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# MEXICAN TAXATION OF FOREIGN CORPORATIONS

ENRIQUE HELGUERA

## INTRODUCTION

A virtually unexploited market, exceptional profits and attractive investment opportunities have all combined to cause a great influx of foreign capital into Mexico. This flow of foreign investment capital has hastened industrialization which, in turn, has accelerated that process. If, to all this, one adds political stability and the rule of law now prevailing in Mexico, a true picture of the present investment climate of this country appears. While the economics of this movement have been studied,<sup>1</sup> the same is not true of the general problem, or the tax law problems, faced by the foreign investor. These problems must be faced in a spirit of honesty and fairness, by both the Mexican government and the foreign corporation doing business in Mexico, so that the solutions reached will be of mutual benefit.

Mexican law distinguishes between foreign and Mexican corporations.<sup>2</sup> To the latter it grants certain privileges<sup>3</sup> not available to the former; a like distinction is also made between Mexicans and foreign natural persons. The present discussion is limited to corporations; the Mexican statute defines domestic corporations as those "that are formed in accordance with the laws of the Republic and have their legal domicile within it."<sup>4</sup> All others that do not come within this definition are considered foreign corporations. They are usually allowed to do isolated acts within the Republic and to defend themselves in the Mexican courts. Before such corporations are granted full legal personality to be able to engage in business, they must meet certain prerequisites.<sup>5</sup>

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1. For example, LAVIN, *INVERSIONES EXTRANJERAS, ANALISIS, EXPERIENCIAS Y OPERACIONES PARA LA CONDUCTA MEXICANA* (1954), a work with some polemic features; SANCHEZ NAVARRO, *ENSAYO SOBRE UNA POLITICA DE INVERSIONES EXTRANJEROS EN MEXICO* (1956) containing a most complete bibliography; ORTIZ MENA, *EL DESARROLLO ECONOMICO EN MEXICO Y SU CAPACIDAD PARA ABSORBER CAPITAL DEL EXTERIOR* (1953), a very interesting technical discussion. A useful contribution represents the recently published U. S. DEPARTMENT OF COMMERCE, *INVESTMENT IN MEXICO, CONDITIONS AND OUTLOOK FOR UNITED STATES INVESTORS* (1956).

2. That the distinction exists, see SIQUEIROS, *LAS SOCIEDADES EXTRANJERAS EN MEXICO* (1953), and *LAS RECLAMACIONES INTERNACIONALES POR INTERESES EXTRANJEROS EN SOCIEDADES MEXICANAS* (1947); RODRIGUEZ Y RODRIGUEZ, *ESTATUTO FISCAL DE LAS SOCIEDADES EXTRANJERAS EN MEXICO*, 1/2 *BOLETIN DEL INSTITUTO DE DERECHO COMPARADO DE MEXICO* 9 (1948); and author's thesis entitled *LA NACIONALIDAD DE LAS SOCIEDADES MERCANTILES* (1953).

3. See titles cited in note 2 *supra*; SIQUEIROS, *RECLAMACIONES* 13, and HELGUERA, *op. cit.* note 3, at 171.

4. Art. 5, Law of Nationality (1934).

5. Art. 250 of the GENERAL LAW OF MERCANTILE ASSOCIATIONS (1934) provides that "[F]oreign corporations legally constituted have juridical personality in the Republic." However, according to Art. 251 they "must prove they have been constituted in accord-

Other specific limitations on foreign corporations are created by special laws, as for example, the laws concerning institutions of credit, insurance companies, finance companies, fishery and forestry. Particularly important are restrictions imposed upon foreign corporations in regard to holding land within the Republic (Article 27 of the Constitution). This is understandable because these activities are especially clothed with the public interest; this is expressed by the fundamental social principles of the Constitution<sup>6</sup> which are directed toward preventing an invasion of the country by interests which may become hostile and thus threaten the national independence, economic as well as political.

#### METHODS FOR INVESTING FOREIGN CAPITAL IN MEXICO

Foreign investment capital may enter Mexico in three ways. These are the direct registration of the foreign corporation, the establishment of a branch in Mexico, and the organization of a Mexican subsidiary.

