MEXICAN TAXES ON FOREIGN INVESTMENT AND TRADE

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I. INTRODUCTION

The brevity of a law review article necessarily limits the subject matter discussed. Accordingly, this Article is confined to Mexican tax treatment of the following six areas:

(1) Direct sales of merchandise by foreign residents to Mexican residents, as this is the most common practice in international trade in Mexico;

(2) Direct foreign investment in Mexican companies, first describing how the profits of these Mexican companies are taxed;

(3) Dividends paid by a Mexican company to a foreign investor, as such dividends are the normal consequence of direct investment;

(4) Profits obtained by a foreign investor from the sale of shares of a Mexican company, as an investor may in due course wish to dispose all or part of the Mexican shares he has purchased;

(5) Interest obtained by a foreign investor from a loan made to a Mexican company in which he has invested, and interest obtained by a foreign bank from a loan made to such Mexican company;

(6) Revenues obtained by foreign parent companies from their licensing of brands and trademarks or their provision of technical know-how and other assistance to their Mexican subsidiaries.

II. PRINCIPAL TAXES ON INTERNATIONAL OPERATIONS

No Mexican tax is due on international operations executed by nonresident aliens with Mexican residents. This is due to the fact that the source of the revenue is generally not located in Mexico, as the seat of the business and the location of the merchandise is abroad and the vendor thereof also resides abroad. However, if the source of the revenue were to be transferred to Mexico, then income tax would be due on any such

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operation, notwithstanding that the vendor had at no time ceased to be a foreign resident. This would be the case despite the fact that the Mexican Constitution does not require aliens to pay taxes in Mexico. In my opinion, the fact that no such obligation is established cannot lead to the interpretation that under such circumstances aliens are not obliged to pay taxes in Mexico. It would be inconceivable to interpret our Constitution in such a way as to place Mexicans in a condition of disadvantage vis-a-vis aliens, and that is precisely what would occur if the source of revenue were located in Mexico.[1] Quoting Manuel Trón, "to the extent that the public expense benefits an alien, it warrants that they contribute to it by paying taxes."[2] This is also how our Supreme Court interprets the Mexican Constitution.[3]

A. Income Tax

One of the secondary laws applicable to international operations is the Income Tax Law (the "ITL"). Individuals and entities residing abroad but obtaining revenues from sources located in Mexico are expressly subject to the income tax.[4] There is no doctrine establishing the location of a source of revenue; the ITL contains a specific definition of each case in which a source of revenue is deemed located in Mexico.[5]

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1. C. M. FONROUGE, DERECHO FINANCIERO, 402 (1987). The concept of "source of revenue" is applied to submit a person to the territorial scope of the law of a nation other than his own, by virtue of what Giuliani Fonrouge calls "the criterion of economic submission that is based on the source which produces the revenue." To illustrate the applicability of this criterion, Fonrouge cites Sorondo, stating that ". . .when a revenue has been obtained by virtue of existence of a given political, economic, social and juridical environment, it is indubitable that the foreign resident who obtains it must grant appropriate participation therein, in the form of taxes, to the general financial exigencies of said environment. . .", and goes on to state that ". . .thus, the question is not of preeminence of an utilitarian reason such as the convenience of capital-importing countries, but of the affirmation of a concept possessing an unquestionable juridico-economic foundation."

See also O. BUHLER, PRINCIPIOS DE DERECHO INTERNACIONAL TRIBUTARIO, 244 (1968). Other authorities have opined in the identical sense. Ottmare Buhler does not refer to the "source of revenue", but to the "principle country of origin" when stating ". . .however, purely economic considerations must lead to the conclusion that a country in which an enterprise obtains benefits cannot be precluded from taxing it. And it is certainly this economic consideration that has proven to be dominant in recent years, for since 1955 it has visibly gained ground from the traditional principle of "country of residence", which had therefore been stronger and had prevailed especially in European countries."

2. M. TRÓN, RÉGIMEN FISCAL DE LOS EXTRANJEROS EN MÉXICO 54, (1990).

3. Appendix to the SEMANARIO JUDICIAL DE LA FEDERACIÓN, 1917-1985, First Part, Plenum, 110 (Mexican Supreme Court of Justice, México, 1986).

4. *Ley del Impuesto Sobre la Renta*, Diario Oficial [D.O.], December 30, 1980 [hereinafter ITL]. Fraction III of Article 1 of the ITL states that: "Individuals and entities are obligated to pay Income Tax in the following cases: . . . III. Those residing abroad, with respect to all revenues from sources located in national territory, when they do not possess a permanent establishment in Mexico or when they do possess such an establishment but said revenues are not attributable thereto."

5. Title V, "*On Foreign Residents Obtaining Revenues from Sources Located in National Territory,*" of the ITL, *id.*, deals expressly with persons residing abroad. The title incudes

When discussing the different tax regimes, I will refer to the pertinent ITL provisions governing the location of the source of revenue.

When a foreign resident acquires the obligation to pay income tax, in the great majority of cases it is complied with through a withholding. Such withholding releases the foreign resident from the obligation to file a tax return in Mexico.

B. Value Added Tax

Another tax that is levied in Mexico on all international trade operations is the Value Added Tax (the "VAT"). One of the primary characteristics of this tax is that, notwithstanding that the vendor of the goods or the renderer of the services is the payer, he is obligated to transfer the tax to the purchaser of the goods or the receiver of the services, and therefore the final amount of the tax becomes an obligation of the latter. A brief summary of this tax is given in Part IV. In cases of international trade operations, a foreign resident cannot be obligated to pay tax in Mexico if the source of his revenue is in a foreign country. This concept is the basis for the definition of the "subjects of the tax" given in the Law of the Value Added Tax (the "VATL"), which establishes that the subjects are those individuals and entities who execute in "national territory" the acts or activities specified in the VATL as constituting the objects of the VAT. The specified acts or activities are the following:

(1) disposition of assets;
(2) rendering of independent services;
(3) granting temporary use or advantage of assets; and
(4) importing goods or services.[6]

Consequently, a foreign resident who executes an operation of international trade cannot be subject to the tax if the source of his revenue is not in Mexico. Thus, it became necessary, in order to refrain from controverting the philosophy of the system on which this tax is inspired (referred in Part III), to provide that the Mexican importer or purchaser of the goods or services introduced into Mexico is the subject of the tax, in spite of the fact that the importer or purchaser did not dispose of the goods nor render the services.

Based on the foregoing, it may well occur that a foreign resident is obligated to pay VAT if he executes in Mexico any of the acts or activities described above, and transfers to Mexico the source of the revenue derived therefrom.

