

TAX IMPLICATIONS FOR FOREIGN IP OWNERS IN MEXICO

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Laura Collada Salcido and Jonathan Rangel of Dumont Bergman Bider & Co outline the relevant Mexican tax codes and international treaties for foreign residents profiting from their intellectual property in the country



Royalties and technical assistance are regulated by the Federal Tax Code (FTC). It provides that royalties will be, among others, payments of any type for temporary use or enjoyment of patents, certificates of invention or improvement, trade marks, trade names, copyrights on literary, artistic or scientific works, including cinematographic films and recordings for radio or television, as well as drawings or models, blueprints, formulas, or industrial, commercial or scientific procedures or equipment, and amounts paid for the transfer of technology or data regarding industrial, commercial or scientific skills, or other similar property rights. (Temporary use or enjoyment of copyrights on scientific works include those on software or sets of instructions for computers required for operating processes, or to carry out tasks of such applications, regardless of the means by which they are transmitted).

Payments made for the right to receive or to retransmit visual images, sounds or both are also considered royalties, as are payments made for the right to grant public access to such images or sounds when transmitted in both cases by satellite, cable, fibre-optic or other similar media.

Payments for technical assistance are not considered royalties but rather the rendering of independent personal services, for which the provider undertakes to provide non-patentable knowledge, which does not imply the transmission of confidential information related to industrial, commercial or scientific skills.

According to article 142 of the Industrial Property Law, a franchise exists whenever, with a licence agreement, technical knowledge is transmitted or technical assistance is provided, so that the grantee may produce or sell the relevant products or provide the relevant services evenly and with the operating, commercial and administrative methods provided by the trade mark owner with the

sole purpose to keep the quality, prestige and image of the products or services.

In this regard, it can be said that these characteristics of a franchise are similar to those for royalties and technical assistance provided by the FTC.

Resident abroad

The first article of the Income Tax Law (ITL) sets out the people or entities that are obliged to pay this tax. Item III of the article exclusively refers to the source of enrichment as determining the source of income and, when it is located in Mexico, the "resident abroad" (Mexican or foreign individuals without a place of residence in Mexico) must pay the corresponding tax for the income obtained from royalties, technical assistance and franchises.

Nevertheless, if there is a place of residence in Mexico, the individuals will be deemed as "residents abroad" if more than the 50% of their annual income does not come from the source of enrichment located in Mexico, among other activities.

Cases in which residents abroad must pay tax

In this light, residents abroad must pay income tax when they receive an income from any source of enrichment located in Mexico, as well as when such income comes from a place of business based in the country.

According to the provisions of the ITL, residents abroad will be bound to make such payments for income in the form of cash, property, services or as a loan, even when allegedly determined by the tax authorities, from sources of enrichment located in Mexico.

Payments for royalties and technical assistance that benefit the resident abroad are considered part of the service provider income, even if the resident abroad is prevented from disbursement. Accordingly, if the resident in Mexico is bound to make additional payments to the service provider abroad due to transportation expenses, travel expenses and personnel expenses, conferences abroad, photocopies, research and collection of information expenses, or of any other type that benefit the resident abroad, such expenses will equally give rise to income tax.

Tax base

The Tax base for income from royalties, technical assistance or advertising is provided by article 200 of the ITL. The tax is calculated by applying the following rates without any deduction:

- Royalties for the use or enjoyment of railroad carriages: 5%.
- Royalties other than those provided by subsection one and for technical assistance: 25%.

Individuals who are required to make payments for royalties as well as for technical assistance will be obliged to withhold the corresponding amount, within 15 days of making the payment abroad, or to deduct the amount of such withholding at the place of business, whichever is first.

International treaties

Royalties

From a general stand point, double taxation between countries occurs when two or more of them impose a tax for the same taxpayer and the same subject matter. International treaties to avoid double taxation have arisen as an effective tool to avoid such a phenomenon.

Accordingly, it is important to mention that Mexico has entered into several tax treaties (most of them to avoid double taxation). According to article 12 of the Model Convention of the Organization for Economic Co-operation and Development (OECD), royalties are regulated as follows:

Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State if such resident was the beneficial owner of the royalties.

The term "royalties" as used in this Article means payments of any kind received as consideration for the use of, or rights to use, any copyright of literary, artistic or scientific work including cinematograph films, formulas or secret processes or information concerning industrial, commercial or scientific.

The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, does business in the other Contracting State in which the royalties arising through established there a permanent establishment or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as applicable.

Where, by reason of a special relationship between the payer and the beneficial owner or between

both of them and some other person, the amount of royalties related to the use, right or information for which they paid exceeds the amount which would have been agreed between the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, giving consideration to the other provisions of this Convention.

In general terms, the withholding rates for royalties are 10%, and in some cases 15%. Nevertheless, by applying the most favoured nation clause, the rate was reduced to 10%. To withhold the rate based on the treaties, it is necessary to comply with the requisites provided by article 5 of the ITL, which refers to obtaining evidence to prove the place of residence.

Technical assistance

This payment is governed by the guidelines of article 7 of the ITL and the Equity Tax Draft issued by the OECD. According to the provisions of this article, if the recipient of income does not have a place of business in Mexico, income resulting from technical assistance will not be subject to taxation in Mexico.

Deductions on IP development

According to article 31, item XI of the ITL, deductions on technical assistance, technology transfer or royalties may be subject to requiring proof before the Mexican Tax Authorities that the individual providing the knowledge or the technical elements has the relevant expertise to do so. Exceptions are made when payments are destined to residents in Mexico, and in the relevant agreement, it has been agreed that the service being rendered will effectively be made by an authorised third party.

