



# Film Financing and Television Programming

## A Taxation Guide



For more than a decade, the KPMG Film Financing and Television Programming Taxation Guide has been recognized as a valued reference tool for industry professionals, filled with information drawn from the knowledge of the KPMG International global network of member firm media and entertainment Tax professionals. The 2022 edition is a fundamental resource for film and television producers, studio and streaming production executives, tax executives, finance executives, and attorneys involved with the commercial side of production.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in production financing, the Guide includes a robust discussion of relevant tax incentive programs in each country.

Each chapter focuses on a single country and provides a description of commonly used financing structures, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

### *Introduction*

A thumbnail description of the country's industry contacts, regulatory bodies, and financing developments and trends.

### *Key Tax Facts*

At-a-glance tables of corporate, personal, and value-added (VAT) tax rates; normal nontreaty withholding tax rates; and tax year-end information for companies and individuals.

### *Financing Structures*

Descriptions of commonly used financing structures in production and distribution, and the potential commercial tax implications for the parties involved. This section of each chapter covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

### *Tax and Financial Incentives*

Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

## Mexico

### *Corporate Tax*

Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

### *Personal Tax*

Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

### *Streaming Tax Considerations*

Provides a look at the unique tax issues that need to be addressed in this evolving segment of the industry. With considerations such as identifying tax collection and reporting obligations in a variety of jurisdictions, understanding international tax implications is essential for streaming providers.

### *KPMG and Member Firm Contacts*

References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business of identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

We look forward to helping you with your film and television production ambitions.

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The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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# Mexico

## Introduction

Currently, there are no specific tax laws regulating film financing and television programming in Mexico. A tax incentive to promote national film production was introduced in 2005 and modified in 2007 (this tax incentive has not been subject to any material changes to date). This incentive is available to all entities and individuals and consists of a tax credit equivalent to the amount invested in national cinematography projects against the income tax payable in that same year. This credit shall not exceed 10% of the income tax payable in the previous tax year. Starting in 2011, a similar tax credit is also available for investments in national theater projects. It is worth mentioning that if the credit is greater to the income tax of the year, the difference may be used to offset income tax of the 10 following years until depleted.

Someone undertaking cinematography film production and television programming in Mexico is subject to the general Mexican tax laws in force. This chapter looks at these general laws. Mexico's tax legislation comprises several laws containing provisions relating to each type of tax. Taxes are usually levied on income, capital, and certain transactions, as well as on income derived from specific activities.

The fundamental legal structure of the country's taxation system is defined by the Mexican Constitution, which establishes procedures whereby Congress enacts tax laws. In addition to special tax laws, the most important one being the Mexican Income Tax Law, there are some basic laws that relate to the general administration of the system, such as the Federal Revenue Law and the Federal Tax Code. Most of the laws are supplemented by a series of regulations and general rules issued by the tax authorities that provide more information on specific procedures and interpretation.

The Federal Labor Law and its associated regulations govern labor relations. The law provides for minimum working conditions and rights, which must be borne by the employer, regardless of whether the employees are unionized or not. The employees cannot waive such provisions under any circumstance. The law is applicable to all employees in Mexico, regardless of their nationality. It is important to clarify that labor reform was enacted in April 2021, establishing that outsourcing services are forbidden; any specialist service is accepted by registration with Labor Authorities or without any registration under certain characteristics.

Regarding the film and television industries, the Federal Cinematographic Law and its regulations, as well as the Federal Radio and Television Law, apply to regulate the general framework and functioning of these industries in Mexico.

## Key Tax Facts

Corporate income tax rate	30%
Highest individual income tax rate	35%
Value-added Tax (VAT) – general rate	16%
Business Flat Tax (IETU) – rate	Abrogated starting 2014
Social Security Dues	36.15% <sup>1</sup> of salary (up to 25 times minimum salary)

<sup>1</sup> Estimated percentage, it would change depending on the job risk factor

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<i>Some minor State and Municipal taxes:</i>	
Payroll taxes – general rate	Between 2% and 3% <sup>2</sup>
Real estate transfer and ownership	It depends on each state
Vehicles ownership	% depending on the value and year of the vehicle; exception in some states
General nontreaty withholding tax rates: Dividends	10%*
Interest <sup>3</sup>	4.9%, 10%, 15%, 21%, or 35%
Royalties for the temporary use or enjoyment of railroad cars	5%
Royalties <sup>4</sup> for the temporary use or advantage of patents or certificates of invention or improvement, trademarks or trade names, and for advertising (payments of any kind for copyrights on literary, artistic or scientific works, including movies and recordings for radio or television, shall be considered as royalties)	35%
Royalties not included above and those for technical assistance	25%

\* Starting in 2014, a 10% withholding tax applies for dividends paid to foreign residents and individuals. Tax treaties may apply to reduce this rate.

## Film Financing

### National Film Commission – Mexico

The production, and in recent years, the co-production of motion pictures, television series, and international commercials have been important factors in the development of the industry. This has brought about constant expansion and technological evolution in the different service areas.

The filmmakers' demand for specific up-to-date information and support services for the film, television, and video industries led to the creation of the National Film Commission, a nonprofit and specialized organization founded by the Mexican Film Institute and the Churubusco Azteca Film Studios.

With the cooperation of the Federal Government, the States Governments, and both public and private organizations and institutions, the National Film Commission and its network of State Film Commissions head the overall efforts to promote the production of films, TV programs, and commercials in Mexico, giving assistance to all companies and producers interested in developing their projects therein.