From the standpoint of the American investor, the most common, the first method listed, may have the inconvenience of subjecting the entire assets to judgments arising out of Mexican corporate activities. The second method is, in fact, only a variant of the first but does permit advantage to be taken of the tax benefits offered to Western Hemisphere Corporations under the Internal Revenue Code of the United States.<sup>7</sup> The advantages, according to a British survey, are that the parent corporation will have title to all merchandise held by its Mexican branch; moreover, the investment by the parent corporation may be increased or decreased according to the financial policies of the parent corporation. On the other hand, there are disadvantages to be mentioned. A foreign corporation cannot acquire land in Mexico. Branches of such corporations do not have to maintain a legal reserve of five percent of their income which may, if accumulated, reduce taxable income. A branch of a foreign corporation cannot obtain a tax reduction if it decides to manufacture in Mexico. In addition there are difficulties in introducing personnel into Mexico, as well as the possibility of a judgment against the branch to be enforced against the parent corporation; it must also earmark part of its capital for use in Mexico. From the standpoint of taxation, the branch

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ance with the laws of the state of which they are nationals by submitting authenticated copies and other documents relative to their constitution as well as a certificate in this respect issued by the diplomatic or consular representative of the respective country in the Republic"; in addition, articles of incorporation and by-laws must not be contrary to the public order of the Republic and, finally, that the corporation establishes itself in the Republic or has there a branch office. After their registration, foreign corporations may engage in business in the Republic (Art. 5). For additional information BERNIAL MOLINA, A STATEMENT OF THE LAWS OF MEXICO AFFECTING BUSINESS (1955).

6. See note 5 *supra*.

7. For definition, see 26 U.S.C.A. 921. See also UNITED NATIONS, UNITED STATES

arrangement offers no advantages over those enjoyed by a Mexican corporation.

The third alternative, namely a Mexican subsidiary, offers to foreign capital the advantage that such subsidiary is of a Mexican quasi-nationality and, consequently, on an equal footing with domestic corporations. A tangible tax benefit may be obtained by the parent corporation if it allows the subsidiary to accumulate profits to be used for expansion in Mexico. These profits are not taxable in the United States until the parent corporation has received them. Additional advantages are that the parent corporation can own stock in the Mexican subsidiary; stockholders can be officers of the corporation and withdraw part of the profits as expenses and salaries; such subsidiary may acquire land in Mexico as well as secure certain tax exemptions; and, finally, such a subsidiary may obtain permission to bring a limited number of aliens into Mexico as officials, provided the corporation has a capital of at least 200,000 pesos.

Foreign financiers have generally used the third alternative. However, it should be noted that some enterprises have preferred to register a branch office of their corporation.

#### TAXATION, SIMPLE AND DOUBLE

It is generally known that Mexican taxes on foreign investments are not the lowest in Latin America. However, this aspect has not been the factor determining the flow of investment capital. The Mexican income tax law is the normal type of tax levied upon the net income of commercial and industrial enterprises, the maximum rate reaching forty per cent. Adding excess and other taxes, the total is about fifty-two per cent; this is approximately equal to the maximum United States tax on corporations.

If single taxation is not such a deterrent, double taxation may well be. According to the authoritative discussion by Flores Zavala<sup>8</sup> "norms exist in our present legislation which clearly give rise to double taxation while, on the other hand, there are provisions attempting to avoid or at least reduce this possibility." It must be borne in mind, however, that Mexico has no convention with the United States concerning the avoidance of double taxation. Negotiations were planned as early as 1947 but not even a draft of the proposed convention has as yet been published. The United States investor must, therefore, rely for the present on advantages offered under the Internal Revenue Code concerning credits for foreign taxes.<sup>9</sup>

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INCOME TAXATION OF PRIVATE UNITED STATES INVESTMENT IN LATIN AMERICA (1953), and FOREIGN CAPITAL IN LATIN AMERICA 109 (1955).

8. 1 FLORES ZAVALA, *ELEMENTOS DE FINANZAS PUBLICAS MEXICANAS, LOS IMPUESTOS* (1955); for a summary of Professor Margain's report to the Tenth Conference of the International Fiscal Association (Rome, 1956), see 8 FOREIGN TAX LAW WEEKLY BULL. No. 7 (1957).

9. For details, see Gallagher, *The United States Foreign Income Tax Credit*, 37 CHICAGO BAR RECORD 455 (1956).

## GENERAL TAXATION PROVISIONS

"As a general rule," states Sequeiros,<sup>10</sup> "foreign corporations are before the law on equal footing with Mexican corporations" and, consequently, "the taxes levied upon them, the tax concepts used, the deductions authorized, and their rights and duties with regard to taxation are the same regardless of their nationality." Nevertheless, numerous exceptions exist and the present tendency is for these to increase rather than to diminish. Consequently, provisions not discussed here may be presumed to be identical for both Mexican and foreign corporations.

