used for inventories and cost of sales, and for plant and equipment acquired abroad.
- Prior years financial statements presented for comparative purposes must be adjusted for inflation by using the NCPI, to present pesos of constant purchasing power as of the date of the most recent balance sheet presented, including adjusting the income statements for inflation, as described in the preceding paragraph.
- Common stock, additional paid-in capital and retained earnings (and other shareholders' equity accounts, if any) must be presented in the statements of changes in shareholders' equity in pesos of constant purchasing power as of the date of the most recent balance sheet presented, by applying the NCPI.

- The statements of changes in financial position for all years presented must be stated in pesos of constant purchasing power as of the date of the most recent balance sheet presented, based on the inflation-adjusted balance sheets, as described above, and on the inflation-adjusted amounts of financing and investing activities, by applying the NCPI.

Also, the original balances in the financial statements, adjusted for inflation as described above, should be first stated as follows:

- Non-monetary assets, such as inventories, investments in associated and other companies, and property, plant and equipment, and related profit and loss effects, at cost adjusted for inflation, using the index method (NCPI), with the exceptions discussed below. These assets must be stated at the lower of inflation-adjusted values or recoverable cost.
- Common stock, additional paid-in capital, and retained earnings, adjusted by the amount necessary to maintain the purchasing power equivalent to that at the dates on which the related amounts were contributed or arose; i.e., by applying the NCPI from the related dates.
- The results from holding net monetary assets or liabilities (monetary position), by applying the NCPI to the net balances at the beginning of each month throughout the year.

In accordance with U.S. GAAP, historical costs are maintained in the basic financial statements and no gain or loss on net monetary assets or liabilities is recognized.

Valuation of Assets and Liabilities

Bearing in mind the aforementioned comments, assets and liabilities on the most recent balance sheet presented, and income, costs and expenses on the income statement, prior to adjusting for inflation, are stated as follows:

- All rights and obligations arising from financial instruments, including derivatives, are recognized on the balance sheets, and classified into one of three categories, depending on the purpose for which acquired: (i) held-to-maturity, (ii) trading, or (iii) available-for-sale. Trading and available-for-sale instruments are reported at fair value, and held-to-maturity instruments are reported at amortized cost. Changes in the carrying amounts of trading instruments, including the related costs and yields, as well as other-than-temporary declines in value of held-to-maturity instruments, are reported in operations under comprehensive financial results.

Gains or losses arising from changes in the fair value of financial instruments classified as available-for-sale, as well as the related gain or loss from monetary position, are reported under comprehensive income within shareholders' equity, excluding the impairment of these assets (which is carried to the results of operations), provided the instruments are not sold or transferred to a different category. Upon sale of the instruments, the effects recognized in comprehensive income are carried to the results of operations for the year.

- Inventory costs may be determined either by the direct costing method (only variable production costs are included in the inventory) or by the full absorption cost method. These inventory costs are stated at current cost, not in excess of realizable value; current cost may be determined by applying the NCPI to the cost recorded on the books or at replacement cost. Cost of goods sold (COGS) may be determined under the last-in first-out (LIFO) method, adjusted in case of depletion of prior years layers, or by applying the NCPI to the current cost recorded at month-end. For tax purposes, through December 31, 2004, the historical cost of purchases during the year was deductible, while COGS was not. Beginning in 2005, COGS is tax deductible, but the LIFO method is not allowed.

This differs from U.S. GAAP mainly because under U.S. GAAP direct costing is not allowed, inventories should be stated at the lower of cost or market, and cost of sales is not adjusted for inflation.

- Investment in subsidiary and/or affiliated companies is primarily accounted for under the equity method; however, lack of control (as defined in Bulletin B-8) prevents the company from applying this method and/or consolidating. Intangible assets acquired in a business combination should be accounted for at fair value at the date of acquisition and reported separately, unless their cost cannot be reasonably determined, in which case these assets should be reported as goodwill. Should there be no active market for these intangible assets, they must be written-down to the excess of the book value over the purchase price or to zero. These assets and other non-monetary assets are subject to impairment evaluations, both at the date of acquisition and at least annually thereafter. However, the stated value of non-monetary assets does not have to be reduced to zero before recognizing a negative goodwill (as required by U.S. GAAP)

Goodwill resulting from business acquisitions is carried in the balance sheet as a non-current asset which, through December 31, 2004, was amortized to income over a period not to exceed twenty years. Beginning in 2005, goodwill is considered to have an indefinite useful life and, therefore, is not amortized but is subject to periodic impairment evaluations. Amortization of goodwill is not tax deductible.