Once it has been decided to film in Mexico, the next step is to negotiate with service providers and unions. Personnel hiring and equipment leasing depend on the size of the project and the bargaining skills of the production representatives.

<sup>2</sup> This rate could differ depending on the State

<sup>3</sup> Please note that a 40% withholding tax rate may apply where payment is made to a foreign related party subject to preferred tax treatment when this foreign related party does not reside in a country with which Mexico has in force a comprehensive information exchange agreement.

<sup>4</sup> Idem note 3.

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It is important to count on the assistance of an experienced Mexican producer or a domestic production company when negotiating labor terms with workers, unions, and cooperatives. Personal relationships with workers will lead to a successful project.

Mexican legislation obliges film production companies to hire personnel of unions registered in the Ministry of Labor and Social Security. In the Mexican motion picture industry, there are two production unions: “Sindicato de Trabajadores de la Producción Cinematográfica de la República Mexicana” (STPC) and “Sindicato de Trabajadores de la Industria Cinematográfica, Similares y Conexos de la República Mexicana” (STIC); however, there are four unions that are also part of the cinematographic guild, which are: “Sindicato de Trabajadores Técnicos y Manuales de Estudios y Laboratorios de la Producción Cinematográfica, Similares y Conexos de la República Mexicana,” “Asociación Nacional Cinematográfica de Trabajadores Independientes,” “Sindicato Nacional de Trabajadores de Productoras Cinematográficas, sus Derivados, Similares y Conexos de la República Mexicana,” and “Sindicato Innovativo de Trabajadores de las Industrias Cinematográficas y del Entretenimiento, Similares y Conexos de la República Mexicana.”

Irrespective of the budget, the National Film Commission is able to provide up-to-date information and assistance on the following:

- Film and TV industry infrastructure
- Search for locations in Mexico
- Legal matters, and
- Liaison between the Federal and States government departments and the production companies

The National Film Commission also maintains a permanent dialogue with the Mexican government to formulate fast and easy ways for foreign producers to negotiate their import permits and work visas and also to deal with any other obligation.

It should be noted that foreign productions and co-productions may approach the Commission. The Commission will study each case to see whether they comply with the various requirements stipulated by Mexican laws for the relevant type of film or TV program.

## Federal Cinematography Law

### *Background*

The purpose of this law is to promote film production, distribution, marketing, and presentation, as well as film safeguard and preservation. It seeks to ensure that, at all times, issues relating to the integration, promotion, and development of the national film industry are studied and focused on.

It is the job of the Federal Executive Branch to apply this law and to see that it is enforced through the Internal Affairs Department and the Education Department.

There is freedom under Mexican law to film and produce movies.

Films will be exhibited to the public in their original version and, the case being, subtitled in Spanish. Films classified for children and educational documentaries can be exhibited translated to Spanish.

Producers of films in any form must prove that their productions duly comply with current labor, copyright, and actors' rights legislations. To the contrary, they will be subject to corresponding fines.

In complying with the Federal Cinematography Law and its regulations, producers, distributors, and film exhibiting enterprises must submit the reports required by the Ministry of Internal Affairs.

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A motion picture shall be deemed a co-production when two or more individuals or legal entities participate in its production. The co-production shall be deemed international when it is realized by one or more foreign persons with the intervention of one or several Mexican persons, under the international treaties or conventions subscribed by Mexico. When such international conventions do not exist, the following requirements must be included in the Co-production Agreement:

- The title of the film in co-production
- The name or social denomination and the nationality of the producers, the authors of the film, and the director
- The script of the film
- The clause evidencing and referring to the document that proves the legal acquisition of the copyrights and, the case being, the authorization or license for the corresponding use
- The amounts and characteristic of the contributions made by each party
- The budget of the total production cost of the film
- The clause that establishes the terms and conditions for the distribution of the income generated by the exploitation of the film
- When presenting the co-produced film to the public, it will be expressed at the beginning of the production credits, as well as in the publicity materials for the film, the name of the country of origin of the majority co-producer, without prejudice of the right of the other co-producer(s) that are mentioned as such
- If the co-produced film participates in any of the international film festivals, it will compete showing the nationality of the co-producers or, in their case, in terms established by the regulation of the corresponding festival
- The clause that establishes the guarantees owed by the parties in case it is not possible to complete the film.

No film, whether produced in Mexico or abroad, can be distributed, promoted, or exhibited publicly without the previous authorization and classification of the Internal Affairs Department granted by means of the General Management of Radio, Television, and Film.

### *Incentives*

The Federal Cinematography Law grants incentives to the cinematography industry. These incentives are to be established by the Federal Executive Authority for the following:

- Businesses promoting production, distribution, presentation, and/or marketing for national films or short films accomplished by cinema students, as well as businesses promoting exhibitions in noncommercial establishments of foreign films with educational, artistic, or cultural message or those carrying out the reproduction, subtitles, or translation in Mexico
- Producers participating, themselves or through third parties, in international film festivals and receiving recognition or prizes
- Exhibitors that invest in the construction of new cinemas or that rehabilitate rooms that are no longer in operation, dedicated to national cinema and that help in the diversification of the foreign cinema material offered.

A Cinema Investment and Incentive Fund (FIDECINE) exists to promote financial aid, guarantees, and investments in favor of producers, distributors, promoters, and exhibitors of national films. This fund is administrated by a trust, to which the tax authorities will be the sole trustor and the beneficiaries the producers, distributors, promoters, and exhibitors determined by the Trust's Technical Committee.

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The resources of this fund will be dedicated to granting risk capital, work capital, credits, or economic incentives for achievement, production, distribution, marketing, and presentation activities for national films.