The Federal Tax Code<sup>11</sup> sets the framework within which the corporation, foreign or domestic, must operate. Among basic provisions of importance may be mentioned those determining sources of government income and the provisions establishing the applicability of the Code.<sup>12</sup> Article 20 defines the taxpayer as "any natural or juridical person who must pay a sum defined in accordance with the law directly to the Federal Treasury." Article 21 fixes, in a manner fundamental to this study, the substance of this general definition. It states that taxpayers include Mexicans residing in Mexico or abroad; foreigners residing in Mexico or abroad (in the latter case subject to tax for acts performed in Mexico or acts producing legal or economic effects within the Republic, through capital owned by such residents abroad, or for income obtained from sources within the Republic); juridical entities, foreign as well as domestic; public institutions; public organisms endowed with functions derived from the State; and any other group which, even though not endowed with a juridical personality, constitutes an economic entity distinct from that of its members.

In accordance with these provisions foreign corporations located in the Republic are subject to taxation just as those doing business exclusively abroad, but which receive income there from within the Republic. A foreign corporation, whether it does business here permanently or only carries out isolated acts, must register in the Commercial Register. This makes it amenable to taxation. Article 21 also makes it clear that the form of foreign association need not come within the types listed in the General Law of Mercantile Associations to be subject to Mexican taxes. At first glance it might seem that the existence of a juridical entity would be an essential requisite; however, our Tax Code does not always follow traditional precepts of the Civil and Commercial Codes. This is one of the departures. In this respect the Fiscal Tribunal<sup>13</sup> has stated that in such a case the group "must

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10. *Op. cit.* note 2 *supra*.

11. Translations available from two publishing institutions in Mexico, namely the American Chamber of Commerce of Mexico and Traducciones.

12. As contained in Art. 1 through 5 of the Code.

13. Decision of October 26, 1937, *cit.* by Flores Zavala, *op. cit.* note 8 at 65.

be held to be a unit, that is, a single taxpayer; this idea is perfectly admissible under our fiscal legislation since the income tax law does not require that the taxpayer possess juridical personality." It is understandable that no government will concern itself with legalistic niceties; government collects taxes wherever it finds taxable objects, regardless of the legal nature of their holders."

Article 38 deals with the payment of taxes effectuated abroad. In this regard, the provision reads as follows: "The payment of taxes is rendered effective in kind, in stamps, or in the form provided by law, or as may be provided in the special contract or concession. The amounts collectable abroad will be paid in the money of the country in which collection is made with foreign money to be exchanged into the Mexican at the rate of exchange fixed by the Treasury Department." Article 29, which deals with joint liability for taxes, contains no provision imposing such liability on foreign corporations for taxes due from their branches.

In regard to proceedings in tax matters, every natural or juristic person "who, in accordance with the law and in the exercise of civil rights, may appear before federal tax authorities, either personally or by attorney . . ." (Art. 69). Here no specific distinction is made between foreign and domestic corporations. Capacity to appear before fiscal authorities coincides with the requirement of "civil rights," meaning capacity under general law to act as an independent legal subject. Article 70, establishing means of verifying these requirements, confirms the correctness of this statement by providing that "in matters where the amount involved does not exceed five thousand pesos, the parties may verify their right to appear by a power of attorney granted in conformity with the provisions of the Civil Code for the Federal District and Territories. In other cases, the power of attorney must have been duly recorded in the public register, in accordance with the Code. Whenever powers of attorney granted outside of the Republic are involved, such powers shall be authenticated before they may have any effect." It follows that a foreign corporation must execute a power of attorney in accordance with the laws of Mexico.

Notice is provided for by Article 71 of the Tax Code. It must normally be given directly to the persons involved or by mail; in case a foreign corporation has not designated a domicile in Mexico, notice may be by publication. Similar provisions govern the demand to pay taxes. Article 89 provides that in case the tax collector is unable to locate the taxpayer or his representative "demand may be made and will attach to his property according to provisions of Article 71 (II) (c) and Article 72 (IV)."

It would seem that the normal attachment procedure<sup>14</sup> for domestic corporations would also apply to property of a delinquent foreign taxpayer

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14. Art. 93-95 of the TAX CODE.

within Mexico. However, it would not affect real property outside the Republic. It may be added that a non-registered foreign entity is given an additional thirty days to file an appeal in the tax court.

#### INCOME TAXATION

Mexican income tax legislation<sup>15</sup> is very broad in scope. It affects all income whether arising from labor or capital or a combination thereof.<sup>16</sup> The definition of income is, therefore, rather broad<sup>17</sup> and equals every type of act or transaction causing any change in the income of the taxpayer.

