Avoidance of Double Corporate Income Taxation between the Federal Republic of Germany and the United Mexican States

A thesis submitted to the Bucerius Hochschule für Rechtswissenschaft and the WHU Otto Beisheim School of Management joint Master of Law and Business Program in partial fulfillment of the requirements for the award of the Master of Law and Business Degree

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July 26, 2013

13,237 words (excluding footnotes)
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CONTENTS

INTRODUCTION

1. GENERAL ASPECTS OF DOUBLE TAXATION

1.1 Overview of the International Double Taxation issue
1.2. Historical background, nature and impact of the OECD model treaty
1.3 Treaty making process under Mexican and German Law
1.4. National legal hierarchy of international treaties and application

2. CORPORATE INCOME TAX IN THE UNITED MEXICAN STATES AND THE FEDERAL REPUBLIC OF GERMANY

1. National legal basis for corporate income taxation
2. Fiscal residency and Permanent Establishment
3. Bilateral Corporate Income Tax Calculation Procedures
   3.1 German corporate income tax model
      3.1.1 Determination of corporate revenue and taxable base
      3.1.2 Calculation of the total corporate income tax due
   3.2 Mexican corporate income tax model
      3.2.1 Determination of corporate revenue for tax purposes
4. International Treaties in National Tax Legislation

3. Treaty Mechanisms for the Avoidance of Double Income Taxation

3.1 Scope of Applicability and General Definitions
   3.1.1 International Tax Residence
   3.1.2 Permanent Establishment
3.2 Generalities of International Corporate Income Tax
3.2.1 Business Profits and Capital Gains 34
3.2.2 Associated Enterprises 35
3.2.3 Dividend Distribution 36
3.2.4 Corporate Interests 39
3.3. Proceedings for Tax Exemption and Accreditation 40

4. BILATERAL COMMERCIAL INFLUENCE OF THE TREATY

4.1. Economic and political overview 43
4.2 Impact on Foreign Direct Investment 45
4.3 Impact on the Multilateral Economic Development 48
4.4 Commitment for Mutual Assistance and Non-discrimination 51

CONCLUSIONS 53

BIBLIOGRAPHY 56
INTRODUCTION

... Globalization has lead states and corporations to become inter-independent in their political and economic relations due to the multinational trade and investment opportunities arising from capital transactions and development projects. Corporations are thus no longer restricted to a single jurisdiction in terms of asset and capital allocation, representing legal issues between national authorities claiming to assess sovereign and economic rights over their economic inflows. On this regard, corporations face the challenge of double taxation when their operations or financial transactions reach beyond their residence jurisdiction. The lack of fiscal harmonization among States inflicts an important economic impact to corporate revenue and ultimately to the very development and globalization of the involved States, as foreign investment opportunities and mutual development are hindered. To counter such economic and legal uncertainty, States with strong economic ties, as in the case of Mexico and Germany, have opted to subscribe agreements for the avoidance of double taxation in order to harmonize their tax system, as well as to foment their mutual relations.

The following research emphasizes the commitment of the aforementioned States to harmonize their fiscal policies and legislations through the subscribed tax treaty. On a first instance the reader will be presented with a concrete overview of the international double taxation issue, paired with an analysis on the importance of the OECD model tax contract and its application under the national Mexican and German legislation as an enforceable legal instrument. For further understanding, the national basis for corporate income taxation, the related legal concepts and as well as the administrative procedures in each jurisdiction used to determine the accumulated corporate revenue, taxable base and total corporate income tax due shall be developed. Once the calculation procedures are set, the correlation between the taxation models shall be harmonized through the direct application of the provisions and avoidance schemes under the subscribed agreement for the relief of double taxation, to the extent of the main economic activities conducted by
transnational corporations. The third chapter shall clarify the scope of applicability of the treaty in addition to the available mechanisms for its application and subsequent tax cancelation in regards to the allocation of transnational capital gains, dividend payments and distributions of related business revenue to permanent establishments or natural persons.