Under U.S. GAAP, goodwill is not amortized, and is also subject to periodic impairment evaluations.

Through December 31, 2004, negative goodwill from business acquisitions was recognized as a deferred credit (presented in the balance sheet between liabilities and shareholders' equity), and should be amortized to income over a period not to exceed five years. The amortization method was not specified. In 2005 and 2006, negative goodwill was recognized as an extraordinary gain upon acquisition of businesses, and any remaining balance from prior years was carried to the results of operations of 2005. Beginning 2007, negative goodwill upon acquisition of businesses is reported under non-ordinary income. At present, this is nontaxable income.

- Property, plant and equipment and related depreciation at inflation-adjusted values, by applying the NCPI or, when imported, the consumer price index of the country of origin, not in excess of recoverable cost, may be used. Depreciation charged to operations is based on the useful life of the assets, preferably determined by independent experts, and usually differs from that allowed as a tax deduction. The write-down to recoverable cost (impairment), when necessary, is charged to operations for the year as a special item (through 2006, and other ordinary expenses beginning in 2007) and, if recoverable cost increases in subsequent years, a write-up may be credited to operations for the year, not to exceed the previously recognized write-down. The capitalization of net comprehensive costs to finance assets under construction (interest, foreign exchange gains or losses and the results from holding net monetary assets and liabilities) was permitted but not required through 2006, and is mandatory beginning in 2007. Capitalized costs should be depreciated over the lives of the related assets.

U.S. GAAP do not accept adjustments for inflation (but translate these assets at historical rates of exchange in highly inflationary economies) and require capitalization of interest costs associated with their construction, to be depreciated over the lives of the related assets. Also, a write-down to fair value (instead of recoverable cost) may be required and charged to operations for the year; however, no subsequent write-ups are allowed.

- Intangibles at inflation-adjusted cost relate mainly to identifiable costs which future benefits are reasonably certain and are under the control of the company. Their recognition is restricted and should be amortized to income over their useful life, unless indefinite. The adjustment for inflation is also restricted to their recoverable cost. These assets are subject to periodic impairment evaluations. The tax deductibility of these items is also restricted.
- Financial statements of foreign subsidiaries for consolidation into the financial statements of a Mexican company, or for applying the equity method of accounting, are first adjusted for inflation in the country where the investees operate, and then translated into Mexican pesos. Differences in translation are carried to shareholders' equity.

Through December 31, 1990, most U.S. companies considered Mexico to be in a hyperinflationary economy (more than 100 percent cumulative inflation over a three-year period, under the provisions of SFAS-52), and translated the financial statements of their subsidiaries at historical exchange rates. Then, beginning in 1991, some companies changed the reporting currency of their Mexican subsidiaries to the functional currency of such subsidiaries, because of, among other factors, the drop in the official inflation rates of the Country; thus, the financial statements of the subsidiaries were translated based on "remeasured" pesos, i.e., a combination of historical and current exchange rates. Again in 1996, the reporting currency had to be changed to the U.S. dollar, because of high inflation. Since cumulative inflation for the three-year period ended December 31, 1998 was below 100 percent, most companies changed again the reporting currency of their Mexican subsidiaries to the Mexican peso in 1999, and have continued to translate the subsidiaries' financial statements based on "remeasured" pesos.

- Minority interest in consolidated subsidiaries is presented as a separate component within shareholders' equity on the consolidated balance sheets. Under U.S. GAAP minority interest is presented between liabilities and shareholders' equity.

- Retirement benefit liabilities (pensions, severance and seniority premiums) are to be recorded in the balance sheet. The related expense is based on a specific methodology (Bulletin D-3) that reflects the concepts of accrual accounting, carrying cost for the year to the income statements systematically over the service lives of the employees covered by the plan (similar to U.S. GAAP).
- For tax purposes, only actual payments or contributions to a trust fund approved by the Treasury Department are tax deductible. Compensated absences are also accrued during the period this benefit is earned by the employee. As a result, differences with U. S. GAAP have been practically reduced to the methods of computation.
- Deferred taxes are accounted for under the asset and liability method, in a way similar to U.S. GAAP. Also, under FRS, deferred employee statutory profit sharing is accounted for under the deferred method of accounting (similar to APB Opinion 11), while under U.S. GAAP it is accounted for under the asset and liability method.
- There are other discrepancies between U.S. GAAP and FRS, and expert assistance should be obtained when trying to evaluate Mexican FRS financial statements.

Disclosure

The classification of certain items varies to a certain extent from U.S. GAAP. Footnote disclosures are less stringent under Mexican FRS than under U.S. GAAP and SEC regulations.