Furthermore, as provided by the Program for the High Impact Film and Audiovisual Industry (ProAV Fund), Mexico's audiovisual industry can claim a cash reimbursement applied on all the documented expenses made during a shoot. Also, they will be entitled to claim a refund of the VAT incurred on them in the country.

Measures to combat base erosion

According to the ITL, companies, individuals and residents abroad must pay tax on all earnings from companies or accounts located in low-tax jurisdictions. Foreign-source income is deemed to come from a low-tax jurisdiction if it is not subject to taxation abroad or if it is subject to an income tax that is less than 75% of the income tax computed under Mexican Tax Legislation. Passive income (royalties) derived directly or indirectly by a Mexican resident through a branch, entity or other legal entity located in a preferential tax regime will be subject to taxation in Mexico in the year in which the income is derived.

Transactions between related parties

Examples of related parties may be a company and its affiliates or subsidiaries; associates, shareholders, managements, main owners and immediate family members of shareholders and executive officers; or a company with one or several common shareholders or main owners, among others.

Transactions between related parties residing abroad will take care of prices established as considerations, given that Mexican Laws, such as the ITL, require the determination of the considerations of transactions, taking into account the prices and amounts of considerations that would have been used with or among independent parties in similar transactions.

The ITL obliges companies with transactions with related parties residing abroad to prove, through a transfer price study, that transactions were carried out at market values, and the statement of compliance with this requirement must be included in the report on the taxpayer's tax condition review, to be filed along with the auditor's report for the company that paid for the service or good.

There are several methods for determining transfer prices, so as to ensure the reasonableness and consistency of prices agreed upon between related parties (and which prevent the committing of a crime such as tax evasion).

Assignments

Intellectual property – as intangible rights – may be transferred by means of an assignment or a licence agreement, as deemed convenient.

The assignment of these rights must be documented, and has to be recognised in the company's accounting records. From an IP standpoint, an intangible asset is a set of immaterial assets represented by rights, privileges or competency advantages that are valuable because they contribute to the increase of income or profits when they are used by the economic agent.

It is worth mentioning that even if the relevant assignment or licence agreement is onerous or is a free transaction, the IP rights' intrinsic value must be recorded in the financial statements so that the assets can be correctly valued and reported.

The entry of the valuation of any intangible assets must be made based on the financial provisions applicable in each country; in this case, we will refer to the International Accounting Standard (IAS 38), which sets forth that "an intangible asset must be acknowledged as an asset if: "(i) it is probable that future economic benefits attributed thereto may be available to the company; and (ii) the cost of such asset may be measured reliably".

There are some methods of assessing assets that change based on the focus given to intangible assets, such as:

- Knowing the real value of the business;
- Managing intangible assets well and making them grow over time;
- Reporting more clearly for future investors.

The following are some of the methods used to measure intangible assets:

- Economic value added;
- Intangible assets monitor;
- Intellectual capital index; and
- Inclusive value methodology.

Once the relevant intangible assets have been financially acknowledged and generate an income, the corresponding tax must be paid to each country.

Consequently, despite the complexity of these issues, considering the local and international tax implications arising from the assignment or licensing of IP rights is significant to any IP owner, as they represent a considerable income that is taxed differently in each country. Therefore, understanding such details can bring important financial and economic benefits.

LAURA COLLADA SALCIDO



Laura Collada Salcido has been the managing partner of Dumont Bergman Bider & Co (DBB) since 2008, and has worked there since 2000.

Laura graduated with honours from the Instituto Tecnológico Autónomo de México (ITAM). She has law specialisations in intellectual property, corporate, civil, constitutional and environmental law from Universidad Panamericana, and a legal specialisation in contracts from the ITAM Mexico, all of them with honours.

Laura started at a renowned IP firm, and then moved to the Mexican Trademark Office where she was the sub-director for the Prevention of Unfair Competition in charge of all administrative infractions. She returned to private practice in 2000, joining DBB in which she was in charge of the litigation department.

Laura's practice covers all IP matters from consultancy, strategies, filing and prosecution, to resolving disputes involving these rights through to litigation and negotiating settlements. She always tries to understand her client's needs to tailor personal and adequate strategies for each and every case.

As managing partner she has modernised the image of DBB, and under her supervision, DBB achieved ISO 9000:2008 certification (by TUV Rheinland) for having a quality management system. Laura has also achieved the complete digitalisation of DBB's archives and can render a paperless service if clients so wish.

JONATHAN RANGEL



Jonathan graduated with honours from the Universidad Nacional Autónoma de México (UNAM) and joined Dumont Bergman Bider & Co in July 2012 as an IP attorney. His area of practice focuses mainly on IP litigation, trade mark and patent prosecution, IP contracts, copyright litigation, trade mark and patent infringement, trade mark and patent litigation, well-known and famous trade marks, and domain names disputes.

He is an active member of professional national and international organisations,

such as the Mexican Association for the Protection of Intellectual Property (AMPPI) where he participates in the trade mark committee and inter-institutional matters.

Before joining Dumont, Jonathan was an associate in the IP litigation area of the firms Goodrich Riquelme y Asociados and Tsuru Morales & Tsuru in Mexico City.

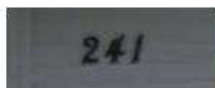
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