Upon analyzing the legal and procedural frame of the exemption and credit principles for double taxation avoidance on strict adherence to Mexican and German legislation, its impact on the mutual economic development shall follow. It is provided that the treaty, in addition to being an efficient legal instrument for the purposes of tax integration, also counters tax evasion through information exchange and mutual assistance in revenue collection programs conducted by both contracting States. The question remains however, up to which extent does the treaty exert positive influence on mutual economic development, foreign direct investment and bilateral trade in connection to the legal, economic and sovereign certainty provided. Germany, as a capital exporting nation has much to gain from its positioning on a key market within the Latin-American region; while Mexico, as a capital import nation, in addition to global market diversification, subsequent emancipation from the North American markets may turn into a major regional investment hub. In spite of the fructiferous commercial and political relations enjoyed by both States, this investigation aims to illustrate the potential impact that the relief of double taxation has on the increase of bilateral trade, export-imports and foreign direct investment, which aims to strengthen the mutual economic and political of the two thriving Nations.
States, as sovereign entities, hold the faculty of levying taxes on the total income generated by its residents out of national or foreign sources, in order to be able to sustain public finances and national development projects.\textsuperscript{1} To achieve this goal, States adopt a universal taxation approach, according to which the revenue generated out of any economic activity, assets and transactions, is subject to tax imposition in a proportional, equitable and progressive way without regard to the actual location of the asset or the source of income.\textsuperscript{2}

1.1 Overview of the International Double Taxation issue

Double taxation is an issue regulated under international tax law, seeking to allocate or limit tax rights between States through both domestic provisions and international agreements.\textsuperscript{3} Traditionally, the universal approach aims to tax all of the revenues that directly benefit a taxpayer; however, as a result of globalization and global economic interdependence the taxation rights on the total wealth of an individual cannot longer be allocated to a certain jurisdiction.\textsuperscript{4} The taxpayer is then subject to a double tax imposition on the basis of both its territorial and economic ties to two States, which leads to a conflict of overlapping tax interests and lack of legal certainty to its detriment.\textsuperscript{5} Under international tax law rules, residence and the source of income are the main criteria to take into account over the limited concepts of territoriality and nationality.\textsuperscript{6} On this regard, a resident may engage into a commercial activity, have its center of vital

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\textsuperscript{1} Rose, Gerd. (2003). \textit{Gründzuge des Internationalen Steuerrechts} (Vol. 5). Wiesbaden: Gabler Verlag. PP.24 \\
\textsuperscript{3} Rose, Gerd. (2003). \textit{Gründzuge des Internationalen Steuerrechts} (Vol. 5). Wiesbaden: Gabler Verlag. PP.21 \\
\textsuperscript{4} Hernandez Jimenez, Carlos, Najera Martinez, Ivonne, & et.al. (2009). Los convenios para evitar la doble tributacion firmados por los Estados Unidos Mexicanos y su influencia en los precios de transferencia (Contador Público), Instituto Politécnico Nacional, México D.F. PP.8 \\
\textsuperscript{5} Hernandez Jimenez, Carlos, Najera Martinez, Ivonne, & et.al. (2009). Los convenios para evitar la doble tributacion firmados por los Estados Unidos Mexicanos y su influencia en los precios de transferencia (Contador Público), Instituto Politécnico Nacional, México D.F. PP.9 \\
\end{flushleft}
interests, or assets within a state and therefore be taxed in connection to his economic interests without necessary being a national.\textsuperscript{7}

The lack of multilateral coordination of fiscal policies and legal frames unavoidably result in a direct economic impact to taxpayers, which in turn discourages foreign investments and undertakings in foreign territories, ultimately resulting in an opportunity loss for a State to develop new economic activities and hence collect revenue out of them.\textsuperscript{8} From the legal perspective, double taxation can be seen as the fiscal subjection on comparable taxes levied by two or even more States on the wealth, assets, capital and transactions that benefit a unique taxpayer during the same period of time.\textsuperscript{9} Therefore, due to the convergence of the universality and income source principles applied by States, it is very likely that a taxpayer will see his capital diluted through the obligation to pay taxes on the same income.\textsuperscript{10} The legal overlap that originates the problem of double taxation, although addressed in local legislation, can be better mitigated through tax treaties aiming to allocate faculties among sovereign States claiming the tax rights on the income given to the source and residence principles taxes an amount or certain income.\textsuperscript{11}