Of the seven schedules into which income is divided, schedules I, II, III, VI and VII<sup>18</sup> apply to foreign corporations. Of particular interest to the foreign corporation is Chapter II which relates to the taxpayer and his domicile; in Article 6 is to be found a provision that states: "where the source of taxable income is located abroad, payments of such taxes to the country in which such source of income is located are deductible." There are additional provisions regarding foreigners. One, Schedule II makes subject to income tax: "[f]oreigners domiciled in the Republic if their income arises from sources situated, or from transactions executed, within or without the country, and foreigners residing abroad for that part of their income from sources of income or transactions in Mexico. If aliens reside in Mexico and obtain income from sources situated, or from transactions effected, outside of the Republic, taxes paid to the foreign country involved are deductible." In addition, Schedule III states that "civil or commercial corporations constituted within or without the Republic, whenever their income arises from sources or transactions realized in the national territory," i.e., within Mexico, are equally subject to Mexican income tax. There is no requirement that the corporation have a fixed domicile in Mexico, or that it be authorized to do business in Mexico; it is sufficient that the corporation has a source of income inside Mexico or receives income from business carried on there.

Article 6 (IV) contains provisions parallel to those of the Tax Code [Article 21 (5)]. Juridical personality means, for income tax purposes, any

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15. Basic law of 1953 as amended 1955. For a complete and up-to-date translation, see FOREIGN TAX LAW ASSOCIATION, *MEXICAN INCOME TAX SERVICE*, 3 v. (1.1.); also publications by institutions listed in note 11 *supra*.

16. Art. 10, Tax Code.

17. "All kinds of rent, profit, gains, income, interest, produce, benefit, dividends, salary, honoraria, and in general, any and all income received in cash, in securities, in kind, or in credit which may affect the patrimony of the taxpayer."

18. I.e., the schedules regarding commerce, industry, agriculture, farming and fishing, capital taxation and privileges and alienation of concessions. For a complete discussion, see MARGAIN, *LA LEY DEL IMPUESTO SOBRE LA RENTA DE 1954 Y SUS REFORMAS DE 1956* (1956).

unit capable of having a patrimony and income.<sup>19</sup> The second paragraph of this clause governs all foreign types of juridical entities having an income from transactions within the national territory. Foreign transactions by Mexicans are dealt with by Article 7; these are taxed notwithstanding the law of taxation in the other country.

The income tax law provides that the domicile of civil and commercial corporations, regardless of whether they are constituted within or without Mexico, and that of associations and foundations is the place where their administration is located. To a certain extent this definition coincides with that given by the Civil Code.<sup>20</sup> Nevertheless, the Treasury Department may, for special reasons or upon the petition of the taxpayer for proper cause, designate some other domicile for tax purposes (Article 8). In the event that a foreign enterprise acts through more than one branch in Mexico, it must designate one as the domiciliary; otherwise the taxing authority may do so unilaterally. For the purpose of reporting consolidated income under Article 63, the same authority may impose the character of the parent corporation on a branch.

Each relevant schedule of the Income Tax Law will now be analyzed briefly. Schedule 1 affects those who "habitually or occasionally engage in acts of commerce" (Article 22); these acts are listed in Article 75 of the Commercial Code.<sup>21</sup> It is possible for a foreign corporation to become liable for taxes even if its business is confined to a single act.<sup>22</sup>

The basis for taxation is the taxable net income which is the total income less deductions. Authorized deductions are set forth in Article 29 but no special provision is made, in this respect, for foreign enterprises. Nevertheless, it may generally be said that Section XV permits deduction by Mexican enterprises of taxes paid by their foreign branches, at the same time disallowing the use of the Mexican tax for these purposes; this, inferentially, affects the type of enterprise here considered. Sections IX and X allow premiums paid to Mexican surety and insurance companies to be deducted, which would indicate that like payments to foreign companies would not be.

There is a special chapter of Schedule I regarding the taxation of banking, insurance and other credit institutions, including such foreign

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19. The specific language is: "Associations, foundations, communities, co-partnerships, estates, corporations, or whatever other groups form an economic unit even not being a juridical personality."

20. Art. 33; for a complete translation, SCHOENRICH, *THE CIVIL CODE FOR THE FEDERAL DISTRICT AND TERRITORIES OF MEXICO AND THE MEXICAN LAWS ON ALIEN LANDOWNERSHIP* (1950).

21. Translation in FOREIGN TAX LAW ASSOCIATION, *THE COMMERCIAL CODE OF MEXICO WITH PERTINENT SECTIONS OF THE CIVIL CODE AND OTHER LAWS AND GENERAL COMMENTARIES* (1956, 1.1.).

