



Mexico

Introduction

A person's liability for Mexican tax is determined by residence status for taxation purposes and the source of income derived by the individual.

Contact

Nora Solano

KPMG in Mexico

Director

T: +52 55 5246 8355

E: solano.nora@kpmg.com.mx

Key messages

Extended business travelers are likely to be taxed on employment income relating to their Mexican workdays.

Income tax

Liability for income tax

A person's liability for Mexican tax is determined by residence status. A person can be a resident or a nonresident for Mexican tax purposes.

A resident is taxed on worldwide income. According to the Mexican Tax Code, an individual should be considered resident for Mexican tax purposes if the individual establishes a home in Mexico. When the individual also has a home in another country, the individual will be a tax resident in Mexico if the individual's center of vital interests is in Mexico. It is considered that the individual's center of vital interests is in Mexico in either of the following cases, among others:

- When more than 50 percent of the individual's total income received during the calendar year is derived from Mexican sources
- When the individual's main center of professional activities is located in Mexico.

On the other hand, the Mexican fiscal code states that in the absence of proof to the contrary, individuals of Mexican nationality are presumed to be residents of Mexico.

Additionally, individuals of Mexican nationality should retain their status as tax residents of Mexico when proving their tax residency in a country with a preferential tax regime for the year in which the notice of termination of tax residence is filed and for the following three years. It is important to mention that this provision is not applicable in those instances where Mexico has executed an unlimited exchange of information agreement with a preferential tax regime country.

Nonresidents are taxed only on Mexican-sourced income. Mexican tax legislation establishes that income derived from an employment relationship should be considered as Mexican-sourced income when the associated personal services are rendered in Mexico.

Extended business travelers are likely to be considered nonresident of Mexico for tax purposes unless they:

- Establish a home in Mexico and do not maintain a home in another location
- Establish a home in Mexico and maintain a home in another location but have their center of vital interest, as described above, in Mexico.

Definition of source

Employment income is generally treated as Mexican-sourced compensation where the individual performs the services while physically located in Mexico.

Tax trigger points

Technically, there is no threshold/minimum number of days that exempts the employee from the requirements to file and pay tax in Mexico since, as explained above, a person's liability to Mexican tax is determined by residence status.

Once it is determined that the individual is a nonresident for Mexican tax purposes, however, the individual could be fully exempt from Mexican taxation as long as:

- The salary is paid by a nonresident who does not have a permanent establishment (PE) in Mexico, or in the case that a PE does exist, when the service is not related to said PE
- The employee is present in Mexico for less than 183 calendar days, whether consecutive or not, in a period of 12 months
- The employer paying the salary does not have an establishment within Mexican territory to which the service is related. The exemption will not be applicable if the employer has an establishment in Mexico, even if such establishment does not constitute a PE for Mexican tax purposes
- The nonresident employee does not receive complementary payments from nonresidents in consideration of services rendered for which salary income was obtained.

Additionally, to the extent that the individual qualifies for relief in terms of the dependent personal services article of the applicable double tax treaty, there will be no tax liability. The treaty exemption will not apply if the Mexican entity is the individual's economic employer and, as such, bears the cost of the individual's compensation.

Types of taxable income

For extended business travelers, the types of income that are generally taxed are employment income, Mexican-sourced income, and gains from sale or leasing of taxable Mexican assets (such as real estate).

Tax rates

For 2011 residents, taxable income is taxed at graduated rates ranging from 1.92 percent to 30 percent. The maximum marginal tax rate is reached on income earned over 32,736.84 Mexican pesos (MXN).

Nonresident income tax should be determined by applying the following rates to the income received and derived from Mexican-sourced income:

Annual income from MXN	Annual income to MXN	Tax rate percent
0	125,900	Exempt
125,901	1,000,000	15
1,000,001	and above	30

Source: KPMG in Mexico, March 2011

When the income in question is received in a 12-month period and such period does not coincide with the calendar year, the above rates should be applied as a function of the 12-month period.

Social security

Liability for social security

Foreigners who work for Mexican employers are subject to Mexican social security contributions when an employment relationship is deemed to exist in Mexico. Such relationship is deemed to exist in Mexico when the employee's activities are supervised, controlled, or governed by a Mexican employer. These are based on several components where the capped salary is 25 times the minimum wage of Mexico City (for 2011 the minimum wage is MXN59.82 per day).

The aforementioned contributions are calculated based on the following percentages and subject to the capped salary:

Type of insurance	Paid by		Total percent
	Employer percent	Employee percent	
Social security (IMSS)*	9.93–24.43	2.73	12.66–27.16
Retirement fund (SAR)	2.00	0.00	2.00
Housing fund (INFONAVIT)	5.00	0.00	5.00
Total percent	16.93–31.43	2.73	19.66–34.16

Source: KPMG in Mexico, March 2011

*The above rates represent the effective rates for individuals with a capped salary. The employer contribution will depend on each employer's risk classification.

Mexico has entered into formal duly signed social security totalization agreements with two countries: Spain and Canada.