1.2. Historical background, nature and impact of the OECD model treaty

After numerous attempts to successfully delimit and allocate taxation rights equitably among States, it was clear that international public law and international organizations would play a major role in solving such issues; ever since, through the creation of the Organization for Economic Co-operation and Development in 1961 its current 34 adherent States have strived to cooperate in achieving economic growth and

\textsuperscript{7} OECD Model Tax Convention. Section 4.
\textsuperscript{9} Aguilar Perez, Araceli, Del Carmen Diaz Vazquez, Maria, & et.al. (2005). Tratado para evitar la doble tributación México Bélgica. (Contador Público), Instituto Politecnico Nacional, México D.F. PP.48
\textsuperscript{11} Rose, Gerd. (2003). Gründzuge des Internationalen Steuerrechts (Vol. 5). Wiesbaden: Gabler Verlag. PP.23
substantially increasing international trade. This international platform provides the opportunity for States to analyze and seek solutions for pressing global issues that range from public policy to tax issues, in order to incentivize mutual economic growth as well as integration in the global economy and international trade consolidation through the harmonization of domestic and international legislations.

In the international taxation field, the commitments reached within the OECD frame came soon to be formalized though the implementation of a Model Convention along with related texts and commentaries, considered as the ideal vehicle to achieve a uniform and equitable system of international taxation. It was nevertheless to be considered that differences in economic and legal systems, as well as political relations would hinder the application of a unique enforceable tax treaty. Taking the above into account, the OECD’s Committee on Fiscal Affairs took the initiative to introduce in 1963 the aforementioned Model Tax Convention, which, along with a set of detailed comments on the articles, contained general yet reasonable guidelines for the elaboration and application of multilateral tax treaties.

The model convention and its commentaries currently serves as a general legal document, which establishes a general set of rules for sovereign States to take into account when drafting agreements for the avoidance of double taxation and of capital evasion. However, as a model and general instrument, the OECD convention and its commentaries are not legally binding on any member state until a personalized treaty has been drafted. Furthermore, following the principles of international public law, a tax

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treaty is only valid and therefore enforceable, once the instrument has been ratified by the chamber of representatives of the contracting States, having previously engage into negotiations in order to adapt the convention according to their internal legal frame and mutual goals and commitments.

A subscribed bilateral tax treaty has the potential to generate positive effects on mutual relations, which include growth of foreign direct investment, internationalization of commercial activities, diversification of markets for both legal and natural persons as well as the eventual consolidation of key national economic activities within the global economy. Within its provisions, States agree on a set of rules and undertakings regarding the taxation rights on the wealth generated by a company, as well as regulating its prices of transference with foreign subsidiaries, whether the case be a re-distribution of dividends to shareholders, interests paid on debt or capital gains on assets. Treaties fulfill an additional purpose as they establish bilateral measures for mutual assistance procedures in tax collecting and prevention of tax evasion.

1.3. Treaty making process and entry into force under Mexican and German Law

Treaty making follows an established process under international law, which includes the stages of negotiation, text drafting, executive approval, legislative review, ratification and entry into force. Under the Mexican legislation, international treaty-making procedures are hierarchically regulated by the Constitution, the Civil Code, the Organic Law of the Federal Public Administration and Organic Law of the Mexican Foreign Service an the Law on International Treaties. On this regard the President holds the faculty to lead and implement international policy, on strict observance of the national

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21 OECD Model Tax Convention. Sections 7, 9, 10.
22 OECD Model Tax Convention. Sections 25, 26, 27.
24 Aguilar Perez, Araceli, Del Carmen Diaz Vazquez, Maria, & et.al. (2005). Tratado para evitar la doble tributación México Bélgica. (Contador Público), Instituto Politecnico Nacional, México D.F.
sovereignty and to the benefit of the Mexican population.\textsuperscript{25} His participation through, the bilateral exchange of signatures with his foreign counterpart reaffirms the States’ commitment for cooperation, which is formalized through its ratification by the legislative branch in order to endow the treaty with legal effects.\textsuperscript{26} As a non-obligatory formality, the Ministry of Exterior surrenders the signed treaty along with an explanatory memorandum to the Ministry of Interior for its co-approval, and later sends the final document to the Senate for its ratification.\textsuperscript{27} The Senate then discusses the contents and decides, on behalf of the State, to approve the contents for their immediate entry into force or to reject its application by making recommendations on the contents.\textsuperscript{28} If the treaty is approved, the Senate issues a decree enabling the President to order the publication of the favorable resolution and the contents of the treaty on the Official Gazette of the Mexican Federation,\textsuperscript{29} for his official ratification and entry into force.\textsuperscript{30}

