

**DOING
BUSINESS
IN**

MEXICO



HLB Mexico

*doing business in
Mexico*

foreword

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general information

Geography and Climate

Mexico is a country covering 1,958,201 square kilometers (760,000 square miles). It has a 3,118 kilometer (1,937 miles) northern border with the United States. The southeastern border with Guatemala and Belize is 1,108 kilometers, or 688 miles long. It is bounded by the Gulf of Mexico on the East, the Caribbean Sea on the Southeast, and the Pacific Ocean on its West and South. The total extent of the coastline is 10,143 kilometers (6,302 miles).

Most of Mexico consists of highlands with fertile valleys across the mountains, except for Baja California and the Yucatan Peninsula. A great bio-diversity and natural resources can be found in its rainforests located in the South. Extensive deserts occupy most of the far North and West. Three mountain systems go across the country: the Western Sierra Madre, the Eastern Sierra Madre and the Southern Sierra Madre.

The climate in the central part of the country is temperate, the southern coasts are generally tropical and slightly cooler in the North. The rainy season in Mexico City lasts from June to September; and average annual precipitation is 23 inches. The mean minimum and maximum temperatures in July are 129C (54°-F) and 239C (74°-F) and, in January, 69C (42°-F) and 199C (66°-F)

Population and Language

According to the official 2000 census Mexico has 97.4 million inhabitants with an annual growth rate of 1.4%. The median age is 22 years. Official employment totals 9 million, while the open unemployment rate is 2.3%.

Mexico City with its metropolitan area (20 million), Monterrey (3 million), Guadalajara (4 million), Puebla (2 million), Tijuana (1.4 million), and Ciudad Juarez (1.0 million) are the nation's most important industrial and commercial cities. Mexico's most important ports are Veracruz and Tampico in the Gulf of Mexico; and Mazatlán, Manzanillo and Acapulco on the Pacific. Other important world-class coastal resorts are those of Los Cabos in South Baja California, Cancun in Quintana Roo, and Huatulco in Oaxaca.

Spanish is the official language, although native pre-Columbian languages and dialects are also spoken, mostly in rural areas. English is spoken amongst a significant proportion of the population.

Currency

The unit of currency is the Mexican peso; each peso is divided into 100 cents.

The exchange rate between the dollar and the Mexican Peso is set by the market movement (free floating system).

Legal Environment

In Mexico, business problems and disputes between individuals or between individuals and companies are solved through litigation based on civil law. However, the Mexican government has institutions functioning as arbitrators or mediators to avoid such disputes being taken to court for decision. The intervention of these institutions allows conducting business operations to continue even if companies have claims or lawsuits against them. Tax cases are handled by the federal tax court.

Government

The current Mexican constitution dates from 1917 and establishes Mexico as a democratic and federal republic divided into 31 states with free and separate state governments and a federal district. The federal government is divided into three powers: the executive, the legislative, and the judicial.

The Executive power is held by the President, elected for a six-year term that may not be re-elected. The President appoints the members of his cabinet subject to approval by the Senate.

The Legislative power is vested in two bodies elected by direct popular vote: The Senate comprises with three members from each State, including the Federal District, elected for six year terms. The other body is Congress, whose Deputies each represent 170,000 citizens. Deputies are elected for three year terms.

The Governor of the Federal District (Mexico City) and the State Governors are elected by direct popular vote and serve for six year terms.

Judiciary power resides in the Supreme Court of Justice which has 21 members, appointed by the Senate. It also has circuit courts and district courts.

The political parties represented in the legislative branch are: PRI (Partido Revolucionario Institucional) was in power for the last 71 years (1929-2000), PAN (Partido Acción Nacional) a right hand party now in power until 2006, PRD (Partido de la Revolución Democrática) the center-left alternative; and PT (Partido del Trabajo) left wing party.

Foreigners in Mexico (Visas)

To enter Mexico, visitors and investors must obtain visas from the Mexican Embassy or a consular office in their home countries.

The Department of the Interior (Secretaría de Gobernación) issues visas under the following categories:

Immigrant

This status is granted when a person is given permission to establish himself or herself or remain in Mexico on a permanent basis. A person is classified as an immigrant when he or she has five consecutive annual renewals on his immigration permit and entered the country to:

- + Fill a management position in a Mexican company or institution.
- + Carry out work as a technician or scientist, research in production, technical or specialized functions in a Mexican company or institution. The company or institution must meet all requirements concerning the hiring of foreigners.