### Cultural Conventions

The following is a list of cultural conventions entered into by Mexico:

Cultural conventions with:	
• Belgium	• Norway
• Canada	• Paraguay
• Korea	• Lebanon Republic
• France	
• Japan	
Cultural and Scientific Convention with:	
• Portugal	
• Senegal	
Convention for Cultural Cooperation with:	
• Germany	• Northern Ireland
• Great Britain	• Paraguay
• Iran	• Hungary
• India	• Democratic Republic of Algeria
• Jamaica	• United States of America
Convention for Cultural Exchange with:	
• Austria	• Italy
• Belize	• Philippines
• China	• Serbia
• Dominican Republic	• Slovakia
• Egypt	• Uruguay
• Finland	• Argentina
• Guatemala	• Bolivia
• Honduras	• Panama

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• Israel	• El Salvador
• Albania	• Nicaragua
• Mongolia	• Ecuador
Convention for Educational and Cultural Exchange with:	
• Colombia	•
• Venezuela	•
• Honduras	•
• United States of America	•
Convention for Cooperation in the Cultural, Educational, and Sport Areas with:	
• Bolivia	• Russia
• Croatia	• Romania
• Guatemala	• Republic of Lithuania
• Estonia	• Grand Duchy of Luxembourg
• Republic of Latvia	
Convention for Educational and Cultural Cooperation with:	
• Argentina	• Spain
• Belize	• Thailand
• Bulgaria	• Slovenia Republic
• Chile	• Poland Republic
• Costa Rica	• Venezuela
• Cuba	• Moldova Republic
• El Salvador	• Panama
• Greece	• Trinidad y Tobago
• Hungary	• Tunisia
• Nicaragua	• Turkey Republic
• Peru	• Nigeria
• Brazil	• Honduras
• Republic of Estonia	• Republic of Indonesia
• Czech Republic	• Republic of Armenia

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<ul style="list-style-type: none"> <li>• Republic of Lebanon</li> <li>• Syrian Arab Republic</li> <li>• Ukraine</li> </ul>	<ul style="list-style-type: none"> <li>• Socialist Republic of Vietnam</li> <li>• Guatemala</li> <li>• Honduras</li> </ul>
<ul style="list-style-type: none"> <li>• Ecuador</li> <li>• Ivory Coast</li> </ul>	<ul style="list-style-type: none"> <li>• North Korea</li> </ul>
<ul style="list-style-type: none"> <li>• Grand Duchy of Luxembourg</li> </ul>	
Treaty for cultural relations with:	
<ul style="list-style-type: none"> <li>• Netherlands</li> </ul>	
Agreement of Cultural, Educational, and Scientific Cooperation with:	
<ul style="list-style-type: none"> <li>• Cyprus Republic</li> </ul>	
Agreement of cultural, scientific, and technique cooperation with:	
<ul style="list-style-type: none"> <li>• Gabon Republic</li> </ul>	

Please note that, in general, these conventions are very basic and only provide for cooperation relating to the cultural and educational areas. One of the more elaborate conventions is the one entered into by and between Mexico and Canada, where specific cinematographic provisions are included.

#### Federal Radio and Television Law

This law provides that the Federal Government holds the rights to radio and television broadcasting in Mexico.

The Communications and Transport Department must give permission and can grant concessions for the commercial exploitation of television and radio. These permissions or concessions can only be granted to Mexican individuals or companies whose partners or shareholders are Mexican residents.

The duration of the concessions cannot exceed 20 years. This concession can be granted again thereafter and with preference over third parties. The process is carried out through public bid.

#### Tax and Financial Incentives

##### *National Film Production*

A tax incentive is available to taxpayers (entities or individuals); this incentive entitles the investors to a credit equivalent to the amount contributed to national cinematography investment projects against the income tax payable for the same year. This credit shall not exceed 10% of the income tax payable corresponding to the prior tax year. If the creditable amount exceeds the income tax payable, the taxpayers may credit the difference against the income tax payable of the following 10 tax years. In addition, the amount of the tax incentive is to be shared amongst all taxpayers in a fiscal year and is limited to MXP 650 million and MXP 20 million per taxpayer and project. Regarding film distribution investments, the amount of the tax incentive per year will be limited to MXP 50 million and MXP 2 million per taxpayer and project.

To apply this tax incentive, the investments must be made in Mexico and must be specifically for the production of a qualifying national cinematographic film.

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For a project to be eligible for the tax incentive, the project must be approved by an interinstitutional committee. The interinstitutional committee must publish, at the latest by the last day of February of each year, a report that contains the amount of the tax incentive awarded during the year, as well as publish the names of the persons benefiting from the tax incentive and their corresponding national cinematographic film projects.

Other Financing Considerations

Foreign Debt Financing Structure

In 2005, Mexico introduced thin capitalization rules limiting the deduction of interest generated from debts derived from capital taken on loan more than a 3:1 debt-to-equity ratio. Over the years, these rules have been subject to amendments, but in general terms, these rules will apply when the debts are contracted with foreign related parties.

In addition, interest payments can be recharacterized as dividend distributions, amongst others, for:

- Back-to-back loans
- Excess of interest charges over arm’s-length charges on intercompany loans
- Demand loans.

Corporate Taxation

The Federal Tax Code provides the basic tax administration procedures applicable to federal tax laws. Generally speaking, it defines taxes, taxpayers, domicile, residence status, and exemptions, as well as rules relating to administrative procedures, litigation before the tax courts, penalties, statutes of limitations, reimbursements, and other matters.