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articles 144 through 162, which define the cases and contingencies in which a source of revenue is deemed located in Mexico.

6. *Ley del Impuesto al Valor Agregado*, art. 1, D.O., Dec. 29, 1978 [hereinafter VATL].

III. INTERNATIONAL TRADE OPERATIONS

As mentioned in Part II, *supra*, income tax is not due on direct sales of merchandise by foreign residents to persons established in Mexico, as the source of revenue is not located in Mexico. However, the importers of merchandise must pay VAT on their imports. The evident purpose of this is to place imported assets in the same situation as assets produced in Mexico, as the intention of the VATL is not to affect only the value or components added to the goods in Mexico, but the total amount of value added to or incorporated into assets traded in Mexico. That is why it provides that whoever imports goods or services to Mexico is obligated to pay VAT. However, following this philosophy, importation of goods, which would not be taxed if disposed of domestically, is exempt from the VAT.[7] This exemption places the importer of goods into Mexico in a situation identical to that of a producer of goods in Mexico for subsequent sale.

A. Permanent Establishment

There are a number of operations that could be characterized as international trade but on which income tax is due. Of particular importance are those operations in which a foreign resident maintains what is known as a "permanent establishment" in Mexico. The concept of "seat of the business", described by Giuliani Fonrouge, is applied to these situations. Fonrouge states that this concept "acknowledges that the development of an economic activity in a place other than the domicile or residençe of the taxpayer has a fiscal effect."[8] This is the criterion adopted in the Mexican legal regime, with the result that the country in which the "seat of the business" or "permanent establishment" is located, is entitled to levy tax on the foreign resident—or the owner or holder of the seat or establishment.

Repeating a statement set out in *Estudio de la Ley del Impuesto Sobre la Renta*:

> "the purpose sought by the concept of 'permanent establishment' is to create a juridical figure permitting the Mexican State to apply the principle of territoriality of the Income Tax Law, so as to permit it to tax the profits obtained by residents in foreign countries and thereby obtain the tax yield equitably corresponding to it from the profits generated in Mexican territory by a resident in a foreign country. This is absolutely equitable and is based on the principle of obtainment of tax when the source of revenue is located in Mexico: if the establishment to

7. *Id.*, art. 25, fraction III.
8. G. FONROUGE, *supra* note 1, at 399.

which the revenue is attributed is located in this country, then said establishment must pay tax in Mexico just as would a Mexican resident who obtains taxable revenues".[9]

Manuel Trón made an interesting comparison between the definition given to the concept of "permanent establishment" in the ITL and that proposed in the Model Convention of the United Nations on Double Taxation Between Developed and Developing Countries. Trón asserts that, for the most part, the definition set forth in the Mexican law found its practical inspiration in the Model Convention.[10] This leads to the conclusion that no resident of a foreign country should be surprised by Mexico acting in accordance with currently prevailing doctrine by including in its ITL a tax on the revenues obtained by foreign residents from permanent establishments located in Mexico.

The law considers that a "permanent establishment" is any place of business in which entrepreneurial activities are either partially or fully conducted. This is the case of branches, agencies, offices, factories, workshops and similar establishments. As mentioned above, if merchandise sold to a Mexican resident is stored in Mexico in a permanent establishment, this circumstance dictates that the seat of the business has been transferred to Mexico. This will cause the foreign resident who is the owner or holder of this "permanent establishment" to be obligated to pay income tax. The base of the tax is the difference between the revenue obtained from disposition, and the cost of the merchandise. The cost is deemed to be the lesser of the invoice price or the price which served as the basis for the payment of import duties upon introduction of the goods to Mexico (the official price).[11] The prices of goods imported into Mexico by such a permanent establishment should be equivalent or similar to market prices, as in the contrary case the ITL empowers the Ministry of Finance and Public Credit to determine a presumable cost of the goods for purposes of deduction when determining the tax base.[12]

When determining the taxable profit of a permanent establishment, it is also permitted to deduct, as do corporations established in Mexico, all expenses necessary for generation of the revenues being taxed.[13] However, no such establishment is permitted to deduct the expenses prorated to it from a home office located abroad. This preclusion is due to

9. E. CALVO & E. VARGAS, ESTUDIO DE LA LEY DEL IMPUESTO SOBRE LA RENTA (EMPRESAS), 95 (1986).

10. M. TRÓN, *supra* note 2, at 260-262.

11. ITL, *supra* note 4, art. 29.

12. This power is granted by art. 65 of the ITL, *Id.*, and the cost is determined with basis on prices current in the domestic or foreign market and in defect thereof on an appraisal made by or upon order of the tax authorities.

13. *Id.*, art. 23, ¶ 1.

the fact that it would be impossible for the Mexican tax authorities to determine whether or not such a deduction is in order, as it would be made by a subject in which the Mexican tax authorities have no competence whatsoever.

As the tax regime of a permanent establishment is made equivalent to that established for corporations residing in Mexico, the reader is refered to matters dealt with in Part IV, *infra*.

In the cases referred to in this subject, however, VAT is due by the foreign resident who must comply with the same obligations established for all taxpayers in the VATL, including that of transferring the tax to the purchaser of the merchandise. Such transfer implies collection, from the purchaser, of an amount equivalent to that of the VAT due from the foreign resident. The operation of this tax is discussed in Part IV, *infra*.

B. Merchandise Deposited in a Bonded Warehouse

The ITL provides an exception to the concept of permanent establishment discussed above. Article 3, fraction V of the ITL establishes that neither the deposit of goods or merchandise in a bonded warehouse by a foreign resident, nor the delivery of such goods or merchandise for import to Mexico, is deemed a permanent establishment.[14] Manuel Trón opines that "such activities should constitute permanent establishment in Mexico,"[15] and that "this configuration, which is presently widely used and applied, is most beneficial for foreign corporations, which are thereby enabled to keep inventory in Mexican territory without having to pay duty, and to make immediate deliveries to Mexican clients."[16]

Notwithstanding however, that no "permanent establishment" is deemed to exist in the case described above, the source of revenue is deemed located in Mexico, since the goods are transferred to Mexican residents and are located and delivered in Mexico. These circumstances are expressly acknowledged in article 150-A of the ITL. As no "permanent establishment" is deemed to exist, however, income tax is not computed on the profit, but on the greater of the amount of the official price having served as basis for payment of duty, or the price shown on the documents issued by the foreign resident by virtue of the sale to the Mexican resident. The tax is assessed at the rate of three percent on the value having served as the basis, with no deduction, and is to be paid jointly with the general import tax, which is due when the goods are withdrawn from the bonded warehouse for their import into Mexico.