Non Immigrant

Tourist

To enter Mexico, visitors and investors must obtain visas from the Mexican Embassy or a consular office in their home countries.

The Department of the Interior (Secretaría de Gobernación) issues visas under the following categories:

Consultants

Consultants may obtain a permit to enter Mexico to attend a board or stockholders' meeting or to render advisory services on a temporary basis. To obtain the permit to work consultants must have submitted proof that a company has contracted their services and the company meets all requirements concerning the hiring of foreigners.

Visitors

Permits of this category allow visitors to carry out specific work or a project and receive payment, whose source may be Mexican or foreign.

Economy

Inflation

The Mexican inflation rate in 2001 and 2000 was 4.4% and 8.9% respectively; the expected inflation for 2002 will be 4.5%.

Imports and Exports

In 1986 Mexico became formally a member of the General Agreement of Tariffs and Trade (GATT). The economic policy followed by former administrations has made Mexico one of the most open economies in the world.

In November 1993, the Mexican, the American and the Canadian governments signed the North American Free Trade Agreement (NAFTA). Since its implementation on January 1, 1994, commercial transactions among the three partners have grown steadily.

In March 2000 Mexico signed a free trade agreement with the European Community effective on July 1st 2000.

With various Latin American countries Mexico has also signed free trade agreements.

Business Hours

Timezone

There are three time zones in Mexico: the Central zone, which is six hours behind GMT; North-Western States are seven hours behind GMT, and Northern Baja California is eight hours behind GMT. Mexico observes summertime from early April to late October.

Working Hours

Business hours in Mexico generally range from 9:00 a.m. to 6:00 or 7:00 p.m. Monday through Friday. Lunchtime is usually at 2:00 p.m.

Large commercial banks are usually open from 9:00 a.m. to 3:00 p.m. Monday through Friday, though some branches are open until 5:00 p.m. In Mexico City, some banks open Saturdays from 9.00 a.m. to 1:30 P.M. smaller banks operate from 9:00 a.m. to 1:30 p.m.

Business Customs

Mexicans are very hospitable and warm, and some businessmen often close deals only when they can call their foreign counterparts friends. Business matters are often discussed and deals are closed over meals.

investment factors

Governmental Policy

Direct foreign investment is welcomed in Mexico especially if it promotes exports of goods or services, creates more jobs, and advances proficiency in new production skills or techniques, trains technicians and workers in a short period or helps to maintain the stability of the Mexican peso exchange rate and the balance of payments.

Majority Foreign Investment

Not requiring authorization

+ Foreigners are allowed to hold up to 100% of the capital stock of certain Mexican corporations without any previous authorization. Such companies may carry out operations in secondary petrochemicals, telecommunications installations, agriculture, and construction and operation of electric power systems, which comply with requirements established by the Law of Foreign Investment.

+ In-bond processing or manufacturing plants (maquiladoras) - Foreign investors may participate up to 100 percent in corporations established to carry out in-bond processing or other industrial or commercial activities for exportation. They can be established in US border areas or in interior cities. Foreign companies may conduct a maquiladora operation by subcontracting the manufacturing process to a company already existing in Mexico or by operating through a «shelter company» that exists solely to manufacture or assemble for its investors.

Labor Regulations

The Federal Labor Law enacted in 1970 applies to all employees and companies and its regulations establish the prevailing labor relations environment. The law stipulates the minimum working conditions and rights, which must be granted by the employer to its work force. Relationships among workers and employers may be individual or collective.

Minimum Wage

The authorized daily minimum wages existing at 2002 in the three different geographical areas within the country are:

Zone A (including Mexico City - the Metropolitan area and cities in the north border)

Zone B

Zone C

Daily Minimum Wages

Mex \$ US dollars

42.15 4.58
40.10 4.36
38.30 4.16

Unions sign collective contracts and negotiate their wages and benefits directly with companies or institutions.

Mexico's labor costs are highly competitive. In 2002, hourly pay and benefits for an employee in Mexico were approximately 6 times lower than the US rates.

The normal working week in Mexico is 45 hours over six workdays. In the services sector, companies work 40 hours a week over five workdays.

Under Mexican labor law, workers must get double pay for the first nine hours of overtime, triple pay thereafter. Sunday work entitles workers to a 25% premium.

After one year of employment, employees can enjoy at least six days' paid vacation adding two days for each of three subsequent years. After five years, two vacation days are added for each additional five years of employment. A bonus of 25% of normal pay during the vacation period is compulsory.

Employees and workers are entitled to an annual year-end bonus, which must equal at least 15 days of salary and must be paid before December 20. Seniority premium consists of 12 paid days per year of service.