Parallel to the Mexican approach, the German President is the authority in charge of conducting Germany’s external policy\textsuperscript{31} having the duty to “…represent the Federation for the purposes of international law… conclude treaties with foreign States on behalf of the Federation… (and) accredit and receive envoys.”\textsuperscript{32} By the power vested on him by the constitution, he initiates the ratification process by submitting the treaty’s final text to the Bundesrat, which shall in turn be entitled to comment on the content in regard to its extent, and forward it to the Bundestag for its approval.\textsuperscript{33} If the contents satisfy the Bundesrat’s criteria, the treaty shall be returned to the Federal Government, which shall in turn submit the contents along with it’s own comments and views on the matter, within

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\item Constitución Política de los Estados Unidos Mexicanos, Constitution of the United Mexican States. Section 89, subsection X.
\item Constitución Política de los Estados Unidos Mexicanos, Constitution of the United Mexican States. Sections 76 subsection I.
\item Deutsches Grundgesetz, German Basic Law. Section 26.
\item Deutsches Grundgesetz, German Basic Law. Section 59.
\item Deutsches Grundgesetz, German Basic Law. Section 76, subsection II.
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three to nine weeks, depending on how urgent and complex the treaty’s content is, to the Bundestag for its vote and consideration within reasonable time.\footnote{Deutsches Grundgesetz, German Basic Law. Section 76, subsection III.}

Once the Bundestag has approved the treaty, the Federal President certifies the treaty contents through an official instrument of ratification holding his signature and that of the second subscribing State’s leader, for its promulgation in the German Federal Gazette.\footnote{Section 82, subsection I, Deutsches Grundgesetz, German Basic Law.} Once formally ratified the treaty will enter into force and therefore be legally binding, on date stipulated in the promulgation instrument, applying a fourteen-day threshold after its promulgation in any other case.\footnote{Section 82, subsection II, Deutsches Grundgesetz, German Basic Law.}

\section*{1.4. National legal hierarchy of international treaties and application}

The Mexican Federal Constitution grants international treaties the same hierarchical level as federal laws and a special quasi-constitutional status if its content relates to the recognition and enforcement of human rights.\footnote{Robledo, Sandra Valdés. (2012). Los Tratados Internacionales en México. Subdirección de análisis de política exterior, Camara de Diputados, I(1), 87.} The Constitution further states that international treaties form part of the “supreme law of the whole Union.”\footnote{Section 133, Constitución Política de los Estados Unidos Mexicanos, Constitution of the United Mexican States.} On this regard, the Mexican Supreme Court of Justice addressed the matter and reached the conclusion that, international law ranks on the same level as federal law, having even the capacity to override it.\footnote{Mexican Supreme Court’s Jurisprudence; XXV, Abpil de 2007; Page: 6; Tesis: P. IX/2007; Thesis; Topic: Constitutional. Available at: http://www.scjn.gob.mx/Paginas/Inicio.aspx} The court’s decision included as Annex I reads as follows:

INTERNATIONAL TREATIES. Are part of the supreme law the union and are hierarchically allocated above the general, federal and local law. Constitutional article 133 interpretations.\footnote{Mexican Supreme Court’s Jurisprudence; XXV, Abpil de 2007; Page: 6; Tesis: P. IX/2007; Thesis; Topic: Constitutional. Available at: http://www.scjn.gob.mx/Paginas/Inicio.aspx}
On the other hand, the German Basic Law states that international legal instruments are to be considered as an integral part and of Federal Legislation. Both classes rank however not on the same hierarchical level as expressly stated, for “…they (international laws) shall take precedence over the laws and directly create rights and duties for the inhabitants of the federal territory.”