22. Art. 34, translated *ibid* and Art. 59 which provides that "... those persons, having only casual acts of commerce, shall pay a tax of 20% on the profit obtained from each transaction."



licensed branches and subsidiaries. These are permitted many of the deductions provided in Article 29<sup>23</sup> and fifteen special deductions listed in Article 42.

Foreign surety companies not domiciled in Mexico are permitted to engage in reinsurance in accordance with the law of surety institutions. On their income they pay a tax of 4% of the value of the premiums received as a result of the business done inside the country. Those foreign companies, which earn more than 100,000 pesos a year (Schedule I), must keep books in accordance with this law, its regulations and the Code of Commerce. In accordance with Article 63 of the Code the company with several branches must consolidate the results and file its declaration of income on that basis.

Because of the nature of their operations, certain taxpayers occasionally find it difficult to make an accurate estimate of taxable income. Article 28 gives the Secretary of Finance power to enter into stipulations to fix the tax base. Article 15, Chapter III, provides that foreign companies or businesses must, before entering into one of these agreements, submit a notarial statement that they will permit inspection by officials of the Secretary of Finance. The purposes of the inspection are to determine the financial condition, particularly the amount of business conducted; the terms proposed for the agreement; the copies of all contracts, concessions, authorizations, or permits which have been granted by federal, state or local governments; the amount of gross income earned in Mexico during each of the last five years, or more if the operation has been carried on longer; the percentage which such income bears to the income earned outside of the country; the amount of gross income that might be said to have been earned in Mexico with both the explanation and basis for the figure stated; the amount of costs and other administrative or operating expenses for each of the last five years, or the time the business has been conducted if longer; the percentage relationship between the operating costs in Mexico and the total operating cost; and, finally the allocation of that part of operating costs which is declared to affect the Mexican income with the explanation and documentation to support the figure.

On the other hand the Regulation also states that foreign companies or businesses operating in the country through branches or agencies shall maintain, in addition to its books of account required by Article 57, the following records: all auxiliary books necessary to determine income and all supplementary books needed to fix costs and expenses connected with the Mexican activities (Article 66).

With regard to the determination of the taxable base the Regulation makes a distinction between "those foreign companies not domiciled in

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23. Those permitted are contained in Sections II to XV and XVIII to XX.

the country but which operate there and have stock in trade" and "those foreign companies which operate in the country through branches or agencies." In spite of this distinction, both are governed by the same tax rules. With regard to the latter companies doing business through branches, however, there must be proof that the value of merchandise received from the parent company is the cost of production plus the costs of transportation, duties and other import costs. If this requirement is not fulfilled the taxpayer will be deemed to have failed to prove these costs and they will be fixed by estimation (Article 43). Commission merchants who act on behalf of foreign enterprises doing business in the country, and who hold a stock in trade there, are expected to maintain the following records: a book of sales and income derived from other operations; a record of all acquisitions of goods with their cost and such other books as are necessary to show other expenses such as advertising, insurance, taxes, commissions; and, in general, all other expenses of management and sale which are made on behalf of the company represented (Article 65).

Schedule II concerns the taxing of industrial activities. For tax purposes these activities include the mining or other extraction of raw materials and storage or transformation; any kind of production of finished goods; the manufacture of any consumers goods; or the rendering of any public service in the field of communication, transportation or the supplying of water, gas, or electricity (Article 68). The tax base is the same as that of Schedule I. Since there are no particular provisions regarding foreign companies in this schedule, there is no need to enter into any detail.

Schedule III deals with the taxation of farming, ranching, or fishing. It is of no interest to a foreign corporation since there is almost no possibility of a foreign company engaging in any of these activities.

Schedule IV deals with the taxation of income earned in the form of salaries or other payment for work performed under the direction or control of a third person, that is wages, salaries, bonuses, commissions, etc. (Article 95). It is obvious that foreign companies, in the technical sense, do not fall within the meaning of this schedule. However, a few provisions should be noted since foreign corporations have a duty to withhold taxes on salaries and report to the appropriate tax office. Only foreign companies or their branches, authorized to do business in the country<sup>24</sup> have this duty. The unauthorized foreign company, which only does an occasional act is exempt from this requirement. The law also deals with the situation in which individuals domiciled in Mexico receive income, taxable under this schedule, directly from a foreign country. Such individuals must report monthly the amount of income as well as the payment due (Article

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24. These have a joint liability for the tax established by Art. 107.

108). Foreigners who receive income, by way of salaries from Mexican companies abroad, are exempt from paying tax under this schedule (Article III, Section VI).