14. *Ley Aduanera*, arts. 96-101, D.O. Dec. 30, 1981.
15. M. TRÓN, *supra* note 2, at 179.
16. *Id.*, at 180.

For purposes of the VAT, the disposition is deemed made in Mexico, as the goods are delivered in Mexico,[17] therefore the foreign resident is obligated to transfer the VAT to the purchaser of the assets in Mexico.[18]

C. *Aliens With Representation in Mexico*

A "permanent establishment" is presumed to exist, notwithstanding that a foreign resident does not have a place of business in Mexico, when any of the following conditions occur:

(1) a foreign resident acts in Mexico;
(2) the act is committed through another person who possesses and exercises powers to contract in the name and on the behalf of the foreign resident; or
(3) the execution of the contract by the representative is for performance of an entrepreneurial activity in Mexico by the foreign resident.[19]

In the cases described above, the foreign resident is considered obligated to pay tax in Mexico, regardless of his not having a location in Mexico from which he conducts entrepreneurial activities. This is so because he is conducting such activities through his representative located in Mexico. This means that, according to the theory of representation, the foreign resident is considered to be the person who is executing juridical acts in Mexico. Consequently, the governing criterion, even though no goods or property of the foreign resident are stored in Mexico, is that of the "seat of the business," which was referred to in Part III, subpart A, *supra*. This is so because Mexico is the place where the contract is executed, and thus in the final analysis the mutual assent to the contract and therefore the perfection of the contract takes place in Mexican territory. In the cases dealt with in this section, the tax due is described in Part III, subpart A, *supra*.

D. *Delivery of Merchandise in Mexico*

The ITL grants a second exception from the general assumption

17. VATL, *supra* note 6, art. 10.

18. The final paragraph of fraction III of art. 32 of the VATL, *Id.*, provides that the tax is only to be transferred upon request of the acquirer. However, I have mentioned it as an obligation because, for the acquirer to be entitled to apply it to offset VAT due him (with which situation I deal in Part IV, subpart D hereof), it must have been transferred expressly, and separately from the price, in the corresponding document. This latter requisite is established in fraction II of art. 4 of the VATL, *Id.*

19. ITL, *supra* note 4, art. 2, ¶ 2.

that "permanent establishment" implies a place of business.[20] This exception occurs when a foreign resident has a stock of goods and merchandise in Mexico from which he makes deliveries for his own account. This exception is established on the presumption that the source of revenue is located in Mexico. The merchandise, stored in Mexico, constitutes the basis of the obligation to deliver. The foreign supplier contracts this obligation by disposing of merchandise to a third party.

It will be observed that this contingency is practically identical to that discussed in Part III, subpart B, *supra*, in relation to merchandise deposited in a bonded warehouse. The only difference is that in the former circumstance it is requisite that the deposit be in the bonded warehouse, whereas in the latter, the merchandise may be stored anywhere except in a bonded warehouse.

Under these particular circumstances, the tax that is due is the same as that described in Part III, subpart A, *supra*.

IV. INVESTMENT IN A MEXICAN COMPANY

Investment in a Mexican company is the most common form of investment in Mexico by foreign residents. The obvious purpose for this type of investment is to obtain profits. The principal taxes levied in Mexico upon corporations are income tax and value added tax. Additionally, as of 1989, a new tax, called the "Tax on Assets" (the "TOA") was imposed.

A. Tax on Assets

The TOA was established due to the fact that a great number of companies registered in Mexico were filing income tax returns showing losses or absence of revenues. This led the tax authorities to believe that in many cases, income tax was being evaded. The authorities based their belief on the reasonable presumption that it is illogical for a corporation that has been operating at a loss for a number of years to continue operating without being liquidated by its shareholders. One could argue, however, the fact that many corporations have filed returns showing losses is due to the treatment given to purchases of merchandise and raw materials under the ITL, which will be analyzed in Part IV, subpart C(2), *infra*. The authorities consequently created a minimum tax that is based on the assets of corporations,[21] but not on their net assets. This is

20. *Id.*

21. *Exposición de Motivos de la Ley del Impuesto al Activo de Las Empresas, Que Entró en Vigor el 1 de Enero de 1989* [hereinafter Exposición]

so because corporations are only permitted to deduct the debts contracted in Mexico with certain subjects of this new tax among which financial institutions (which are exempt from this tax) are not included and neither, obviously, are foreign residents. It is called a "minimum tax" because it is not due if the amount of income tax payable exceeds that of the TOA.[22] This means that this new tax does not affect companies whose productivity is superior to that presumed by the new tax. Productivity, however, is measured over three year intervals, at the end of which the tax paid in the first year only becomes a firm payment if the amount of income tax due over the lapse of the three years has not exceeded that of the TOA.

This tax is due at the rate of two percent on the tax base, which consists of the sum of (1) financial assets, (including investments in negotiable instruments but not including shares, and accounts and bills receivable); (2) inventories; (3) fixed assets; and (4) deferred expenses and charges, less the aggregated amount of the taxpayer's debts to other payers of this tax.

During the debates held on this tax by the Chamber of Deputies in the course of its proceedings for approval of this law, it was mentioned that statistical studies revealed that the reasonable yield, which entrepreneurs will expect from an investment, is six percent of the assets. It was also stated that if the income tax for corporations, which will be thirty-five percent as of 1991, is applied to this minimum reasonable yield, the result will be 2.1 percent of the value of the assets; with the percentage rounded to two percent.[23] This leads to the conclusion that in the final analysis the TOA will not have to be paid if the benefits obtained by a company exceed six percent of the assets comprising the base of the TOA.

B. Credit for Taxes Paid Abroad

In 1989, the year this new law went into effect, the following was established as the joint operating mechanism of the TOA and the income tax:

(1) the TOA was paid first;

22. *Id.* The Exposición states that, through the mechanisms for accreditation of both taxes, ". . .it is attained that subjects of income tax having paid or paying an amount at least equal to that of the new tax due by them shall suffer no increase of the tax burden borne by them."

23. This rationale is expressed in pp. 143-155 of the *Diario de los Debates de la Cámara de Diputados,* Número 37, Año *I*, corresponding to 22 Dec. 1988, which pages contain the discussions taken place in the Plenum of the Chamber of Deputies on the report of the latter's Commission of Finance and Public Credit on the initiative of law submitted by the President to the consideration of the Chamber.

