

Mexico

Federal Taxation

Individual Taxation

Introduction

Mexico is a federal republic of states; it includes 31 states and the federal district. The capital city is Mexico City.

Individuals are subject to income tax. No separate capital gains tax exists, but capital gains are included in taxable income. A net worth tax applies to individuals undertaking business activities. Employed individuals must make social security contributions.

Due to the nature of Mexico as a federal republic, income and other taxes are imposed by the federal government and the state governments and, in some cases, by municipalities.

The tax administration agency in Mexico is the *Servicio de Administracion Tributaria* (SAT).

The currency is the Mexican peso (MXP).

1. Income Tax

1.1. Taxable persons

Residents are liable to income tax in respect of their worldwide income. Non-resident individuals are liable to income tax only on their Mexican-source income.

An individual is a resident of Mexico if he has a dwelling in Mexico. If an individual also has a dwelling in another country, he is considered to be resident in Mexico if his centre of vital interests is located in Mexico. For these purposes, the centre of vital interests is considered to be in Mexico, inter alia, in either of the following cases:

- more than 50% of his total income in a calendar year is Mexican-source income; or
- his main centre of business activities is in Mexico.

However, Mexican national individuals are deemed to be tax residents of Mexico even if they establish a residence in any other country where income may be subjected to preferential tax regime treatment (CFC legislation). The attribution of residence will be applicable during a 3-year period. However, this provision will not apply in case the relevant country and Mexico have signed a treaty for the exchange of information.

All individuals must separately file their tax returns. There is no joint tax return for married couples, except for married persons under the joint asset ownership regime. In this case, the person obtaining the higher income should file the return, including all revenues and deductions related to these goods.

For taxation purposes, partnerships are treated as separate taxable persons from their members.

1.2. Taxable income

1.2.1. General

Individuals are subject to tax on all items of income, unless expressly exempt. Income is broadly defined to include payments in cash, benefits in kind and inflationary gains.

The income of individuals is divided into 10 different categories, namely:

- employment income;
- income from independent personal services;
- rent from immovable property;
- capital gains from the transfer of property;
- income from the acquisition of goods;
- business income;
- dividends and profit distributions;
- interest income;
- income from prizes; and
- other income.

For purposes of the computation of income, the taxable base is reduced by applicable deductions and allowances. The individual tax rate is progressive and runs anywhere from 1.92% to a maximum rate of 28%.

From 2008, loans, donations and prizes exceeding MXP 600,000, individually or as a whole, must be reported to the tax administration (corresponding income is considered taxable income).

1.2.2. Exempt income

The most important types of exempt income are:

- compensation for damages limited to the market value of the relevant property;
- income derived by individuals from agriculture, livestock, forestry or fishery, limited to 40 annual minimum salaries;
- capital gains from the disposal of shares and other qualifying securities effected on the stock exchange under certain conditions;
- interest on qualifying federal government bonds and other securities, provided certain conditions are met;
- inheritances and bequests;
- capital gains from dwellings up to 1.5 million investment units (without ceiling if the individual has lived in the dwelling during the 5 years immediately prior to the alienation; and
- certain social security benefits (e.g. pensions received under the National pension fund system up

to a certain limit) and some other benefits received by workers.

1.3. Employment income

Employment income includes salaries derived from dependent personal services; income received by members of production cooperatives and members of civil companies and associations; fees received by members of corporate boards, administrators and general managers; fees received by persons rendering personal independent services mainly to one client, provided that the services are rendered in that client's premises; and professional income and business income derived from legal entities or individual entrepreneur, where the individual elects to pay the tax under the rules governing employment income. Employment income is subject to tax at progressive rates.

1.3.1. Salary

Income from dependent personal services includes all items of income received by an individual with regard to his dependent personal services, especially salary and bonuses. Certain items of income (i.e. welfare benefits) are exempt. Reimbursements for duly substantiated expenses are not taxable.

As from 2008 the computation of the income tax on individuals was changed. The fiscal subsidy was integrated in the progressive tax rate table and the credit on monthly salaries was replaced by a new employment subsidy. Accordingly, the computation of the withholding tax currently involves two steps: (i) the liability resulting from the application of a new tax table and (ii) the reduction of this liability by the application of the new employment subsidy.

Employment income is subject to monthly withholding.

Monthly income tax table for the year 2008:

Monthly taxable income (MXP)	Tax due on lower limit (MXP)	Marginal rate on excess (%)
up to 496.07	0.00	1.92
496.08 – 4,210.41	9.52	6.40
4,210.42 – 7,399.42	247.23	10.88
7,399.43 – 8,601.50	594.24	16.00
8,601.51 – 10,298.35	786.55	17.92
10,298.36 – 20,770.29	1,090.62	19.94
20,770.30 – 32,736.83	3,178.30	21.95
over 32,736.84	5,805.20	28.00

Neither commuting nor moving costs are deductible. Instead, only certain expenses are deductible at the end of the tax year (see 1.7.1.).

1.3.2. Benefits in kind

Benefits in kind are fully taxable and valued at their cost for the employer or at their market value, with the exception of welfare expenses.

In case of stock option plans, income from exercising the option to purchase company (or other related-party)

shares is deemed to be employment income in case the purchase price of the stock falls below its market value.

1.3.3. Pension income

For tax purposes, pension payments are generally treated as employment income. However, pensions paid by the social security system are exempt.