The Annual Revenue Law, which is effective from January 1 of each year, establishes the federal taxes, duties, fees, and all other types of internal revenues that are payable to the federal government during that calendar year. However, the administration of taxes is in accordance with the applicable tax laws for each specific tax.

Overview of the Mexican Tax System

The Mexican Income Tax Law establishes the following:

Persons subject to tax:	Basis:
Residents →	Worldwide income
Permanent establishments (PE) →	Attributable income
Nonresidents without PE →	Mexican-sourced income

Individuals are considered Mexican residents (solely for tax purposes) when they establish their place of abode in the country. If such persons have their place of abode in another country, then they would be considered Mexican tax residents if they have their vital centre of interest in Mexico.

For these purposes, the vital centre of interest is considered in Mexico among others when:

- a) 50% of the revenue is derived from Mexican sources
- b) Main place of activity is situated in Mexico.

Mexican individuals who change their residence to a country considered as a preferential tax regime would still be considered residents in Mexico for four years (year of notice and following three years) from

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the date in which new residence is established, unless that country has entered into a broad information exchange agreement with Mexico.

Legal entities are deemed Mexican residents when the principal business administration or effective control is established in Mexico.

Mexican residents and permanent establishments pay tax on a calendar year basis. Residents abroad without a permanent establishment in Mexico are, in general terms, subject to withholding tax by the payer of the item of income. Each withholding tax remittance is deemed to be a final payment.

Please note that there is no entity classification for income tax purposes. The most usual entities are the limited liability entities known as “sociedad anónima” or “S.A.” and “sociedad de responsabilidad limitada” or “S. de R.L.,” which can both take the form of variable capital entities “C.V.”

### *Dividend Payments*

Dividends paid out of the previously taxed earnings account (CUFIN) should not trigger any further corporate taxation in Mexico. However, dividends paid out more than the CUFIN trigger a corporate tax for the company paying such dividends on the excess amount. The corporate tax on the dividends distributed is determined by applying the corporate tax rate to the grossed-up dividend. This factor is 1.4286.

This dividend tax can offset the company’s annual corporate income tax of the year in which it was paid and the monthly or annual corporate income tax of the following two years.

Starting in 2014, dividend payments made to individuals or foreign corporations are subject to a 10% withholding tax whether the dividend is paid out of the CUFIN or not. Tax treaty benefits can be applied to lower this rate.

The following items can be treated as dividends:

- Loans to shareholders that do not comply with specific requirements
- Nondeductible expenses that benefit shareholders
- Off-books income
- Additional income assessed by the tax authorities
- Earnings distributed from a contract joint venture.

Foreign dividend income is included in taxable income. However, an ordinary foreign tax credit is allowed, provided certain requirements are met.

### *Tax Consolidation System*

Starting in 2014, the tax consolidation system has been abrogated. A new three-year deferral scheme has been included in the Mexican Income Tax Law. This is an optional regime called the “integration regime.”

In the following you will find a general overview of the optional so-called “integration regime” in terms of the Mexican Income Tax Law (MITL) in force since 2014.

The integration regime consists of deferring the payable income tax for a three-year period. In this sense, the group of entities has to determine an integrated or global tax result and such obligation relies on the integrating entity (holding); notwithstanding, each company integrating and each integrated entity has to determine its individual tax result.

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The individual tax result of each entity must be determined by applying the general rules for Mexican entities in terms of the MITL and, after that, the integrating entity has to compute the global or integrated tax result with a specific formula.

Once the integrated tax result has been determined, the integration ratio must be applied to the amount obtained and multiplied by the percentage of participation (percent of equity held). The amount obtained will be the proportion of the deferral income tax payable after the third year after the determination, and adjustment for inflation must be computed.

It is worth mentioning that such ratio is the proportion of the tax losses and profits divided by the profits without considering the losses, meaning the proportion of the deferral is equal to the proportion of the tax losses generated at the group level over the profits; therefore, in a group of entities without current tax losses no deferral would apply.

In general terms, the proportion aforementioned will be the tax subject to be deferred and in the proportion of the integration held. The difference between the total payable income tax and the deferral tax will be the amount payable for the current year.

Below you will find the general requirements that entities must fulfill in order to apply the integration regime as well as certain formalities that must be met.

Requirements of integrating company	Requirements of integrated company
<ul style="list-style-type: none"> <li>• Must be resident in Mexico.</li> <li>• Be the owner of more than 80% of the voting shares of one or more integrated entities, directly or indirectly.</li> <li>• No more than 80% of its voting shares are owned by other companies, unless they are a tax resident in a country with which Mexico has in force a comprehensive information exchange agreement.</li> <li>• The shares publicly traded through a recognized stock exchange will not be computed for this purpose.</li> <li>• In case of companies not issuing shares, the value of their partnership interest will be considered.</li> </ul>	<ul style="list-style-type: none"> <li>• Will be considered an integrated entity if more than 80% of its voting shares are property, directly, indirectly, or in both forms, of an integrating company.</li> </ul>

Furthermore, the entities below are not eligible to be considered as “integrating” or “integrated” entities:

- Nonprofit entities
- Financial institutions or capital investment companies
- Nonresident entities, even if they have in Mexico a permanent establishment
- Entities that are in a liquidation process
- Partnerships, nonprofit associations, as well as cooperative associations
- Entities under a coordinated tax regime (auto transportation)

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- Joint ventures
- Entities under a maquila program
- Entities that, before entering the “integration regime,” have tax losses pending amortization from prior years
- Entities providing public air transportation services.