There are no provisions for foreign employees working in Mexico under a contract with a foreign employer and with no Mexican employer. In such cases, although the employee could be deemed to be subject to Mexican social security contributions, it may be argued that there would be no basis to calculate such contributions (no salary borne in Mexico) and no vehicle to remit them (no Mexican employer). Thus, Mexican social security contributions would not be applicable under this approach.

Compliance obligations

Employee compliance obligations

Annual tax returns are due by April 30 following the tax year-end, which is December 31. Extensions are not permitted. Nonresidents are not obligated to file a Mexican annual tax return since the payments made are considered as final or definitive.

Employer reporting and withholding requirements

Mexican income taxes are paid on earned income, Pay As You Earn (PAYE).

Individuals are required to remit tax payments on compensation as follows:

- When compensation is paid by Mexico or from abroad, but the cost of the individual's compensation is charged back to a Mexican entity under a secondment agreement and, as such, reflected on the Mexican payroll, the tax obligation will be satisfied via tax withholdings. Under this scenario, the Mexican employer will determine the individual's monthly tax liability and remit the corresponding taxes to the Mexican tax authorities.
- When compensation is paid from abroad, the cost of the individual's compensation is not charged back to a Mexican entity, and the compensation is not reflected on the Mexican payroll, the individual will be required to file personal tax returns through the Internet by wiring the tax amount due from the individual's personal Mexican bank account.

Monthly personal tax returns and withholdings are due by the 17th day of the month following that in which the compensation was paid. Nonresident tax returns should be paid within 15 days following the receipt of the income, unless a Mexican entity is obligated to withhold the tax or one of the following alternative options is used, in which case the due date will be the 17th day of the month following that in which the compensation was received.

Income taxes associated with salary income received by nonresident individuals can also be paid via one of the following payment alternatives:

- The foreign employer withholds the Mexican tax and remits to the tax authorities. It is important to mention that this would require the foreign entity to be formally registered in Mexico as a withholding agent.
- The Mexican entity where the services are being rendered collects and makes the tax payments.
- A nominated and jointly liable Mexican representative makes the payments.

Other

Work permit/visa requirements

Foreigners who are paid from abroad can enter into Mexico with a Multiple Migratory Form (FMM); this is the necessary paperwork and is provided at the port of entry. Foreigners with restricted and strictly restricted nationalities must apply for a visa in advance.

If the foreigner's residence in Mexico will last for more than six months, the individual has five days to request the redemption of the FMM in return for a nonimmigrant card (FM3). This should be done by submitting the following documentation at the local migratory office nearest to the individual's place of residence (depending on the foreigner's nationality, the requirements and information requested may vary):

- Passport
- Payment of fees
- Completed form
- Five passport-sized photographs
- Original of the FMM

If the foreigner is paid by a Mexican entity or a mirror payroll is established by a Mexican entity, the foreigner should apply for an FM3 at the Instituto Nacional de Migración (INM) with a letter of invitation, written in Spanish, from a corporation, association, or chamber of Mexican business that expresses the purpose of the visit, the estimated period of stay abroad, and confirmed economic ability to bear all expenses in Mexico.

It is important to mention that it is possible to start the process of obtaining an FM3 at the Mexican consulate of the home country. In this case, a seal is placed on the passport. Once in Mexico, the individual should ask for an FM3 at the INM.

An FM3 is valid for a one-year period, and it may be extended up to four additional years. An immigrant visa (FM2) is granted after holding an FM3 for five years.

Foreigners must obtain approval from the INM to engage in different activities from the ones they have been expressly authorized. In addition, they must notify the INM of any changes to their immigration status or situation.

Double taxation treaties

In addition to Mexico's domestic arrangements that provide relief from international double taxation, Mexico has entered into double taxation treaties with approximately 39 countries to prevent double taxation and allow cooperation between Mexico and overseas tax authorities in enforcing their respective tax laws.

Permanent establishment implications

There is the potential that a permanent establishment (PE) could be created as a result of extended business travel, but this would depend on the type of services performed and the level of authority the employee has to bind the foreign entity in Mexico.

Indirect taxes

Value-added tax

The standard rate of value-added tax (VAT) is 16 percent.

The Mexican value-added tax law (LIVA) establishes that VAT is due on the following activities carried out in Mexican territory:

- Sales
- Rendering of independent services
- Imports of good or services
- Leasing

Mexican entities

All individuals and entities engaging in acts or activities in Mexico consisting of alienation of assets, rendering of independent services, granting of temporary use or advantage of assets, and import of goods or services must register for VAT purposes. This tax is paid on a cash flow basis.

Non-Mexican entities

Non-Mexican entities that have established a Mexican PE have the obligation to register with the Mexican tax authorities; consequently, they are compelled to comply with all Mexican tax obligations, including VAT obligations.

Non-Mexican entities that engage in sales or leasing activities in national territory subject to VAT will be subject to withholding for the corresponding VAT amount by the Mexican taxpayer.