Practical Considerations

Mexico is a large and diverse country. Substantial research is generally recommended before an investment decision is made. Below is an outline of three critical areas we believe any potential investor should pay particular attention to before any definitive decision is made. These include location, infrastructure, and state incentives.

a) The primary focus of many investors is location. This may be motivated by a need for proximity to the US border, by the location of a customer or supplier, by the availability of a specific resource, among others.

The Maquiladora industry has encouraged the development of Border States such as Nuevo Leon, Chihuahua, and Baja California. What is perhaps less well known is the substantial development of industrial resources catering to new investment in inland States such as Jalisco, Guanajuato, as well as Querétaro, roughly 130 miles north of Mexico City.

b) While the benefits of each of the above locations are largely dependent on the specific requirements of each investor, it is generally very difficult to invest in an area with substantial infrastructure deficiencies. Fortunately, all the sites mentioned above have modern industrial locations, with up to date communication capabilities, as well as access to banks and modern ground transportation. Larger urban areas such as Guadalajara and Monterrey have the advantages of better access to International Airports, as well as other conveniences afforded by metropolitan areas, such as access to a more educated workforce, broader availability of high quality housing, as well as more diverse recreational possibilities.

c) The different states within the country compete intensely for foreign investment. These may offer different kinds of incentives to encourage specific types of investment. The States of Querétaro and Guanajuato have been lately distinguished for making generous concessions, demonstrating a better acquaintance with the needs of the foreign investor, in addition to providing less restriction than those typically encountered in other Mexican States.

types of business organisations

A foreign corporation or individual may do business in Mexico through an agent or legal representative, a branch or a corporation organized outside Mexico, or an affiliate constituted in Mexico.

Sole Proprietorship

Mexican laws allow an individual to own and run a business. He must be registered with the Department of Finance and Public Credit and comply with all levy requirements. The individual may choose to file in either the simple or the general system of taxation. There is no minimum capital required. A foreign investor may do business as an individual through an agent or legal representative.

Under Mexican law, the following are the main forms of business entities:

Corporations

1. - Sociedad Anónima or S.A.- Organization similar to a US Corporation
2. - Sociedad Anónima de Capital Variable or S.A. de C.V.- (more flexible corporation with variable capital).

These two forms are the most commonly used by foreign investors.

- 3.- Sociedad de Responsabilidad Limitada or S.R.L. Limited Liability Company
4. - Cooperative associations (sociedades cooperativas)
5. - Joint Ventures

This type of association may include corporations or individuals and may be formed to carry on a common business objective.

All five types of associations are taxed as business corporations.

Constituting a Mexican S.A. (corporation)

In order to establish branch operations in Mexico, a foreign corporation must do the following:

- Obtain prior authorization from the government. This is presently granted readily.
- Register with the National Foreign Investment Registry.

Branches are liable for corporate income tax and generally have the same obligations as Mexican corporations. Additionally, they are subject to a withholding tax if they pay dividends from sources

other than the «net tax profit» account, a retained earnings account for profits on which income tax has already been paid.

It is rather easy to incorporate a Mexican S.A. The steps to follow are:

* A permit must be obtained from the Department of Foreign Affairs.

* Two shareholders must appear before a notary public. The minimum subscribed capital is \$ 50,000 Shareholders' liability is limited to the amount of their contribution. Any outstanding balance on shares must be paid within five years. Taxes and fees in respect of incorporation are charged by: Public Commerce Registry, Foreign Investment Registry (if applicable) Municipal Sanitation and Treasury Department licenses. Notaries.

Shareholders' Meeting

A shareholders' meeting must be held at least once a year within four months of the 31st of December of each year.

Sole Administration or Board of Directors

The shareholders, in a general meeting, may appoint a sole administrator or a board of directors with normal powers and the right to delegate power. This administrator or director may or may not be a shareholder. Administrators or directors may be foreigners living abroad, provided they do not represent a greater percentage than that of foreign ownership. Labour has no required representation. Shareholders representing 25% of the share capital have the right to elect one director. Directors' meetings may be held anywhere.

Fiscal Year-end

The fiscal year for corporations must end on December 31 each year except in the case of the corporation's liquidation or closure.

Statutory Requirements

Accounts

Corporations must within three months of the closing date prepare a balance sheet, a statement of income, a statement of stockholders' equity, a statement of changes in financial position, and the related notes to the financial statements.