(2) income tax was then determined;

(3) the TOA paid was credited to the income tax as determined above; and

(4) if the income tax exceeded the TOA only the balance was paid.[24]

This mechanism gave rise to income tax becoming a tax complementary to the TOA, and this, in turn, caused certain foreign tax authorities, principally those of the United States, to take the position that only income tax paid in Mexico (i.e., what had actually been paid to the Mexican Treasury under the specific denomination of income tax) would be accepted by them as a credit applicable to United States income taxes. Yet, although it was evident, as mentioned previously, that the real intention of the Mexican Government was for the TOA to be complementary to income tax, this purpose was not attained by TOA as worded in 1989.

This situation constituted a substantial obstacle for one of Mexico's primary objectives—attracting foreign investment. More specifically, the impossibility of offsetting Mexican income tax by crediting it to the tax due in the foreign investor's resident country, was a cost which decreased the yield of the investments of foreign residents. This cost precipitated an amendment in 1990, from which year the following procedure will apply:

(1) income tax is determined first and is paid to the authorities;

(2) the amount of the TOA is determined;

(3) the amount of the income tax paid is credited to the TOA; and

(4) if the amount of income tax exceeds that of the TOA, no amount whatsoever is paid for the latter.[25]

This new procedure will permit foreign investors to credit to the income tax payable by them in their own country the income tax paid in Mexico.

C. *Income Tax*

This tax is due on a profit which generally does not coincide with the book profit determined pursuant to generally accepted accounting principles in Mexico.[26] This failure to coincide is principally due to the

24. *Ley del Impuesto al Activo de las Empresas,* art. 9.

25. *Id.*

26. Instituto Mexicano de Contadores Públicos, A.C. PRINCIPIOS DE CONTABILIDAD GENERALMENTE ACEPTADOS (1989). Generally accepted accounting principles in Mexico are issued by a national association called "Instituto Mexicano de Contadores Públicos" ("Mexican Institute of Certified Public Accountants"). The period of high inflation undergone by Mexico over the past four years caused issuance of a Bulletin of Accounting Principles,

fact that certain effects of inflation are incorporated for the determination of book profits, and because certain expenses are not allowed as deductible items in determining taxable profits.[27]

1. Incorporation of the Effects of Inflation

When determining taxable profits, all interest paid by the taxpayer is not deducted, nor is all interest obtained by him counted. This occurs because, for tax purposes, no effect is given to the "nominal interest" generated by credits; the only amount deducted or accrued, as the case may be, is that of "real interest", the difference between the nominal interest and the rate of inflation in the period. If the rate of inflation during the period is greater than the nominal interest rate, then there will be a loss due to inflation, when examined from the point of view of credits, or a gain due to inflation will have been obtained, if the effect is examined from the point of view of debts.[28] The effect of the fiscal provisions governing such matters is shown objectively in the following example. In this example, reference is first made to a taxpayer who receives interest and therefore has credits outstanding in his favor:

	Period 1	Period 2
Interest obtained in the period	$1,000	$1,000
Less: loss of purchasing power of the credit, due to inflation in the period	(800)	(1,300)
Taxable interest, which actually represents the increase of patrimony, in economic terms	$200	
Deductible loss due to inflation, which represents the decrease of patrimony, in economic terms		($ 300)

Now let us examine what occurs to a taxpayer who pays interest because he has debts outstanding:

Number B-10, the purpose of which is to govern the manner in which the effects of inflation are to be reflected in financial statements.

27. The non-deductibility of certain items may be due to either of two reasons: first, that they do not satisfy the requisites for deduction established in the ITL, *supra* note 4, art. 24, or second, because, although they may in fact be disbursements actually made by the taxpayer, they may be included among those not considered by the Law as strictly indispensable for generation of taxable revenue.

28. *Id.*, art. 7-B. This article establishes the procedures for determination of deductible interest, accruable interest, gain due to inflation and loss due to inflation.

	Period 1	Period 2
Interest accrued in the period	($1,000)	($1,000)
Less: assumed gain of the debtor in correlation with the loss of purchasing power suffered by his creditor due to inflation in the period	800	1,300
Deductible interest, i.e., that considered to have actually decreased the patrimony of the debtor	($ 200)	
Taxable gain due to inflation, deemed to have increased the patrimony of the debtor.		$ 300

Inflation in the period is determined by reference to the consumer price index determined by the Banco de Mexico.[29] In the case of non-bearing interest debts, the rate of inflation applied to the outstanding debt will represent taxable gain due to inflation. On the same token, on non-interest bearing credits the rate of inflation applied to the outstanding credit will represent deductible loss due to inflation.

Another effect of inflation that is included in the determination of taxable profit bears relation to the depreciation of fixed assets and consists of the following: depreciation, computed on the historical cost of fixed assets, is increased by the inflation from the month of acquisition of the fixed asset through the last month of the first half of the period in which the asset has been used in the fiscal year in which the deduction for depreciation is made.[30]

2. Acquisition of Merchandise and Raw Materials

In Mexico there is a singular regime, quite divergent from other countries, for deducting the cost of products sold in a fiscal year. It consists of deducting the cost of the merchandise or raw materials acquired, in the fiscal year of acquisition, regardless of the date of sale. This is equivalent to deducting the final inventory in the fiscal year, and it is precisely this procedure, which has given rise to so many companies operating with tax losses. To eliminate or at least mitigate the income tax those companies would have to pay for the year, those companies advance the dates of purchase of their needs to the forthcoming year. That is why I disagree with the tax authorities' opinion (see Part IV, subpart

29. *Codigo Fiscal de la Federación*, D.O., Dec. 31, 1981 [hereinafter C.F.F.]. Banco de México is the Central Bank of the Mexican Government. Its monthly determinations of the national Consumer Price Index are to be in compliance of article 20-B of the C.F.F.

30. ITL, *supra* note 4, art. 41. ¶ 7.

A, *supra*) that the constant filing of tax returns showing losses is due to evasive procedures on the part of companies.