Following the contents its Article 79, the German Basic Law allows international treaties to reform its content by adding explanatory language and fundamental principles to the Basic Law statutes without adherence to the otherwise strict amendment principles to the extent that such amendments help in clarifying the treaty’s entry into force when its content addresses “…a peace settlement… or (is) designed to promote the defense of the Federal Republic…” In addition, international law may influence the country’s emergency measures during a State of Tension for the protection of civilian population, to the extent that such measures must not observe further formalities if “such legal provisions… (Be) made by an international body within the framework of a treaty of alliance with the approval of the Federal Government.” The Basic Law further addresses any possible conflict of law on its Article 100, stating that in case of doubt regarding the integration of an International Treaty to Federal Legislation, federal courts should refer to the Federal Constitutional Court for a final binding decision on the matter.

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41 Deutsches Grundgesetz (German Basic Law) Section 25.
42 Deutsches Grundgesetz (German Basic Law) Section 25.
43 Deutsches Grundgesetz (German Basic Law) Section 31.
44 Deutsches Grundgesetz (German Basic Law) Section 79.
45 Deutsches Grundgesetz (German Basic Law) Section 80, subsection a, paragraph 3.
46 Deutsches Grundgesetz (German Basic Law) Section 100.
SECOND CHAPTER

Corporate Income Tax in the United Mexican States and the Federal Republic of Germany

The tax monopoly faculties exercised by both States derivate from their respective supreme law, which in turn further empowers their legislative organs to establish new fiscal measures and taxes in order to maintain public finances and internal development. In the light of the above, Taxpayers in both countries enjoy legal certainty and are subject to a proportional fiscal burden based on pre-established indicators that take into account variables such as the expenses made to generate the income as well as any losses incurred during the normal course of business.

1. National legal basis for corporate income taxation

Under article 31, paragraph IV of the Mexican Constitution, every citizen has the obligation to “… contribute to the public expenditures of the Federation, and the State and Municipality in which they reside, in the proportional and equitable manner provided by law.” Although every citizen holds equal rights and obligations pursuant to the fulfillment of legal prerequisites of a given tax class, the Mexican government relies on a progressive tariff system, meaning that the extent of contributions and rates is directly proportional to the income of the passive subject according and its economic capacity. Furthermore, in order to grant legal certainty to taxpayers, the Federal Fiscal Code states on its first article that only through a congress approved law can a certain tax be enforced and levied on the income of the target population. Such legal instrument must then be duly motivated and include fixed tax rates, its calculation process, payment schedules and

47 Deutsches Grundgesetz,(German Basic Law) Section 105.
48 Constitución Política de los Estados Unidos Mexicanos,(Constitution of the United Mexican States) Section 31, subsection IV.
49 Körperschaftssteuergesetz (German Corporate Income Tax Law) Section 10.2.
50 Constitución Política de los Estados Unidos Mexicanos,(Constitution of the United Mexican States) Section 31, subsection IV.
51 Mexican Supreme Court’s Jurisprudence; Proporcionalidad y Equidad Tributarias establecidas en el artículo 31, fracción IV, XXV, April de 2007; Page: 113; Tesis: P. IX/2007; Jurisprudence; Topic: Constitutional. Available at: http://www.scjn.gob.mx/Paginas/Inicio.aspx
ultimately, the prerequisites or economic activities subject to imposition for a specific public spending in order to be deemed legal.\textsuperscript{52} The code further stresses that fact that only through fulfillment of specific factual or legal situations by the taxpayer can taxes be levied on its income, meaning that taxes cannot be arbitrarily levied.\textsuperscript{53}

The Mexican revenue system (Servicio de Admistración Tributaria) is empowered to levy taxes on income to both legal and natural persons\textsuperscript{54} pursuant to the the Federal Income Tax Law which further states on its first article that all persons residing in Mexico, regardless of the source or their income are subject to the payment of income tax for the development of the nation.\textsuperscript{55} In addition, all residents abroad that operate and generate earnings within Mexican territory through a permanent establishment are also compelled to pay income tax only on the proportional share of profits generated through the economic activities of such establishment.\textsuperscript{56} The Mexican State thus, adopts a universal tax approach as it has the faculty to collect taxes on the revenue of both its residents and foreign companies operating through a permanent establishment.\textsuperscript{57}