Flat rate business tax

The flat rate business tax (IETU) is a new tax in force as of January 1, 2008 that is paid on a cash flow basis and is imposed on Mexican tax residents or nonresidents with a PE in Mexico who receive income from independent and professional services, sale of goods, and rental income. The tax rate for 2011 is 17.5 percent.

The IETU is a type of alternative minimum tax. It must be computed and compared to the income tax. In the event the IETU is higher than the income tax, a credit procedure has been established where only the excess IETU over the income tax is paid.

A foreign entity, nonresident for Mexican tax purposes, that provides and receives payments for its services will not be subject to IETU as long as such entity does not constitute a PE in Mexico and/or the services rendered are not related to such PE.

On the other hand, the IETU law allows certain deductions provided that they are related to the taxpayer's business activities or the management thereof. The IETU law, however, does not allow salary deduction from the taxable income.

Although the salaries paid are not a deductible item allowed by the IETU law, such law also establishes a tax credit with respect to said salaries (the portion taxable to the employees) that is applicable against the IETU due for the same year. Such credit, however, cannot be applicable in future tax years if any remaining balance exists.

Transfer pricing

Mexican transfer pricing regulations rely on the arm's-length principle. The arm's-length principle requires taxpayers undertaking operations with related parties, as well as with residents in low-tax jurisdictions, except when proven that the latter are not related parties of the Mexican taxpayer, to determine their taxable revenue and authorized deductions by considering the prices and/or compensation that would have been agreed by or between independent parties in comparable transactions.

In order to document the compliance of the arm's-length principle by Mexican taxpayers, the Mexican income tax law (*Ley del Impuesto Sobre la Renta* or LISR) and the flat rate business tax law (*Ley del Impuesto Empresarial a Tasa Unica* or LIETU) establish the transfer pricing documentation requirements that must be complied with by said taxpayers.

Specifically, the LISR sets up the transfer pricing requirements that must be met by Mexican taxpayers in Fractions XII,¹ XIII, and XV of Article 86, as well as Articles 215 and 216, and of the LIETU in Fraction III of Article 18. Among those transfer pricing requirements, taxpayers must not only prepare supporting documentation regarding domestic and cross-border intercompany transactions, but also file together with the annual tax return some information regarding their cross-border intercompany transactions, through an informative return.

If the *Servicio de Administración Tributaria* (SAT) concludes that a company underpaid taxes in Mexico because it employed transfer prices that did not comply with the provisions of the LISR, the taxpayer will be liable for the following:

- Omitted taxes, restated for inflation
- Interest
- A penalty that may range between 55 percent and 75 percent of omitted income tax, or between 30 percent and 40 percent of the excess of the tax loss originated due to transfer pricing.

According to the Federal Fiscal Code, there is no specific penalty for not preparing supporting transfer pricing documentation. However, in the case taxpayers do not comply with the transfer pricing documentation requirements

stated in Article 86 of the LISR, Mexican tax authorities might deny the deduction of expenses for income tax purposes originated as a result of intercompany transactions.

In addition, Article 76 of the Federal Fiscal Code allows the SAT to assess penalties in cases in which it deems a company's transfer pricing is not consistent with the arm's-length standard under the Mexican transfer pricing regulations detailed in the LISR, as stated before. Said article also provides for a 50 percent reduction in the penalty imposed for underpaid taxes or for determining a loss in excess due to transfer pricing if the taxpayer keeps supporting transfer pricing documentation.

At the same time, Appendix 9 of the Multiple Information Return must be filled by all companies conducting cross-border intercompany transactions with their foreign related parties, with the exception of transactions covered by Article 216 – BIS of the LISR.

Companies filing the Dictamen Fiscal must file the transfer pricing information in the appendices of the Dictamen Fiscal, which is usually on June 30. In addition, the Information Transfer Pricing Return for Cross-border Intercompany Transactions must be filed with the Dictamen Fiscal.

Companies not filing the Dictamen Fiscal Information Transfer Pricing Return for Cross-border Intercompany Transactions and the transfer pricing documentation must be ready by the time the income tax return is due, which is March 31.

Local data privacy requirements

On July 5, 2010, the Mexican Official Gazette published the Federal Law of Data Privacy Protection (*Ley federal de Protección de Datos Personales en Posesión de los Particulares*). However, there is a one-year relief to name the person in charge of keeping personal data. As such, this law will be fully in place effective July 2011.

Exchange control

Mexico does not restrict the flow of Mexican or foreign currency into or out of the country.

Nondeductible costs for assignees

Nondeductible costs for assignees may partially include contributions by an employee and employer to non-Mexican pension funds.

¹ Transfer pricing documentation is required by Mexican legislation. However, taxpayers whose revenue during the previous fiscal year did not exceed MXN13 million (for the operative company) and MXN 3 million (for service providers) are not required to produce supporting documentation with regard to cross-border intercompany transactions. However, there is no exception to the requirement of complying with the arm's-length principle.

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