Neither pension contributions nor insurance premiums are deductible for the computation of the employee's income tax.

1.3.4. Directors' remuneration

Fees and other remuneration earned by resident individuals in their capacity as members of boards of directors or other management bodies are treated as employment income and are subject to withholding tax.

1.4. Business and professional income

Business and professional income derived by individuals is subject to special rules. There are three regimes: (i) business and professional activities; (ii) the intermediate regime; and (iii) the small taxpayers' regime.

The concept of business income encompasses any income derived from commercial and industrial activities. Income derived from agriculture, breeding of livestock, fishing and forestry, as well as from transport of goods and passengers, is also treated as business income subject to this regime. The concept of professional activities is defined as income received for the rendering of personal independent services other than those regulated under employment income.

In addition, individuals are also subject to the business flat rate tax (*impuesto empresarial a tasa unica*, IETU) of 17.5%, in force as from 1 January 2008. IETU is a direct tax that operates as a cash-flow tax and a minimum income tax. The income tax is creditable against IETU (see Corporate Taxation, 3.1.).

1.4.1. Business and professional activities regime

Under the business and professional activities regime, income is accrued to taxable income when it is effectively received in cash, cheques, in kind, or in the form of services.

Individuals who derive income under the business and professional activities regime are required to make monthly advance payments on the 17th day of the month following that in which the income is received. The tax is assessed by applying the table as indicated in 1.3.1.

1.4.2. The intermediate regime

A taxpayer who carries out business activities exclusively and whose income in the previous tax year does not exceed MXP 4 million may elect to be taxed under this regime. For these purposes, the term "exclusively"

means that at least 90% of his taxable income derived from business activities in the previous year.

Under this regime, taxpayers are required to make monthly advance payments assessed at a 5% flat rate. Moreover, taxpayers are favoured with more relaxed record keeping rules (i.e. they may only have a book of income, expenses and a registry of investments and deductions). Taxpayers are also released from certain administrative obligations (i.e. filing a report with the tax authorities regarding their most important clients and suppliers as well as transactions with related parties).

Taxpayers under this regime, that in the previous year reported income exceeding MXP 1.75 million but not higher than MXP 4 million, are obliged to use tax cashiers or equipment or electronic systems for tax register purposes.

1.4.3. The small taxpayers' regime

Individuals selling goods or rendering services exclusively to end consumers (i.e. neither issuing nor receiving fiscal vouchers) and with a turnover in the preceding year not exceeding MXP 2 million, may elect to be subject to a 2% flat tax based on their turnover. A monthly allowance can be deducted in an amount equivalent to 4 times the minimum salary in the relevant region.

1.5. Investment income

1.5.1. Dividends, interest and royalties

Investment income is normally included in the individual recipient's taxable base.

Dividends must be accrued as any other income for the individual. This person can credit against its annual income tax the income tax paid by the distributing company, provided that this income tax is considered accruable income and the individual has the certificate issued by the distributing company regarding the dividend.

Interest and royalties derived by resident individuals are fully taxable and must be reported in the recipient's annual tax return; however, certain interest is exempt (e.g. interest on qualifying federal government bonds and other securities).

For withholding tax on dividends, interest and royalties, see 1.9.2.

1.5.2. Income from immovable property

Rental income is taxed on its net amount, i.e. the gross rent received less related expenses. However, individuals may elect to deduct 35% of the rent as "constructive expenses" instead of deducting the substantiated expenses. All taxpayers can deduct the amount of the local property tax paid during the same tax year.

1.6. Capital gains

1.6.1. Types and treatment of capital gains

There is no classification of short-term capital gains or long-term capital gains. However, special rules apply to different kinds of assets.

As a rule, capital gains are computed as the difference between the adjusted acquisition price and the consideration received. The acquisition price is adjusted pursuant to special rules and includes, amongst other items, the cost of improvements made to the asset and all expenses and taxes inherent to the acquisition.

Taxable capital gains of individuals are calculated as the difference between: (i) the higher of the consideration received for the transfer or the assessed value of the underlying property, and (ii) the adjusted cost of acquisition and allowable deductions on such property.

Individuals obtaining capital gains from the alienation of real property must make an advanced payment for each operation, applying the progressive tax rate table.

1.6.2. Exempt capital gains

Capital gains realized by individuals in connection with the transfer of property through a bequest, gift or company merger are exempt from income tax. In these cases special rules are provided for the computation of costs in the acquirer's hands.

Furthermore, an exemption is granted to individuals who sell their dwelling, subject to certain limitations.

Capital gains derived by resident individuals from the sale of shares in Mexican companies, available for sale to the general public and sold through the Mexican Stock Exchange, are also exempt. From 2 October 2007, however, this exemption is not applicable in respect of capital gains derived from the sale of shares where:

- a person or group of persons that has a direct or indirect participation of at least 10% of the capital of the issuing company alienates, through one or several simultaneous or successive operations, 10% or more of the paid shares of the relevant company within a 24-month period, including operations carried out through financial derivative operations and any other operation of the same or similar nature. This is also applicable in respect of a person or group of persons that has the control of the issuing company as defined by the securities market law;
- the alienation is not carried out in a recognized stock exchange, or it is carried out in a recognized stock exchange but in a way that does not give the alienator the opportunity to accept more competitive offers before or during the period in which the shares are offered.