Therefore, the group of entities that comply with the requirements before mentioned will be eligible to apply the integration regime.

The group of entities must request an authorization with the Mexican Tax Authorities (MTA) to be considered as part of the integration regime.

The authorization aforementioned must be filed at the latest by August 15 of the year prior to the application to the benefits and the determination of the integrated tax result of the group.

Generally, entities applying this optional regime will have the following obligations:

- Accounting book registries of the integrating and integrated entities
- File the corresponding tax informative return and, if applicable, copy of the tax opinions by third parties that have the purpose of reducing the tax result or to increase the tax loss generated in a year
- File the annual tax return of the integrated tax result
- For integrated entities:
  - Provide the integrating entity, within the three months of the close of the tax year, their tax result or loss
  - File their annual tax return within the three months following the close of the fiscal year
  - Make public in May of the corresponding tax year, the relative information regarding the IT that has been deferred, using the Web page of the MTA or the means that such tax authority indicates through general rules
- File monthly advanced payments.

The integrated entity that no longer wants to be considered in this optional regime or ceases to meet the requirements must divest from such regime on the date that one of these assumptions occurs and will pay in the following month the tax that has been deferred during the time the entity applied this regime.

When an integrating entity no longer wants to operate under this regime or it ceases to meet the requirements to be considered as such, each entity of the group must divest on the date that these assumptions occur and will pay in the following month the tax that has been deferred under the application of the regime.

#### *Inflationary Accounting for Tax Purposes*

The Mexican Income Tax Law recognizes the effects of inflation in determining taxable income. Taxpayers shall determine an inflationary adjustment on payables and receivables and may restate tax depreciation and net operating losses for inflation using the national consumers’ price index published in the official gazette by the Mexican central bank known as the “Banco de México.”

Inflationary taxable income derives when the annual average of debts exceeds the annual average of assets.

## Mexico

### *Transfer Pricing Rules*

The law establishes the obligation for all taxpayers who conduct transactions with related parties to determine their taxable income and allowed deductions, considering for those transactions the prices that would have been applied with or between independent parties in comparable transactions. With these provisions, the law includes the arm's-length principle. These provisions also empower the Tax Administration Service (SAT) to estimate the profit or prices when they consider that a taxpayer's transactions are not carried out at arm's-length.

The law includes the comparability principle, by means of which a transaction with related parties generates an arm's-length result when this result is comparable to the ones obtained by independent companies that carry out comparable transactions. Also, it allows making reasonable adjustments when differences that affect the result significantly exist, in order to determine which is the arm's-length result.

The law provides arm's-length pricing methods, which the SAT may apply for its enforcement. The transfer pricing methods provided by the law comply with the methods contained in the OECD Transfer Pricing Guidelines.

Summarizing, the law recognizes the following methods to determine arm's-length prices:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Profit Split Method
- Residual Profit Split Method
- Transactional Net Margin Method (similar to the United States' Comparable Profits Method).

Taxpayers must consider first the comparable uncontrolled price method before any other method, because it is the most direct and reliable, in order to determine if the conditions of the commercial and financial relations between related parties fulfill the characteristics of being contracted at market prices. This method will not be applicable when the taxpayer demonstrates that the application of this method is not the most appropriate in the particular case.

Also, the law establishes the obligation to all taxpayers carrying out transactions with related parties abroad to prepare and maintain documentation supporting that these transactions fulfill the arm's-length principle. This documentation consists of the following:

- Name, address, and country of residence for tax purposes, of the taxpayer and its related parties with which it carries out transactions, as well as the documentation that supports the direct and indirect relation between them
- Information regarding the taxpayer's functions, assets, and risks
- Information and documentation of the transactions with related parties
- The transfer pricing methodology applied according to the law, including the information and documentation of comparable companies.

If the SAT concludes that a company underpaid taxes in Mexico because it applied transfer prices that did not comply with the provisions of the law, then the taxpayers will be liable for the following:

- Omitted taxes adjusted by inflation
- Interest

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- A penalty that may range between 55% to 75% of omitted income tax or between 30% to 40%; however, if the taxpayer has supporting documentation, this penalty may be reduced by 50%.

At the latest by March 31 of each year, an informative return must be filed reporting the operations carried out with related parties residing abroad during the previous calendar year. It must be filed jointly with the annual return.

Under current provisions, it is possible to obtain advanced pricing agreements. They are considered to be in effect for the year in which they are requested, the one immediately preceding and up to three subsequent years.

Additionally, the tax authorities may totally or partially forgive interest arising from adjustments to prices or payments on operations between or among related parties, provided said pardon is given by a competent authority based on reciprocity with the authorities of a country with which Mexico has a tax treaty in effect and said authorities have refunded the corresponding tax without interest payments.

The foregoing is applicable although a transfer pricing ruling is requested to the tax authorities to confirm the method used for determining transfer prices in related-party transactions.

#### *Tax Havens*

In 2005, the concept of “resident of a tax haven” was amended to “subject to a preferential tax regime,” and this means that any location where taxes paid are less than 75% of the amount that would be paid in Mexico will be regarded as such. Therefore, if Mexican residents or PEs in Mexico of residents abroad make payments to foreign residents where the amount will be subject to a preferred tax regime, then the payment will be subject to a 40% withholding tax without any deduction on the gross income received, provided the payment in question represents Mexican-sourced income subject to tax. In this sense, business profits obtained by a foreign resident are not subject to Mexican tax in any form, unless it is attributable to a permanent establishment in Mexico of the foreign resident.