Income Tax Filing

Mexican corporations must file an annual income tax return, no later than three months after the end of the fiscal year. The statutory auditor's function is to examine the books and records at least once a month, and to submit a report on the company's year-end financial information. Statutory auditors can call shareholders' meetings whenever considered necessary. In fulfilling this responsibility, the statutory auditor may use the services of independent professionals.

taxation

Jurisdiction

Parameters for Determining Income or Gain Subject to Corporate Income Tax Mexican resident corporations are subject to taxation on their worldwide income. Mexican resident corporations include those incorporated in Mexico as well as those who have established their place of effective management within. Foreign corporations with permanent establishment in Mexico are also subject to Mexican Corporate Income Tax on the income attributed to the permanent establishment.

Payments abroad such as interest and royalties are subject to a withholding tax. Income Tax Treaty countries are subject to preferential withholding rates.

Major Taxes on Corporations

Corporate Income Tax

Corporations are generally subject to Corporate Income Tax at a 35% rate. This tax rate will go down as follows: 34%, for 2003, 33% for 2004 and 32% for 2005 and the following years. A withholding tax also applies to dividends paid abroad, which varies depending on whether the foreign shareholder is resident of a Treaty country. Other forms of payment abroad, such as Royalties and Interest, are also subject to withholding.

Assets Tax

Mexico applies a 1.8% tax to the net value of assets on Mexican soil of Mexican resident companies and certain non-resident companies. The tax is fully creditable against the Mexican Corporate Income Tax. Consequently, the Assets tax applies as a form of minimum income tax.

An Asset Tax holiday exists for 4 years for companies beginning operations. The assets subject to the tax include fixed assets and real estate, and also inventories, deferred charges, and other financial assets.

Value Added Tax

Mexico applies a Value Added Tax («VAT») of 15% to most transactions using cash flow for tax basis. A special 10% VAT rate has been enacted in certain border regions. VAT is a recoverable tax for businesses. A company may offset VAT paid against VAT recovered and either forwards the difference to the tax authorities if positive, or request a refund if negative. A non-resident corporation must obtain a tax registration to request a VAT refund, however.

Mexico has enacted special programs in order to encourage its export industry. Manufacturers that register under the Maquiladora PITEX or ALTEX programs may enjoy 0% VAT on goods and services purchased for goods they export.

Mandatory Profit Sharing Mexican resident corporations are required to pay 10% of their taxable income to its employees on a yearly basis. This tax is nondeductible for Income Tax Purposes.

Taxable Income of Resident Corporations

The Tax Base

Computation of taxable income begins with gross receipts from which specified costs and business expenses are deducted to arrive at net taxable profits taxed at a 35% rate. As stated above, net operating losses can be carried forward a maximum of 10 years.

Dividends

Dividends received from other Mexican Companies are generally included in taxable income.

Deductible Expenses

Deductible expenses include amortization deductions, bad debt losses, automobile expenses, depreciation, interest expense, insurance premiums, rent, repairs, research, royalties, salaries, payroll contributions, meal expenses and certain taxes, among others.

Inflationary Accounting

Mexico applies inflationary accounting. Assets and Liabilities are subject to inflationary adjustments whereby the reduction in the value of liabilities for inflationary reasons must be included in income and the reduction in value of assets for inflationary reasons may be deducted from income.

Depreciation and Amortization

Mexico generally permits only straight-line depreciation and amortization for tax purposes. The applicable annual rates for certain items are as follows:

Real Estate	5%
Office furniture & equipment	10%
Machinery and equipment (Specific rates vary depending on type)	6.25%
Electricity generation and distribution Mills Metal production	10%
tobacco and carbon derivatives	6%
Pulp and paper products	7%
Manufacturing of motor vehicles and parts, metal products	8%
Leather products	9%
Textile products	11%
Aircraft construction	12%
Construction Industry, including	
certain automobiles, cargo vehicles and tractor trailers	25%
Agricultural, livestock, fishing and related	25%
Restaurants	25%
Others	10%

Mexico also allows accelerated depreciation for tax purposes applicable only for real estate, machinery and equipment, crafts and ships, railroads, and telephonic and satellite communications. Accelerated depreciation cannot be applied in Distrito Federal, Guadalajara and Monterrey.

Capital Gains

Capital Gains are taxed at ordinary Corporate Income Tax rates. All items on Mexican soil are generally subject to Mexican capital gains, even if held by a foreign resident taxpayer, unless this treatment is affected by Treaty.

Net Operating Losses

Net Operating Losses may be carried forward up to ten years. These may be adjusted for inflation. Mexico does not allow loss carry backs.