Schedule V provides for the taxation of income earned either regularly or casually by natural persons as a result of professional, artistic, cultural, athletic, or technical activities, as well as by agents of savings and banking institutions created to provide housing; also controlled are insurance and surety companies, whose activities require a license issued by the state. Foreigners residing outside of the country in the employ of Mexican companies are exempt from taxation (Article 112).<sup>25</sup>

Schedule VI is designed to provide for the taxation of distributed earnings or the distribution of capital, particularly "all profits which are distributed or which should be distributed by all types of Mexican companies and foreign companies operating inside the country" (Article 125, Section X). The representatives, agents, agencies or branches in Mexico of foreign companies must retain the amount due and make a return stating the earnings distributable which are obtained within the country. The person to whom the income is attributable is subject to this particular taxation, any agreement to the contrary notwithstanding (Article 126). The basis for taxation is the earnings to be distributed, determined after the deductions authorized by law. Earnings falling within this category are taxable at the rate of 15%. In regard to Mexican companies and foreign companies established in the Republic, Article 138 demands that they must determine such earnings in accordance with proper accounting principles; the net amount reached is increased by amounts dependent on the various forms of reserves. From this overall amount the following items may be deducted, provided it can be shown that these deductions have lessened the amounts payable: the amount of income tax in Schedules I, II, and III formerly paid, providing this has not previously been used to reduce the tax payable under Schedule VI; the amount of income tax payable under Schedules I, II, and III already paid in the year reported out of this amount; the same two deductions with regard to the excess profits tax; and all losses which affected capital reserves or distributable earnings occurring within the last two tax years immediately preceding the year being reported. This deduction is available only if made in the year immediately following the loss. There are many other deductions but these are the only ones allowed to the representatives of foreign companies or their branches. Mr. Margain explains the prohibition against

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25. According to Art. 113 regarding taxation of persons organized in mercantile enterprises, are subject to Schedule I, II and III. It seems rather improbable that foreign companies would ever fall under this provision. It could well apply to groups of foreigners engaged in professional activities of non-mercantile nature. It is, however, to be kept in mind that foreign companies must demand of professionals rendering services to them, receipts showing that taxes have been paid on the value of such services.

other forms of deduction, in accordance with the recent amendments to the law, in the following way: "A foreign agency, branch, or representative operating inside the country has no capital of its own. In the sense of mercantile law the capital belongs to the parent corporation residing outside of the country which has but an investment account with the branch, against which it may draw freely and, as a consequence, raise or lower the capital at its pleasure. For this reason, it is obvious that in no event could it be deemed a social [company or corporate] capital and hence it is impossible for such a branch to create a capital reserve." The same author continues that "from another point of view, to permit the deduction for capital reserves when dealing with the tax of dividend income would be to allow an undue evasion. This would amount to allowing branches to deduct for income tax purposes amounts returned to the parent company in whatever percentage they felt possible; thus at the expense of the tax collector such a company would be able to avoid paying the tax on income from dividends without reinvesting any of the funds in the business."<sup>26</sup> In conclusion he states that "for this reason it is deemed appropriate to exclude these kinds of operations and, instead, to state that any sum transferred by foreign branches to the parent company will be deemed to be earnings subject to this particular tax unless it falls within one of the permitted exceptions."<sup>27</sup>

Foreign banks, not domiciled in Mexico, are given special tax treatment in Article 144 which provides a 10% levy on interest payments made on the account of their bonds or other types of debts which are traded on the exchanges in Mexico, as well as the same rate on interest received for financial activities conducted within the country by foreign domiciled banks.<sup>28</sup>

There are certain of the exemptions in Schedule VI which are of interest. For example, there are the interest payments made to insurance companies by foreign companies on account of technical reserves maintained to protect reinsurance issued within the terms of the General Law of Insurance Companies and interest paid to insurance companies outside of Mexico for the same purpose (Article 149, Section VIII). Section XI of the same article makes an identical provision for surety companies.<sup>29</sup>

Schedule VII taxes licenses and other concessions and the transfer thereof. This schedule includes within its definition any exploitation of concessions licensed by competent authorities or under contracts granted

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26. *Op. cit.* note 18, at 68-70.

27. *Ibid.*

28. Art. 133 adds that transactions within the Republic by foreign domiciled banks shall be taxed at a rate to be stipulated with the Secretary of Finance.

29. Art. 150 provides that if the credit, insurance or surety company wishes to add its interest income to that taxable under Schedule I and it so declares, then the income will be exempt within this Schedule.

by federal, state or local governments, as well as the sale or acquisition of this type of property and any other kind of operation having to do with the extraction of sub-soil resources (Article 152). Persons obtaining income through any of these activities are subject to the tax under this schedule, the base being the total amount of income obtained during the year (Articles 153, 155). There are no special provisions for foreign companies.