Based on a general rule (annually adopted), the 40% withholding would apply only for transactions between related parties, if the related party does not reside in a country with which Mexico has in force a broad information agreement.

If the Mexican residents have investments in entities subject to preferred tax regimes, then the income generated through these entities will generally be taxed on current basis in Mexico. Some exceptions may apply and these investments should be reviewed on a case-by-case basis.

#### *Tax Payment*

The annual income tax payment is due at the latest by March 31 of the following year for legal entities and by April 30 of the following year for individuals. Monthly estimated payments are due by the 17th day of the following month. Tax payments shall be made electronically. For this purpose, the taxpayer shall open a bank account at any recognized Mexican bank and obtain from the tax authorities a specific operation number and complete the transfer.

The Mexican bank should provide the taxpayer with an electronic transfer code confirmation of the tax payment.

#### *Amortization of Expenditure*

##### *Depreciation*

The amount of the tax deduction is determined by considering the effects of inflation on fixed asset, deferred expenses, and deferred charges investments.

This deduction is computed based on the original amount of the investment, including some expenses incurred to acquire the asset, in accordance with rates provided by law, in proportion to the number of full

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months during which the asset was used. The resulting amount is adjusted with inflation indices for the period between the month of acquisition and until the last month of the first half of the period during which the asset has been used in the tax year for which the deduction is claimed.

Examples of some of the maximum depreciation percentages allowed are as follows:

- 10% for office furniture and equipment
- 25% for cars, buses, freight trucks, tractor trailers, and trailers
- 30% for personal desktop and laptop computers, servers, and printers
- 16% for radio and television broadcasting companies.

Notwithstanding the above, the maximum amortization rates allowed in respect of deferred expenses and charges, and for disbursements made in pre-operating periods, are as follows:

- 5% for deferred charges
- 10% for disbursements in pre-operating periods
- 15% for royalties, for technical assistance, and for other deferred expenses.

In these last two cases, if the benefit of the investment is realized in the same tax year, then the total amount can be deducted in said tax year.

### Losses

Net operating losses may be carried forward for 10 years and may be restated for inflation. If the taxpayer fails to apply such loss within the 10-year term allowed, then the right to apply this loss in future periods is lost. If losses are not applied in a tax year where it could have applied, the portion thereof can no longer be used to offset taxable income.

Net operating losses cannot be transferred to another corporation through merger. In a spin-off, the net operating loss may be transferred only in proportion of the inventories and accounts receivables divided (commercial activities) or fixed assets divided (other activities).

In a merger, the surviving corporation may carry forward its net operating losses to offset the earnings derived from the same line of business activities that gave rise to the loss in question.

Capital losses on company liquidations or mergers are nondeductible. However, capital losses on share transfers can offset capital gains on share transfers only.

With certain exceptions, companies who changed their controlling partners or stockholders and have net operating losses pending to be carried forward may only apply such losses against profits derived from the exploitation of the same lines of business that gave rise to the losses.

### Foreign Tax Relief

Mexican residents are entitled to an ordinary foreign tax credit provided that the foreign income is subject to Mexican income tax. The credit shall only apply when the income included in gross income, received or accrued, includes the income tax paid abroad.

Please note that starting in 2014, the Mexican Income Tax Law provides a detailed computation method for the determination of the tax credit with several limitations.

In general terms, the foreign tax credit limitation for business activities is 30% of the tax profit from foreign sources determined in accordance with the MITL.

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In the case of the underlying tax, the limitation is arrived at by computing the tax profit (net profit) from foreign sources up to the Mexican tax rate. For income tax paid on dividends that are distributed by foreign entities to Mexican residents, the income tax paid abroad is creditable as long as the Mexican holding company has owned at least 10% of the stock of the foreign subsidiary for the six-month period prior to the dividend distribution. If the Mexican holding company does not fully own the foreign subsidiary, then the foreign tax credit is determined based on a proportion equal to the participation owned by the Mexican holding company.

When a Mexican entity indirectly participates in the dividends or profits of a foreign company, the income tax paid abroad is creditable in Mexico up to the second corporate level as long as the company is a resident of a country with which Mexico has entered into an agreement for broad exchange of information. In addition, the foreign company directly held by the Mexican entity must participate in at least 10% of the capital stock of the company that is indirectly held and the indirect participation of the Mexican entity must be at least 5%. The percentages of participation in the capital stock described in this paragraph must be maintained at least during the six months prior to the date when the relevant dividend or profit is paid.

When the tax credit allowed cannot be totally applied, the remaining balance may be carried forward for 10 years.

## Indirect Taxation

### Value-added Tax

The general VAT rate is 16%. However, a 0% rate applies, namely to sales of patent medicines and some food products, as well as to exports of goods and some services. The importation of the products subject to the 0% rate is not subject to the payment of tax. Starting in 2014, the rate applicable in the border regions is no longer 11% but the same general rate of 16%. Also, certain activities are exempted from a VAT perspective.

VAT is generally imposed on the gross income derived from the sale or disposal of property, including conditional sales, the rendering of independent services, the temporary use or enjoyment of property, and the importation of goods or services (technical assistance, fees, commissions, royalties, and certain interest paid abroad), including taxes, duties, interest, and reimbursements. Inventory shortages are also taxable unless the taxpayer can substantiate that such shortages do not involve any transfer or disposal of property.

Any person carrying out taxable transactions in Mexico is subject to this tax.

Legal entities contracting independent personal services are obliged to withhold VAT when the service provider is an individual.