Main Differences Between Book and Tax Treatment of Income and Expense Items

Income or Expense	Tax Treatment
Interest income and foreign exchange gains	Not taxable as such, but included in inflationary effect determined under the income tax regulations
Bad debts and other allowances for receivables	Deductible when the requirements of the Income Tax Law are fulfilled (1)
Inventory purchases	NonDeductible when made, through December 31, 2007 (1)
Cost of goods sold	Deductible, through December 31, 2007 (1). Transition provisions are established beginning January 1, 2005
Depreciation and amortization expenses, except goodwill	Deductible at the maximum rates specified by law, under the straight-line method, and adjusted for inflation under rules differing from Mexican FRS (1)
Goodwill	Nondeductible (1)
Accruals	Amount due to specific creditors payable on defined dates may be deducted; all others are non-deductible (1)
Employee statutory profit sharing	Deductible when the requirements of the Income Tax Law are fulfilled (1)
Negative goodwill, reported as gain on business acquisitions beginning in 2005	Nontaxable (1)
Tax loss carryforwards	Tax losses may be carried for ten years, adjusted for inflation (1)
Tax on assets (minimum tax payable)	Tax on assets paid may be offset with income tax payable in the succeeding ten years (1)

(1) These items usually result in temporary differences.

Chapter 14

Auditing Standards and Practices

Auditing Standards

Generally accepted auditing standards applicable in Mexico are very similar to (though less stringent than) those applicable in the United States and are contained in the bulletins issued by the Auditing Standards and Procedures Commission, a branch of the Mexican Institute of Public Accountants.

Reports on the financial statements (opinions) must be signed with the name of the public accountant (an individual), although it is permitted to mention the name of the accounting firm of which he or she is a member.

Audited Financial Statements

All companies listed on the Mexican Stock Exchange, as well as banking institutions, insurance companies and other companies in the financial sector, and majority government-owned corporations, are required to submit annual financial statements with the opinion of a Mexican Public Accountant.

As discussed in Chapter 7, many business taxpayers and not-for-profit organizations are obligated to file audited financial statements (tax reports) for review by the Federal Tax Administration, a branch of the Treasury Department. Most companies use their auditor's reports for this purpose, a practice that almost completely avoids lengthy direct audits by the tax authorities at the taxpayers' premises.

In general, local as well as foreign banks request audited financial statements as a standard requirement for granting loans and/or lines of credit.

Audit Reports

The following basic financial statements are included with public accountants' reports:

- Balance sheet
- Income statement
- Statement of changes in shareholders' equity
- Statement of changes in financial position
- Footnote disclosure

Tax Reports

To be allowed to sign tax reports, the public accountant must be certified and registered with the Federal Tax Administration, and comply with annual requirements as to continuing education.

In addition to the independent auditor's report, basic financial statements and footnote disclosures mentioned above, the tax report must be submitted in magnetic media through the Internet, complying with very strict regulations as to format, and must contain the following information which is equivalent to approximately sixty to seventy printed pages:

- A special report signed by the auditor (an individual), stating that all federal tax obligations have been complied with. Materiality considerations are practically not allowed for purposes of this report.
- Detailed analyses of income and expense accounts included in the statement of income.
- A detail of amounts subject to federal taxes and dues, either withheld or payable by the company, and including social security dues, retirement fund and housing fund, sworn by the chief financial officer.
- Reconciliation of taxable to book income (or loss).
- Reconciliation of income included in the income statement to that included in the income tax return.
- Detail of federal taxes payable at year end, stating the date and place of payment.

This report requires both additional work and responsibility from the public accountant to ascertain that all federal taxes have been paid properly, almost regardless of materiality. The report also requires additional work from the companies' personnel to prepare the related supplementary information mentioned above, and special training on the use of the software required by the Federal Tax Administration, in addition to an electronic "key" and "certificate" and a password for delivery.

It is a common practice for the tax authorities to review reports filed by public accountants, including the supporting audit work papers. No bases are established for the selection and, thus, the likelihood for a company being selected, even for several consecutive years, is unpredictable. Generally, these reviews include the public accountant visiting the authorities, so that they may question him or her on the work performed, and request additional detailed information, which usually has to be prepared by the company's personnel.

Statutory Examiner's Report

This type of report is discussed in Chapter 5.

Other Reports

The public accountant, depending on the needs of the companies, may issue other reports. Regulations applicable to these reports are somewhat similar to those in the United States.

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The information contained herein is of a general nature Guide to increase business efficiency and productivity and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

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