Title IX of the Income Tax Law provides for the excess profits tax. This tax is paid by those whose annual income, according to Schedules I, II, or III, is more than 300,000 pesos and whose taxable earnings exceed 15% of the capital employed (Article 170). Capital employed, at least insofar as it is applied to juridical persons and to branches or agencies of foreign credit, insurance, or surety companies, is determined by calculating the capital, according to accounting principles, at the close of the year preceeding the year in which the declaration is being made and by adding all amounts earned since then whether in the form of paid-in capital, capital reserve, or undistributed earnings. To the amount thus calculated is added all increases in the active capital and all earnings on shares. From this sum may be deducted all payments, made during the year in question, which lower the capital, as well as any payments from capital reserves or undistributed surplus held over from the prior tax period, whenever these have decreased the balances before the close of the accounting period in question (Article 171). With regard to the operating capital of branches or agencies of foreign companies doing business in the country that do not have their own capital in the true sense of the word, the system designed by the law is quite different. The operative capital is fixed at 40% of the net worth as shown by the balance sheet at the close of the preceding tax period. Net worth consists of the circulating worth and the difference between the cost of permanent investments and of depreciation as well as deferred payments for amortization as of the close of the preceding fiscal year (Article 172). For purposes of calculating the excess profits tax the amount of the ordinary income tax paid may first be deducted from the income declared in each of Schedules I, II and III. The rate of the tax runs from 5% to 25%, in proportion to the amount that the earnings exceed the allowable 15%. In accordance with Article 180 branches of banks and other credit institutions, together with insurance and surety companies, apply the rate fixed annually by the controlling agencies of the Secretary of Finance.

Titles XI and XII of the same law deal with the administrative re-determination and responsibilities of third parties. The former, a kind of administrative review of prior tax determinations, allows for a period of 15 to 45 days for demanding review before the Director of Income Taxation. The longest period is available to foreign companies or other tax payers not having agents or representatives in the country (Article 197).

The following circumstances present third party liability for failure to keep proper books for tax purposes: (1) where any payments have been made to persons residing outside of the country, in which case the tax should be withheld either in accordance with the terms of the law or the particular agreement made; (2) where all refinancing or reinsurance premiums are paid by Mexican companies abroad; (3) where all payments are made to taxpayers within Schedule V (In this latter case, the withholding shall be 2% on each amount paid for those operating permanently within national territories, or the amount resulting from a calculation of the tax on the total amount paid for those not acting permanently within the national territory.); and (4) where all payments are made within the meaning of Article 125. It is also clear that there is a joint responsibility for taxes on the part of the representatives of corporations, boards of directors, members of controlling committees of stock companies, general managers, and administrators of companies or other enterprises. Article 204 establishes the same kind of liability for the resident agents of foreign companies.

#### MERCANTILE INCOME TAX

The new federal Tax on Mercantile Income<sup>30</sup> was proposed to simplify and coordinate taxation in this area by substituting one unified levy for a multitude of federal and state taxes which formerly encumbered commercial and industrial transactions. The new tax affects all commercial acts from which income is obtained, such as the sale or rental of property, personal services, commissions or mercantile brokerage.<sup>31</sup>

Chapter II deals with the scope of taxation and domicile. Article 10 provides that the tax on mercantile income applies to all natural or juridical persons who habitually obtain revenue from operations as a result of activities in national territory. It would appear that foreign corporations, not domiciled or habitually operating in Mexico, would not be affected by this law. However a Bureau ruling in the case of Bunge Mexico, S.A.<sup>32</sup> decided

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30. "Impuesto Sobre Ingresos Mercantiles," Dec. 31, 1951 and Jan. 24, 1952. For a commentary on this law and its antecedents, see LOPEZ VELARDE, *APUNTES DE UN SEGUNDO CURSO DE DERECHO ADMINISTRATIVO*, 127 (1954).

31. "Income is any profit, in cash, in property, in services, in goods, in letters of credit, in future credit or in any other form in which it is gained from the operations affected . . . The tax is based on the total revenue of the operations herein covered at the time of the transaction, be it on terms or on credit, including the transaction expenses, the interests or any other service which augments the operation . . . All conveyance of ownership of a mercantile character from which revenue is perceived is considered a sale of property; property rentals are all concessions of temporary use or enjoyment of anything which are those of mercantile character, subject to this tax . . . The mercantile commission is that given the commission agent for executing acts of commerce for his client, and mercantile brokerage is the activity of bringing together the parties to a contract." Articles 2 and 7.