It is necessary to pay tax on the rendering of independent services when it is partly or entirely rendered in Mexico by a Mexican resident or when the benefit derived from the service is taken advantage of in Mexico. Independent services are understood to be, amongst others, services rendered by individuals or corporations, including the transportation of persons or goods, the granting of insurance and bonds, commissions, technical assistance, and the transfer of technology.

Until December 31, 1998, the Value Added Tax Law established that circus and movie theatre tickets were exempt from this tax. As of 1999, the Value Added Tax Law provides that tickets for the exhibition of films will be subject to this tax at the rate of 16%.

In the case of the importation of tangible goods, tax is payable as soon as the goods are available for the importer at the customs or tax building; in the case of temporary imports, tax is payable when the imports become final. Importation of intangible goods arises when a Mexican resident purchases the intangible

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from a nonresident and when the temporary use or enjoyment of the intangible supplied by a nonresident takes place in Mexico. The obligation to pay the tax arises at the time the payment is effectively made.

Likewise, services provided by foreign residents are considered imported when they are enjoyed in Mexico. However, in this situation, the Regulation to the Value Added Tax Law establishes that an amount equivalent to the VAT paid thereof can be credited in the same monthly return, hence resulting in a virtual VAT, provided the Mexican entity's credit factor is 1 (only has taxable activities).

In this sense, activities subject to a VAT rate of 0% are treated the same as activities subject to the normal 16% rate, meaning that the VAT paid on any inputs in a month may be credited against the 0% rate and a refund of the VAT paid on the inputs can be requested.

Taxpayers carrying out exempted activities may not be able to credit the virtual VAT, as mentioned above, when importing services.

The exportation of goods and services, as defined by law, is subject to the 0% tax rate; consequently, exporters can offset or claim a refund of the taxes passed on to them by their suppliers of goods and services.

### Business Flat Tax

This tax was abrogated starting in January 2014.

## Personal Taxation

### Nonresident Artists

Residents abroad who have no permanent establishment in Mexico or have such an establishment the income is not attributable thereto, are required to pay tax on income obtained from sources of wealth located in Mexico. Tax rates, modes of payment, and exemptions are defined for each type of income obtained from sources of wealth located therein.

Taxable income includes any payment generating a benefit to the foreign resident and made for acts or activities mentioned below. These include the avoidance of a disbursement and the payment of tax on their behalf (except VAT passed on by such a resident under the terms of the law), as well as income determined by the tax authorities in cases covered by law (e.g., transfer pricing, etc.).

When payments to a resident abroad are made in a foreign currency for withholding tax purposes, the tax is determined by converting the payment into Mexican currency at the exchange rate prevailing on the date on which payment is due.

### Personal Services Provided by a Foreign Resident

Generally, wages, salaries, and income obtained from rendering of personal services in a subordinate or independent capacity is considered to be located in Mexico when the related services are performed therein.

For salaries and wages, the tax is determined by applying the following rates to the income obtained during the calendar year:

• Up to	MXP 125,900	Exempt
• From	MXP 125,900 to MXP 1,000,000	15%
• Over	MXP 1,000,000	30%

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The law exempts wages and income obtained by nonresidents rendering personal services, provided that the services rendered have a duration of no more than 183 days in a 12-month period, and the related payments are made by residents abroad who have no permanent establishment in Mexico, or if they have such an establishment, the services performed are not related to activities of the establishment. This treatment does not apply when the payer has an establishment in Mexico, even if it does not qualify as a permanent one, and the services performed are related to such establishment, as well as those situations when the provider of the services to such an establishment receives supplementary payments from residents abroad for the services rendered.

### Independent Personal Services

It is assumed that services rendered in an independent capacity are performed in their entirety in Mexico when there is evidence that a portion of such services are rendered in the country, unless the provider can demonstrate that they were partially rendered abroad. In the latter case, the tax is computed on the portion corresponding to the services rendered in Mexico. In addition, services are deemed to be rendered in Mexico unless otherwise proven, when the payments for such services rendered are made by a Mexican resident or a Mexican permanent establishment of a foreign resident to a foreign resident that is a related party. The tax is computed by applying a rate of 25 percent on the total income obtained, with no deduction allowed.

The persons obtaining income from the rendering of independent personal services are required to issue receipts that meet requirements stipulated in the regulations.

The law exempts independent personal services from Mexican taxation when a foreign resident, without a permanent establishment or having any kind of establishment in Mexico the service is not related thereto, pays the service, and provided the stay of the foreign service provider is less than 183 days, consecutive or not, in any 12-month period.

### Artistic Activities or Public Shows

Foreign residents who receive income from artistic activities or public shows are taxed in Mexico when the artistic activity is carried out or when the show is presented in Mexico.

It is assumed, except when proven otherwise, that artists or whoever presents a public show participates either directly or indirectly in the profits obtained by the service provider who grants the temporary use or enjoyment or sells assets related to the presentation of the show.

The tax is determined by applying the rate of 25% to the total income obtained, with no deduction allowed.

A 35% rate on net income can be applied if a representative is appointed in Mexico and some requirements are complied with.

### Other Services

Fees paid to board members are considered to be located in the country whenever such fees are paid by a company that is a resident of Mexico. In this case, the tax payable is determined by applying 25% to the total income obtained, no deduction allowed.

### Royalties, Technical Assistance, and Advertising

Income from royalties, technical assistance, or publicity is taxable in Mexico when the rights or goods for which the payments are made are taken advantage of therein or when they are paid by a Mexican resident or a foreign resident with a permanent establishment in Mexico.