To avoid the damage done to tax collection by taxpayers' advancement of their purchases, the *Código Fiscal de la Federación* was amended in 1990 to provide that thereafter every corporate fiscal year would end on December 31. This attempted solution will give rise to further problems for companies.[31]

The sole exception from the procedure of deducting purchases in the year of their making is related to merchandise purchased abroad, which is not to be deducted until the fiscal year of its sale or until it is imported into Mexico and duty has been paid on it.[32]

3. Deductions

In general terms, all expenses incurred by a taxpayer which are necessary for generation of taxable profits are deductible. Deductibility is subject only to compliance with certain formal requisites such as, possession of evidentiary documents on which the number of the respective issuers in the Federal Registry of Taxpayers is shown, or that the tax on payments to third parties has been withheld and paid over when due.[33] Certain other expenses were expressly established by law as nondeductible because the legislature considered them unnecessary for the generation of taxable revenue. These latter include income tax absorbed by a taxpayer despite its being an actual charge on a third party. This occurred, for example, with loans made by foreign banks to Mexican borrowers, in which it became usual practice to establish that all taxes levied by Mexico upon the foreign creditor would be absorbed by its debtor. Appropriations of assets or reserves for liabilities (such as, reserves for

31. E. CALVO & E. VARGAS, IMPUESTO SOBRE LA RENTA CORRELACIONADO, chapter III, subject 1.2 (1990). We state therein that

> "...this amendment will cause grave problems for companies the operating or financial cycle of which does not coincide with the calendar year; companies with seasonal sales such as, for example, toy manufacturers, are in this case. It may also cause the profit as determined for Income Tax purposes to fail to coincide with that generated in the operating cycle. It will surely also create problems for those subsidiaries of foreign corporations that are obliged by the laws of their country to consolidate their results with those of their parent, when the fiscal year of the parent does not coincide with the calendar year. In such a case a Mexican subsidiary will in practice have two fiscal years: one coinciding with the calendar year as provided by Mexican law, and another, extralegal fiscal year, that coincides with that of its parent. This in its turn will almost inevitably imply a doubling of expenses in audit of financial statements: one for the lawful fiscal year in Mexico, and another for the statements used to consolidate abroad. It will also be one more obstacle to add to those already existing for the attraction of investment to our country."

32. ITL, *supra* note 4, art. 24, fraction XVI.

33. The formal requisites for deduction of expenses are established in art. 24 of the ITL, *Id.*, while those for deduction of depreciation of fixed assets and of amortization of expenses and deferred charges are established in art. 46 thereof.

bad debts or for indemnities to employees) may not be deducted until the contingencies for which they are made have arisen and they are canceled as charges to them. Profit sharing to employees (PSE), granted by constitutional provision (which is equivalent to ten percent of the base of income tax, but excluding the effects of inflation which was referred to in Part IV, subpart C(1), *supra*), is also nondeductible; and the effect of the nondeductibility of this payment to employees is equivalent to an increase in the effective rate of income tax.[34]

4. The Tax Rate

The rate of income tax has been decreased gradually in recent years. It was forty-two percent in 1988, was decreased to thirty-seven percent in 1989, to thirty-six percent in 1990, and will decrease to thirty-five percent as of 1991. The nondeductibility of PSE, however, causes the effective rate of tax to increase as shown by the following example:

Profit before corporate income tax (but after deducting PSE)	$1,000
PLUS - PSE (for example)	80
Taxable profit	$1,080
Income tax rate for 1990: 36%	$ 389
Effective tax rate on profit (after deducting PSE)	38.9%

D. Value Added Tax

The VAT, which was initially addressed in Part II, *supra*, requires an in-depth analysis in order to understand its operation. One of its characteristics is that although it is levied upon a company that makes a disposition, the patrimony of the company does not suffer the incidence of this tax. In fact, the company transfers the tax to the purchasers of its goods or services while at the same time the company itself suffers from the transfer of VAT from the suppliers of the goods and services that it acquires. As this tax, transferred to a company by its suppliers, is credited by it to the VAT due by it, it only pays the balance to the authorities. The end result is that the company suffers no part of the economic incidence of the VAT, as illustrated by the following example:

Cash received by the taxpayer from its clients to which it transfers VAT on the sale of goods and services in the month	$15

34. *Id.*, art. 25.

Less: Cash outflow from the taxpayer to suppliers for VAT transferred on purchases in the month which is recovered from the cash received	(8)
Net cash payable by the taxpayer to the authorities for VAT levied on sales of goods and services	$ 7

The above effect, however, is not produced for a taxpayer exempt from VAT, as it will have no amount with which to offset the VAT transferred to it by its suppliers. These taxpayers are obliged to absorb this VAT as an expense that affects their patrimony.[35] The only case in which a taxpayer may credit the VAT transferred by its suppliers, notwithstanding that it does not pay VAT on its own dispositions, arises when it is subject to the so-called "zero tax rate." This means that it is not exempt; in fact, it is a subject of VAT at a zero percent rate, thus it transfers the amount of zero dollars to its clients. This regime of zero rate of VAT is applicable principally to the sale of foods and the export of goods.[36]

It will be seen from the above that although the sole purpose of VAT is to obtain revenue from final consumers of goods and services, certain companies are treated as consumers because they are exempt from payment of VAT.

V. Dividend Revenue

Mexican income tax is payable by foreign residents who obtain dividends from Mexican enterprises, as the source of revenue is considered to be from Mexico because the corporation distributing the dividend is a Mexican resident.[37] The tax is withheld by the company that pays the dividend, and as the latter pays it over to the authorities, the foreign resident is released from the obligation to file a tax return.

The tax on dividends is levied at the rate of thirty-six percent (thirty-five percent as of 1991) but is not levied on dividends paid from a "Net Taxable Profit Account" ("NTPA").[38] Establishment of the NTPA has two purposes: first, to avoid taxing shareholders on dividends from profits that were taxed when generated by the company, and second, to foster reinvestment of profits, by permitting shareholders who leave their profits invested in the company whose shares they hold will conserve the value, in real terms, of the profits on the distribution of

35. VATL, *supra* note 6, arts. 9, 15, 20, and 25.
36. *Id.*, art. 2-A.
37. ITL, *supra* note 4, art. 151, ¶ 1.
38. *Id.*, art. 124.

which no tax is due. This purpose is attained by making annual adjustments to profits so as to allow for inflation in the period. The form of adjustment to compensate for inflation is shown in the following table:

Year	1990	1991	1992
Profit at the end of the year	$100	$200	$300
Rate of inflation		28%	20%
Adjusted profit for 1990 ($100×1.28×1.20)			$154
Adjusted profit for 1991 ($200×1.20)			240
Adjusted profit for 1992			300
Balance of NTPA at the end of 1992			$694

The effect of the adjustment for inflation is that the profits for the three years, which were nominally 600 dollars, became 694 dollars. The balance of the NTPA increases with this adjustment, but subsequently decreases as dividends are paid. Upon such payment a new adjustment is made for the inflation taking place from the date the dividend is paid to the end of the fiscal year; but before any dividend is paid, the balance of the NTPA is adjusted for inflation from the date of the next preceding adjustment to that in which the dividend is paid. Dividends are not subject to VAT since they are not included as taxable revenue in the law.[39]

However, the book profit is not adjusted to determine the balance of the NTPA. Pursuant to the following formula, an attempt is made to approximate the book profit using the basis on the taxable profit, as that is the amount on which tax must be paid:

Taxable profit for the fiscal year	$160
Less:	
Profit sharing to employees	(8)
Corporate tax for the fiscal year	(57)
Non-deductible items	(12)
	83
Plus: Dividends obtained by the Mexican corporation from investment in shares of other Mexican corporations	7
Net taxable profit (NTPA)	$90

39. The activities that are subject to VAT are listed in Article 1 of the VATL, *supra* note 6, and consist exclusively of disposition of assets, rendering of independent services, grant of temporary use or advantage of assets, and import of goods or services.