Deductibility of Payments made to Parent Company

Payments made to parent companies are subject to strict scrutiny by the Mexican Tax Authorities. Any deduction will be disallowed in the absence of adequate support.

Transfer Pricing Legislation

Mexican Tax authorities also pay close attention to the pricing adopted for charges between related parties in an international setting. Mexico has adopted transfer pricing rules that closely mirror model OECD rules.

Credit for Foreign Taxes

Mexico allows taxpayers to credit foreign income taxes paid against Mexican Corporate Income tax due on the same income. Consequently, a Mexican corporation that receives dividends from a foreign resident corporation may credit foreign taxes associated with the dividends.

Taxation of Non-Resident Corporations

Taxation of Permanent Establishments

A Permanent Establishment is a level of presence in Mexico that is subject to Corporate Income Tax in the country even though the entity is not a Mexican resident. Such presence generally includes branches and representative offices, among others. Such activities are subject to the normal 35% rate, as applied to income attributed to the permanent establishment.

Not all presence by a non-resident in Mexico qualifies as a Permanent Establishment. However, Mexico has stringent domestic rules for permanent Establishment classification. Residents of Treaty countries, on the other hand, are subject to Permanent Establishment classification rules as determined by the relevant Treaty in question.

Liquidations

Taxation of Liquidation Gains

Liquidation Gains are taxable even if the shareholder of the liquidated corporation is not a Mexican resident. Liquidation reimbursements in excess of capital contributions are subject to dividend treatment. The excess is multiplied by a 1.5385 adjustment and then taxed at the 35% corporate tax rate. The 1.5385 adjustment will go down according to tax rate decrease.

Reorganisation

Merger and Consolidation

Mexico generally permits tax-free corporate reorganizations, so long as these are made pursuant to a plan submitted to and approved by the Tax Authorities. Additionally, Mexico also permits a limited form of tax consolidation. Again, a plan must be submitted and approved by the Tax Authorities before the consolidation is permitted.

Taxation of Shareholders (Corporations and Individuals)

Taxation at Source of Investment Income Paid to Non-Residents

Interests and royalties, among others paid by a Mexican resident corporation to non-residents will be subject to the appropriate withholding tax applied either by domestic legislation, or, if applicable, by Treaty. Domestic withholding rates for interests and royalties are 21 %, and 25%. Other items that may be subject to withholding include independent personal services and rents, among others. Shareholders that reside in a treaty country will be subject to the Treaty rate, which is generally more beneficial than the domestic rate.

Dividends paid by a Mexican resident corporation to non-residents are not subject to withholding tax.

However, Mexico subjects income that has not been previously taxed in Mexico to a punitive tax at the time it is paid to a foreign shareholder in the form of a dividend. This tax is calculated by applying a 35% tax to 1.5385 times the dividend amount. The 1.5385 adjustment will go down according to tax rate decrease.

Capital Gains

Assets deemed to be located in Mexico are generally subject to Mexican capital gains treatment, even if owned and sold by a non-resident. The capital gains rate applicable is generally the same as the corporate or personal rate applicable to seller. This rate may be modified by Treaty.

Taxation of Domestic Shareholders of Foreign Corporations

Foreign dividends paid to Mexican resident shareholders are generally taxed at the applicable corporate or personal income tax rate. Capital gains on foreign shares are also subject to Mexican capital gains taxation at the applicable rate. Tax basis is subject to inflation adjustment. Mexico exempts certain stocks traded on Mexican equity markets from capital gains.

Returns

Mexico requires all taxpayers to use the calendar year as a tax period. A return must be filed within the first three months of the subsequent year. Advance payments are calculated based on the taxable income of the previous tax year or on the last profitable period so long as it is within the last five years.

The statute of limitations for tax audits is ten years. Penalties and interest can be imposed for the period comprised between the return and the tax assessment.

Investment Incentives

Mexico provides tax incentives for export oriented manufacturing operations under its Maquiladora, PITEX, and ALTEX regimes. These programs generally provide customs and VAT advantages, but are not afforded significant income tax benefits over ordinary Mexican corporations.

Other Significant Taxes

Payroll Taxes include Social Security Contributions of 4.375% by the employee and 22.55% by the employer. The employer is also subject to 5% contributions to the employee housing fund, and 2% contributions to the employee retirement fund. Additionally, there is a salary tax in some Mexican states. The rate is fixed not exceeding 2% payrolls.

There is a state tax levied on real estate transactions. The tax generally applies to the buyer. The rate varies from state to state.