32. February 17, 1948. The text of the decision was:

"The principle of domicile established in Article 5 of the Tax of Mercantile Income Law only applies to businesses domiciled in national territory, not to those who have their domicile in foreign territory. For the latter the place

that there was taxable mercantile income from the sale of merchandise located in Mexico City to a business domiciled in Mexico City, even though the domicile of the seller was not within Mexico.

The distinction drawn as to the "place of sale rule" was further clarified in another Bureau ruling<sup>33</sup> which stated that "the ordinary sale of a shipment of goods is a mercantile operation taxable as to profit according to Article 1, Section 1, of the law. It is not taxable by stamps within the tariff. Mere registration of an invoice, or of a contract of sale made outside of the national territory, is neither taxable as mercantile income nor by the stamp tax of Section XIX of the tariff if the seller has his domicile and the income is obtained outside of national territory. The only tax that must be paid in such case would be for registration of the contract."

Income is considered earned at the place where the taxpayer has his business, industry or commerce; that is the same place where he is obliged to file his tax returns (Article 11). The amount of the tax is 18 mills on the entire taxable amount. In other chapters, the law deals with semi-taxable income (Article 17) and exempt income (Article 18).<sup>34</sup>

Although no other provisions mention foreign corporations, it is believed that foreign corporations or branches established in Mexico are subject to the mercantile tax. As has been pointed out the occasional transaction may also be taxed. It can happen that a foreign corporation buying from a Mexican merchant has to pay the tax if the latter fails to do so.<sup>35</sup>

#### OTHER TAXES

The General Stamp Tax is of limited interest. This tax must apply to non-mercantile contracts, acts and documents celebrated or issued abroad or within the Republic, if they are to have force or effect. Foreign corporations may be taxed for either type.<sup>36</sup>

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of earning the income is decisive. As in this case, the sale was made in Mexico City and it is there that the taxable income was earned, given that the merchandise was, at time of sale, in Mexico City, and in accordance with Article 5, it is resolved that the sale made by the Bunge Corp. of New York to Colgate Palmolive, S.A., even though the invoice was made in New York, is taxable on the entire amount of the sale in accordance with Article 8."

33. *Id.* note 32.

34. Among the exempt group are income derived from banking, insurance and surety companies and allied activities.

35. "It is not obligatory to consign the repercussion of the tax in bills and documents which cover the sale of merchandise which is exported, if the buyer resides abroad." CIRCULAR 102-A-1, D.O., Feb. 20, 1950.

36. Of principal interest are certificates in which foreigners solicit acquisition of land, water rights, concessions for exploitation of mines, waters or combustible minerals (fixed quota: 1,000 pesos); or for aliens who enter cooperative corporations. ORGANIC LAW, Art. 27 I; concessions extended by the federal government for the exploitation of natural resources or public services (20 pesos per stamped sheet of official paper) or legalization of signatures.

Perhaps the most important single stamp tax transaction involves the charters and by-laws of foreign corporations registering in Mexico. Article 42 provides that this tax is based on capital, or in the absence of specific capital, on the difference in credits and debits as shown by the balance sheet for the year preceding the tax levy.

The new Law of Inheritance for the Federal and District Territories<sup>37</sup> does not appear to apply to foreign corporations (Article 2). However, foreign corporations become involved to the extent that the stocks and bonds of any corporation domiciled in the Federal District and Territories are taxable even though the stock certificates are abroad and persons domiciled outside of Mexico inherit them (Article 3, Section IV). Also considered an object of this tax are "those movables created by a source of wealth situated in the District or Territories, even when the goods are found abroad or in some State of the Republic and are inherited by persons also domiciled abroad."<sup>38</sup>

Foreign corporations also must pay import and export duties as well as immigration charges for employees brought into the country.

Finally, foreign corporations cannot claim the advantages offered by the Industrial Development Law.<sup>39</sup> Article 13 limits "applications to those industries which operate, or will operate, in the form of corporations chartered and functioning in accordance to Mexican law." The circular<sup>40</sup> regarding the tax exemption under this law would indicate that as long as the mold is Mexican the control can be foreign. The instruction includes among the necessary declarations this query: "... whether or not the natural or juridical person is subsidiary to, or has connections with, others already established in the country or abroad, and indicating the names and domiciles of those persons and the character of their relationship."

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37. D.O., Dec. 11, 1940.

38. The tax is subject to a set-off for inheritance tax paid to the state or foreign country. Art. 3, § V.

39. D.O., Jan. 4, 1955; Rules in D.O., Dec. 2, 1955.

40. D.O., Dec. 2, 1955.