Pursuant to this formula, the dividends obtained by the company are added because for tax purposes they are not included as profits when they derive from the NTPA of Mexican companies or when they are taxed at thirty-six percent (thirty-five percent as of 1991) if they do not. They are not included because tax has already been levied once on them, and since they are included in book profits, they are added to taxable profits in an attempt to assure that these are as equal as possible to book profits.

VI. SALE OF SHARES

Mexican income tax is also due on dispositions of shares by foreign residents when the issuer corporation resides in Mexico.[40] The location of the source of the shares in Mexico justifies the payment of tax in Mexico. A share is a negotiable instrument whose value increases (this increase is what causes tax to be due) due to the efforts of its issuer company. The company is domiciled in Mexico and thus has the advantage of Mexico's infrastructure, and produces in Mexico the profits which cause the value of the shares representing its capital stock to increase.

The general regime on these operations is that income tax at a rate of twenty percent on the total amount of the transaction, with no deduction,[41] is payable by the vendor of the shares. There are two exceptions to this general rule: (1) in some cases and subject to some limitations, the tax is levied on the profit, but at a rate of thirty percent; and (2) some operations are exempt from this tax. These exceptions are discussed in Part VI, subparts A and B, *infra.*

When the acquirer of the shares from the foreign resident is a Mexican resident, or resides abroad but possesses a permanent establishment in Mexico, he is obliged to withhold the tax due by the foreign resident and pay it over to the authorities, thereby releasing the latter from the obligation to file a tax return. However, there are also cases in which the acquirer is a foreign resident. In these cases, the principle of territoriality of laws would relieve the foreign resident of the obligation to withhold Mexican income tax, since he would be outside the scope of application of Mexican legislation. It is therefore provided for such cases that the acquirer is to pay over the tax by means of a return filed at an authorized office within the fifteen days following obtainment of the revenue.[42] No VAT is levied upon the disposition of shares; these operations are

40. ITL, *supra* note 4, art. 151, ¶ 1.
41. *Id.*, art. 151, ¶ 2.
42. *Id.*, art. 151, ¶ 3.

exempt.[43]

A. *Tax on Profits*

An exception to the general rule that tax is due on the total amount of the disposition, with no deductions, occurs when the person disposing

(1) has a representative who resides in Mexico,[44] and
(2) resides in a country where dispositions of shares are subject to a corporate tax rate of thirty percent or greater.

1. Representative in Mexico

A foreign resident who has a representative in Mexico is permitted to pay income tax on the profit obtained from his disposition of shares, and not on the total amount obtained therefrom, because in such cases it is possible for the Mexican authorities to determine whether or not the stated tax base is correct. This possibility exists because the representative is obligated to keep, for a term of five years, all evidentiary documents relative to his payment of income tax for the account of his principal.[45]

The representative of a foreign resident is jointly liable with his principal for any amount of the tax on the sale of shares remaining unpaid. However, there are two cases in which the representative is released from joint liability. The first occurs when the acquirer of the shares assumes express joint liability with the vendor for payment of the tax. In such cases, the ITL does not establish that the acquirer must be a Mexican resident. This omission is an inadequacy, because if the acquirer resides in a foreign country, the Mexican tax authorities will only be able to determine whether or not the tax has been paid correctly if the country is included among those which have executed Information Exchange Agreements with Mexico.[46]

The second of these cases occurs when a certified public accountant (CPA) duly registered by the tax authorities issues an opinion setting forth that the tax on the operation was determined with strict observance

43. VATL, *supra* note 6, art. 8, fraction VII.

44. Article 9 of the C.F.F., *supra* note 29, deems all individuals who have established their dwelling in Mexico (unless they have remained in another country for more than 183 calendar days, consecutive or not, and have acquired residence for fiscal purposes in another country) as residents of Mexico. Entities having established in Mexico the principal administration of their business are also deemed Mexican residents. The presumption that, barring evidence to the contrary, all individuals and entities of Mexican nationality are Mexican residents is also established in art. 9.

45. ITL, *supra* note 4, art. 160, ¶ 1.

46. D.O., Jan. 23, 1990, Mexico executed a Tax Information Exchange Agreement with the U.S.A. on Nov. 9, 1989.

of all fiscal provisions.[47] This alternative does not imply that the CPA issuing the opinion will acquire joint liability. If his opinion was not issued in accordance with the tax provisions, the sanctions established in the *Codigo Fiscal de la Federación,* which vary in accordance with the gravity of the offense committed by the professional, will be imposed on him. The opinion of a CPA is the alternative most frequently resorted to, even when the foreign resident has a representative in Mexico, because the computation of the "cost for tax purposes" of shares is so complex that the intervention of an accountant will almost inevitably be required. This situation is referred to in Part VI, subpart A(3), *infra.*

2. Country of Residence of the Vendor

The second prerequisite for the tax on the sale of shares to be paid on the profit obtained therefrom and not on the total amount of the transaction is that the vendor reside in a country that levies corporate income tax on the sale of the shares at a rate of thirty percent or more. The countries that meet this prerequisite are: Federal Republic of Germany, Austria, Canada, Denmark, Spain, the United States, Finland, France, Greece, the Netherlands, the United Kingdom, Italy, Japan, New Zealand, the Irish Republic, and Switzerland.[48]

Although the intention of this provision has never been published, it is intended to preclude investors in Mexican shares from resorting to "tax havens" as places of residence in order to obtain benefits that usually imply a decrease in tax collection both for the true countries of residence of the investors and for that of the location of the source of revenue. Despite this, one must ask whether the sole circumstance of the country of residence of a vendor levying tax on these operations at a rate lower than thirty percent justifies the authorities' disregard of the capability of the vendor to pay tax. The corporate income tax rate in Mexico is thirty-six percent and will be thirty-five percent in 1991. In view of this fact, levying tax at a rate of twenty percent on aggregate revenue from a sale of shares is equivalent to presuming that the profit obtained therefrom has amounted to fifty-five percent of said aggregate revenue less its presumed cost of 44.5 percent, and admitting no evidence to the contrary, paying a thirty-six percent tax rate on the presumed profit.