The German state holds the power to legislate and to exercise its fiscal monopoly to tax the income generated by its residents\textsuperscript{58} applying and unlimited (unbeschränkte) approach disregarding its source, pursuant to section 1.1 EStG.\textsuperscript{59} The right to levy taxes on income is coordinated between the federation and the federal States (Länder), according to a set distribution key, in order to minimize the burden on taxpayers by avoiding double taxation on different government levels.\textsuperscript{60} The German Fiscal Code is in turn the legal instrument that grants legal certainty to taxpayers as it punctually States that only through legislation can taxes be deemed valid and collected\textsuperscript{61}, which in turn

\textsuperscript{52} Codigo Fiscal de la Federacion. (\textit{Mexican Fiscal Code}) Section 1.
\textsuperscript{53} Codigo Fiscal de la Federacion. (\textit{Mexican Fiscal Code}) Section 4.
\textsuperscript{54} Ley del Servicio de Administración Tributaria (\textit{Internal Revenue Service Law}) Section 2.
\textsuperscript{55} Ley del Impuesto Sobre la Renta. (\textit{Mexican Income Tax Law}) Section 1.
\textsuperscript{56} Ley del Impuesto Sobre la Renta. (\textit{Mexican Income Tax Law}) Section 2, paragraph 1.
\textsuperscript{57} Ley del Impuesto Sobre la Renta. (\textit{Mexican Income Tax Law}) Sections 1 and 2.
\textsuperscript{58} Deutsches Grundgesetz. (\textit{German Basic Law}) Section 106.
\textsuperscript{61} Abgabeverordnung. (\textit{German Tax Code}). Section 4.
shall only be levied on “…those who fulfill the statutory requirements for the tax liability, in order to generate income.”62

Germany considers the personal ability to pay as the general principle to determine the taxpayers’ fiscal obligations, based on indicators such as income, total assets or consumption being taken into account to calculate the imposition according to a progressive income taxation model in which higher resources signify a proportionally higher tax payment.63 Taxpayers in different economic situations will be subject to different tax regimes and rates in proportion to their corresponding indicators, while on the other side taxpayers in equal economic situations will be taxed on an equitable basis without further prerogatives or special treatments.64 Resident or operating companies in Germany have the constitutional duty to pay taxes on “…income and corporate surpluses”65, the Corporate Income Code enlists a number of legal entities, including public limited and limited liability companies, which are subject to corporate income tax on the basis of their effective place of management66 or their domicile67. Residing companies are taxes on the principle of global income taxation being unlimitedly liable whether the source of its income is national or foreign.68

2. Fiscal residency and Permanent Establishment

Residence plays a key role in determining the tax liabilities of a corporation towards a given State, beginning in parallel to its legal capacity upon registration in any given national commercial register and coming to an end with the cancelation of such registry following willful dissolution or liquidation.69 Various approaches have been established to establish residence, including the physical allocation of the assets and place

62 Abgabeordnung. (German Tax Code). Section 3, Subsection I.
65 Deutsches Grundgesetz, German Basic Law. Section 106, subsection 1, paragraph 6.
66 Abgabeordnung. (German Tax Code) Section 10.
67 Abgabeordnung. (German Tax Code) Section 11.
68 Korperschaftsteuergesetz. (German Corporate Income Tax Law) Section 1, subsection 2.
of trade\textsuperscript{70}, the place of registration determined by law or by the articles of association\textsuperscript{71} and to a more specific extent, the place of effective business management\textsuperscript{72}. To this extent a given corporation will be subject to the jurisdiction of the German revenue authorities if its business management activates are located within German territory.\textsuperscript{73} Should this trait be difficult to address, the authority shall then resort to the allocation of the majority of the taxpayer’s assets in order to exercise it’s jurisdiction, examining whether “…the activity is or has been predominantly performed or exploited within the (German) territory…”\textsuperscript{74} in order to be entitled to levy taxes on the business profits and transactions conducted by a company. A legal person can additionally be subject to German corporate income tax if it conducts business within German territory through a permanent establishment, defined as “…any fixed place of business or facility serving the business of an enterprise”\textsuperscript{75}. The presence of assets within the territory is nevertheless not a sine-equanon precondition for tax liability as a natural person who, by being subject to instructions, sustainably conducting business on its behalf or by maintaining stocks of goods would become a permanent representative to the company.\textsuperscript{76}