The following rates apply:

- Royalties for the temporary use or enjoyment of railroad cars – 5%

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- Royalties for the temporary use or enjoyment of patents or certificates of invention or improvement, brand and trade names, as well as publicity – 35%
- Royalties different than those provided above and those for technical assistance – 25%.

It is worth mentioning that some of the aforementioned withholding tax rates for payments made abroad may be reduced by application of tax treaties to avoid double taxation.

### Resident Artists

#### Personal Services

In general, individuals who receive salaries, wages, and payments for personal subordinated services are taxed on all amounts received for such items.

The taxable amount received provides the basis for determining the taxable income for the year. The monthly and annual tax is determined by applying a graduated scale, with a maximum rate of 35%. The tax is withheld and paid by the employer or the person making the payment on a monthly basis. The employer computes the annual tax for its employees unless the employee finds himself/herself in one of the following situations: (i) when he/she obtains taxable income that differs from that previously mentioned, (ii) when he/she informs the employer that he/she will file the tax return, (iii) when he/she stops working before December 31 of the year in question or when he/she rendered services to two or more employers at the same time, (iv) when he/she obtained salary income from foreign sources or from persons not obligated to withhold, and (v) when his/her annual income exceeds MXP 400,000.

#### Annual Taxable Income MXP for 2021 Tax Year

Exceeding	Not Exceeding	Marginal Rate	Tax on Lower Level
0.01	7,735.00	1.92	---
7,735.01	65,651.07	6.40	148.51
65,651.08	115,375.90	10.88	3,855.14
115,375.91	134,119.41	16.00	9,265.20
134,119.42	160,577.65	17.92	12,264.16
160,577.66	323,862.00	21.36	17,005.47
323,862.01	510,451.00	23.52	51,883.01
510,451.01	974,535.03	30.00	95,768.74
974,535.04	1,299,380.04	32.00	234,993.95
1,299,380.05	3,898,140.12	34.00	338,944.34
3,898,140.13	and on	35.00	1,222,522.76

The corresponding tax rates are adjusted for inflation when the inflation exceeds 10% since the last adjustment. Generally, married persons are taxed separately, not jointly, on all types of income.

A subsidy to employment against monthly tax payments may be applied. The purpose of the subsidy to employment is to reduce the tax burden of lower income taxpayers.

The following is the monthly subsidy to employment table:

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Taxable Income MXP for 2021 Tax Year

Exceeding	Not Exceeding	Applicable Monthly Subsidy to Employment Amount
0.01	1,768.96	407.02
1,768.97	1,978.70	406.83
1,978.71	2,653.38	359.84
2,653.39	3,472.84	343.06
3,472.85	3,537.87	310.29
3,537.88	4,446.15	298.44
4,446.16	4,717.18	354.23
4,717.19	5,335.42	324.87
5,335.43	6,224.67	294.63
6,224.68	7,113.90	253.54
7,113.91	7,382.33	217.61
7,382.34	and on	0

The tax credit that the Mexican employers could apply against monthly withholdings was abrogated starting January 1, 2008.

*Professional and Independent Personal Services*

Professionals, artists, and others rendering professional or independent services are taxed on all amounts received as fees for these personal services. Individuals residing abroad with a Mexican permanent establishment are subject to tax on income from personal services attributable to such establishment. To compute their taxable income, these taxpayers may deduct all ordinary and necessary expenses for obtaining such income, including depreciation and amortization under the straight-line method on the cost of tangible assets used in obtaining income, together with installation expenses. If a tax loss is incurred in a tax year, it can be carried forward for the following 10 years.

The taxable amount received less the above-mentioned allowable deductions, deductions for medical and funeral expenses, and authorized donations give the basis for determining taxable annual income for professional and independent personal services subject to tax. The annual return must be filed by April 30 of the following year. Such taxpayers are required to make monthly estimated tax payments at the latest by the 17th day of the following month according to the fees received less allowable deductions by applying a graduated rate scale with a maximum rate of 30 percent. These estimated tax payments are offset against the final tax.

*Employees*

*Social Security Implications*

Social security includes insurances covering accidents, diseases, invalidity and life (26.65%), nursery (1 percent), and retirement and old-age fund (6.275%). The employer portion for the social security contributions ranges between 30% and 36% of the salary, depending upon the risk of the work performed. The employee portion is approximately 2.78%.

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The social security monthly base is capped at 25 times the Minimum Updated Unit (UMA by acronym in Spanish). The UMA for 2021 in Mexico City is MXP 89.61 per day (or approximately US\$4.36 at the rate of 20.52 Mexican pesos per U.S. dollar). Additionally, a housing fund (5 percent) and state payroll taxes, which rate usually is between 2% and 3% of the payroll depending on the state, apply.

### *Employee Profit Sharing*

Mexican entities are required to pay a mandatory employee profit sharing of 10% of its profits from the second year of operation. The profit for this purpose is the taxable income for IT purposes less the nondeductible expenses for payments made to employees (47% or 53%) that are not taxable to these employees.

The profit sharing must be paid to the employees 50 days after submitting annual tax return, normally is paid by May 20 of the following year. Limitation on Profit Sharing exists, because of Labor Reform in 2021, 90 days of salary or average of last three years by each employee.

Profit sharing paid may be deductible for IT purposes for the fiscal year in which it is paid. Any profit sharing paid may also be added to any tax loss incurred.

A Mexican branch of a foreign resident must pay the employee profit sharing in the same manner as a company.

There is no exemption for the profit sharing as such if the employees are in the operating company. Directors, administrators, and general managers of companies do not participate in the profits. Please consider that the courts have interpreted this to include only high-level management (General Manager, CEO, CFO type positions).

## Mexico

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