47. I agree with the opinion stated by M. TRÓN *supra* note 2, at 256, in the sense that, for joint liability to cease, it is necessary that a notice stating that the opinion of a public accountant shall be delivered, be given to the tax authorities, and that said opinion be delivered in the term established in the Regulations of the ITL.

48. M. TRÓN *supra* note 2, at 191. Absence of the name of a country from this listing does not imply that its residents cannot elect this alternative; it is merely a matter of proving that the condition required does in fact occur in the pertinent country.

3. Determination of the Amount of Profit

The revenue obtained from the sale of shares is compared with their cost for tax purposes, with deduction of commissions paid by the vendor when transferring the shares. One of the characteristics of this "cost for tax purposes" is that adjustments for inflation are made, not only to the face value of the shares sold by the foreign resident, but also to the surplus of the issuer company. The purpose of these adjustments is to eliminate from the taxable revenue that part of the price due merely to the effects of inflation.[49] In other words, if the adjustment for inflation were not permitted, the profit of the vendor would not be taxed in economic terms, but in purely nominal terms; and this would imply an excessive tax burden, because in times of inflation the nominal prices of goods become mere points of reference totally lacking in economic content.

The surplus of the issuer corporation is also adjusted for inflation when determining the cost of the shares for tax purposes, because shares are negotiable instruments that convey title, not only to the capital stock of the issuer company, but also to a proportional part of its surplus. The acquirer of a share obtains title to a proportional part both of the stock and of the surplus. Obtaining title justifies the making of an adjustment to the surplus of the issuer as from the date of acquisition of the shares by their then-vendor to that of his sale. In practice, this determination of the cost of shares for tax purposes presents fairly complex problems which justify intervention by public accountants, as mentioned in Part VI, subpart A(1), *supra*.[50]

B. Dispositions that Are Tax Exempt

The applicable laws have established, for more than thirty years, a tax exemption for individuals residing in Mexico who obtain profits from dispositions of shares quoted in the stock market and destined for circulation among the investing public in accordance with rules established by the Ministry of Finance and Public Credit. All shares presently quoted in the Mexican stock market (170 issuers, according to the *Registro Nacional de Valores e Intermediarios*) comply with these requisites.

The purpose of this exemption, which has been extended to cover

49. ITL, *supra* note 4, art. 19-19A.

50. M. TRÓN *supra* note 2, at 204, summarizes the way to determine the cost of shares for tax purposes as follows:

> The average cost per share is the result obtained from averaging among all shares of the issuer and property of the alienator, the result of updating the face value of said shares, adding thereto profits per share generated and subtracting therefrom losses per share suffered by said issuer, and also subtracting the aggregate amount of all dividends per share obtained by the alienator; all the foregoing, as adjusted for the effects of inflation.

foreign residents, is to foster investment of risk capital and thereby promote the growth of Mexican corporations.

VII. INTEREST REVENUE

Under this heading, discussion will focus on the tax regime applied to the interest obtained by a shareholder residing in a foreign country, from loans made to a Mexican subsidiary in which the shareholder has invested, and to the interest paid by a subsidiary to banks domiciled abroad. These are the most frequent forms in which Mexican subsidiaries of foreign corporations are financed.

In both of these cases, the source of revenue is deemed located in Mexico if the capital is invested in Mexico. This is presumed to be the case if the payer of the interest is a Mexican resident or a foreign resident that has a permanent establishment in Mexico.[51]

The tax rate on interest obtained by foreign parent companies from loans made to their Mexican subsidiaries is thirty-six percent (and will be thirty-five percent as of 1991) on the total amount of the revenue, with no deduction, and is due when the interest becomes payable.

When the creditor of a Mexican subsidiary is a foreign bank registered with the Ministry of Finance and Public Credit, the tax rate decreases to fifteen percent, which is also applied to the total amount of interest, and is similarly due when the interest becomes payable.

In both of the cases mentioned, the debtor is under an obligation to withhold the tax from the foreign creditor and is jointly responsible for its payment. Compliance with this requisite is in turn a requisite for deductibility of the interest so paid. Therefore, any failure to comply with this obligation to withhold the tax and pay it over to the authorities will not only imply enforcement of the joint liability, with potential additional complications in the form of surcharges and sanctions, but also forfeiture of deductibility of the interest for income tax purposes.

A. Value Added Tax

Under the VATL, interest on credits is deemed equivalent to the rendering of a service.[52] The tax, which is levied at the rate of fifteen percent, is absorbed and paid by the debtor, who is considered to have imported the service. Interest paid to foreign banks registered at the Ministry of Finance and Public Credit is exempt from VAT,[53] but this tax is payable on interest paid to a creditor residing abroad which is not

51. ITL, *supra* note 4, art. 154, ¶ 1.
52. VATL, *supra* note 6, art. 18.
53. *Id.*, art. 15, fraction X.

such a bank, as would be the case of the home office of a Mexican subsidiary.

B. Cases in Which Interest Is Deemed Dividend

The ITL contains a provision that empowers the Ministry of Finance and Public Credit to consider that payments made abroad as interest are actually dividends when certain conditions are met.[54] The Ministry's consideration that such interest actually constitutes a dividend will give rise to application of the tax regime described in Part V, *supra,* instead of that described in this Part (which application may in certain cases even benefit the debtor). A forfeiture of deductibility of the amount alleged to have constituted interest will also result, because upon its becoming a dividend, the reason for its deductibility will have ceased to exist.

In order to presume that interest is actually a dividend, one of the following four contingencies must occur:

> (1) The debtor has made in writing an unconditional promise to pay a part or the whole of the credit obtained, on a date determinable at any time by the creditor;
>
> (2) The credit is convertible into shares of or corporate participations in the debtor;
>
> (3) In the event of default by the debtor, the creditor is entitled to intervene in the administration or direction of the debtor; or
>
> (4) The interest payable by the debtor is conditioned on the obtainment of profits, or its amount is based on profits.

VIII. Revenue from Royalties

This concept includes the compensation received by a foreign resident, whether for the rendering of technical assistance, the transfer of technology, or the licensing of a patent, brand, or trademark.[55] The law considers that the source of revenue is located in Mexico when advantage of the goods or other assets for which royalty is paid is taken in Mexico. This advantage is deemed to have been taken when royalties are paid by a Mexican resident or by a foreign resident possessing a permanent establishment in Mexico.[56]

The tax rates on revenue from royalties are fifteen percent or thirty-six percent (thirty-five percent as of 1991), according to the nature of the

54. ITL, *supra* note 4, art. 66.

55. The other items that are taxed as royalties are listed in fractions I and II of article 156 of the ITL, *Id.*

56. *Id.*, art. 156, ¶ 1.

goods or services which give rise to their payment. Royalties paid for temporary use and advantage of drawings, models, plans, formulas, and/or procedures, for information relative to industrial, commercial, or scientific expertise, or, in general terms, for any technical assistance or transfer of technology, are taxed at the rate of fifteen percent. Payments by Mexican residents for professional or technical services related to any of the above items are deemed equivalent to royalties.[57]

Grants of temporary use and advantage of patents, certificates of invention or of improvement, trademarks, or brands are taxed at the rate of thirty-six percent. However, there is a contingency that will permit the rate of thirty-six percent to decrease to fifteen percent. This contingency will occur when a contract executed by a Mexican resident with a foreign resident involves a concept included among those taxed at the fifteen percent rate, in addition to a patent or a certificate of invention or of improvement. For example, if the compensation for technical assistance paid by a Mexican resident to a foreign resident is in relation to a patent or certificate of invention property of the latter, then both the royalty for the technical assistance and the royalty for use of the patent or certificate are taxed at the rate of fifteen percent.

The compensation obtained by a foreign resident from disposition of drawings, models, plans, formulae, or procedures to a Mexican resident is deemed a royalty.[58] In every such case the tax on the foreign resident is to be withheld and paid over by the Mexican resident who makes the payment, and it becomes due when the royalty is payable. This form of payment releases the foreign resident from the obligation to file a return with the Mexican tax authorities.

A. Value Added Tax

The Mexican resident who pays for the royalties is deemed to have imported a service[59] and is obliged therefore to pay VAT at the rate of fifteen percent on all payments made.

B. Requisites for Deductibility

The requisites for deductibility of the payments discussed above are the same as those described for interest payments discussed in Part VII, *supra,* with the identical requirements of withholding and paying over, and identical consequences for those who default on these requirements.

57. *Id.*, art. 156, ¶ 4.

58. *Id.*, art. 156, ¶ 5. The obvious purpose is to preclude evasion of the tax through disposition of the assets instead of a grant of temporary use or advantage thereof.

59. VATL, *supra* note 6, art. 24, fraction III.

However, additional requirements are also established in order to preclude foreign residents from obtaining payments of what are alleged to be royalties but actually constitute profits disguised as such for remittance abroad under the more beneficial tax treatment. This beneficial tax treatment consists of the payment of only fifteen percent tax instead of the thirty-six percent (thirty-five percent as of 1991) that would be payable by the Mexican subsidiary if it reported as profits the amounts it attempted to pay under the guise of technical assistance.[60]

The Mexican resident must be in a position to prove to the Ministry of Finance and Public Credit that the foreign resident furnishing know-how to it possesses technical resources appropriate for transfer in exchange for compensation. It is also required (1) that the service be rendered directly by the person receiving the revenue, not through a third party (for example, no deduction would be permitted if the payment were made to a strawman); (2) that the payment be made for services actually rendered (i.e., that there has taken place a real, actual transfer of know-how justifying the payment of a compensation), not for the mere possibility of their rendering; and finally (3) that if the contract giving rise to the payments is of a type requiring registration at the National Registry of Transfers of Technology, it has been so registered.

IX. GROSS-UP OF THE TAX DUE IN MEXICO.

It is a common occurrence in international transactions that the foreign resident establish that all taxes due in a country foreign to it (in this case, in Mexico) on its compensations be absorbed by the payer so that the payments received by the former will be in full, net of any and all deduction. This practice was discussed in Part IV, subpart C(3), *supra*, in the context of loans made to Mexican residents by foreign banks.

The ITL includes a provision (which is so obvious as to be unnecessary) to the effect that in cases such as that described in the paragraph above, gross-up or pyramidation of the taxes absorbed by the Mexican debtor shall occur.[61] This obligation is obvious because income tax is due by the foreign resident who receives the payment, and when it is absorbed by a Mexican resident it becomes an additional compensation paid to the foreign resident, and so on and so forth, in theory *ad infinitum*.

60. ITL, *supra* note 4, art. 24, fraction XI.

61. *Id.*, art. 144, ¶ 2. "When a person making any of the payments referred to in this Article pays for the account of the taxpayer the tax due by the latter, the amount thereof is deemed revenue included among those listed in this title." The title to which provision refers is Title V, in which the revenues that, when obtained by a foreign resident, are deemed to proceed from a source located in Mexico, are established.

The way to avoid this infinite recurrence is through the procedure known as gross-up of the tax, which consists of applying the mathematical "rule of three" to the obligation of payment. Taking technical assistance—which is taxed at a rate of fifteen percent—as an example: if a payment of 100 dollars net of taxes represents only eighty-five percent of the compensation, then what amount of payment would represent 100 percent of the compensation? Applying the "rule of three" to this problem, we divide 100 dollars by 0.85 and obtain 117.65 dollars. Application of this formula is shown below:

Total compensation for technical assistance	$117.65
Less: 15% income tax	(17.65)
Net amount delivered to the foreign payee	$100.00

The Mexican resident who pays the royalty will in his turn have to pay VAT (as he will be deemed to have imported services) on the amount determined by grossing-up—in our example, on 117.65 dollars. This is fair because the amount of tax absorbed by a Mexican payer is no more than an additional compensation paid to his payee, on which VAT is due under the law.

X. CONCLUSION

Indeed, there are problems with Mexico's system of taxation. In the six areas of tax treatment discussed in this Article, certain problems stand out. For example, the PSE should be treated as a deductible item in determining taxable income. This treatment avoids increasing the effective corporate tax rate as discussed in Part IV, subpart C(4), *supra.* In fact, an amendment to the ITL is justified since tax authorities receive a double taxation benefit: first, the ITL levies a thirty-six percent tax on the profit companies share with their employees; and second, the ITL levies an additional income tax on employees receiving the shared profit.

Despite its problems, there are certain advantages to the Mexican tax system. For instance, the TOA is not a tax burden on foreign investment in Mexican corporations, so long as taxable profit exceeds six percent of the investment in assets, deducted by debts to other TOA taxpayers. Furthermore, it is convenient for foreigners to invest in corporations registered with the Mexican stock exchange because a sale of shares is exempt from income tax.

From the tax standpoint, Mexico is an attractive country for foreign investment. Its corporate tax rate of thirty-six percent in 1990, which will be reduced to thirty-five percent in 1991, compares favorably to

those established in the developed countries. Thus, the Mexican tax will not represent an additional burden reducing return on investments that foreign investors could expect in their own country.