The Mexican Fiscal Code follows an equivalent approach to its German counterpart, as residence of legal persons is mainly determined by the “main center of business interests.”\textsuperscript{77} It further adds that the fiscal authorities will have the power to conduct valuations and hearings at the establishment where the majority of assets and properties belonging to the company are located in case the company fails to submit a valid place of residence or incurs into forum shopping practices.\textsuperscript{78} On spite of the above, the Federal Income Tax Law (Ley del Impuesto sobre la Renta) points that legal persons are liable to tax payments on their universal income should they be registered, or hold their center of managerial interests within Mexican territory.\textsuperscript{79} Foreign companies shall in

\textsuperscript{70} Abgabeordnung. (German Tax Code) Section 8.
\textsuperscript{71} Abgabeordnung. (German Tax Code) Section 11.
\textsuperscript{72} Abgabeordnung. (German Tax Code) Section 10.
\textsuperscript{73} Abgabeordnung. (German Tax Code) Section 20.
\textsuperscript{74} Abgabeordnung. (German Tax Code) Section 20.
\textsuperscript{75} Abgabeordnung. (German Tax Code) Section 12.
\textsuperscript{76} Abgabeordnung. (German Tax Code) Section 13.
\textsuperscript{77} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 2.
\textsuperscript{78} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 4.
\textsuperscript{79} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 1.
addition be regarded as Mexican residents for tax purposes, if they conduct business within the country through a permanent establishment, or in the case that they generate wealth out of the country’s economic sources.\textsuperscript{80}

For the purposes of Mexican Income Tax liability, a permanent establishment shall be deemed to be “any place of business in which economic and managerial activities, as well as independent personal services take place partially or as a whole… including among others branches, agencies, offices, factories… or any place of exploration, extraction or employment of natural resources.”\textsuperscript{81} Notwithstanding the above, a foreign legal person may have tax liability, even without holding assets or a permanent establishment per se within the jurisdiction, if it conducts business through a person other than an independent agent, empowered to celebrate contracts with legal faculties to represent the corporation in the realization of its economic activities in Mexican territory.\textsuperscript{82} Any person who, in addition to being subject to direct instruction, holds stock of goods, assumes risks or effectuates economic activities on behalf of a legal person will therefore constitute a permanent establishment and source of taxation for the latter.\textsuperscript{83} A subordinate relationship between the corporation and the agent shall be presumed if the later receives monetary compensation regardless of the achieved results or agrees to pricing schemes that differ from those that would have applied in similar non-related transactions.\textsuperscript{84}

3. Bilateral Corporate Income Tax Calculation Procedures

3.1 German corporate income tax model

German corporate income tax is a classified as a personal subject tax levied on a proportional rate based on the direct yearly earnings of a company.\textsuperscript{85} The corporate income tax law (KStG) serves as the prime legal frame upon which corporate taxation is

\textsuperscript{80} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 1, subsections II and III.
\textsuperscript{81} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 2.
\textsuperscript{82} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 2, paragraph II.
\textsuperscript{83} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 2 paragraph V.
\textsuperscript{84} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 2.
based as its statutes regulate the applicable methods to calculate the taxable income, the applicable tax rates and the resulting burden to be covered by the company, in addition to establishing the rules for the application of carry forward loses, deductions and other benefits. The aforementioned law is complemented by the general income tax law for purposes of concept clarification, application of general tax rules as well as proceedings. This duality of law application does not endow corporations, however with a separated personal legal sphere, reason for which authorized deductions are limited in comparison to natural persons (health insurance, alimonies, etc.) For taxation purposes, separability does exist between the legal sphere of the company and that of its shareholders regarding taxes on profit already collected at a company level, which nevertheless do not increase shareholder’s fiscal liability on the already paid amounts. Such is the case of dividend payment, as the amount paid is subject to taxation both at company and shareholder’s level due to the amounts being distributed.

In addition to having tax liability on business revenue, capital and other types of income as listed on S.2 EStG, corporations are obliged to maintain and adequate and ordered bookkeeping pursuant to S.238 of the German Commercial Code (HGB), “on the basis of the asset comparison model”. Upon certain additions and restrictions to expenses, a derivative tax balance sheet is obtained from the annual commercial balance sheet. As for the payment scheme, the general income tax law states that corporate tax is an annual tax, which is calculated on the taxable income of the corresponding year, such income is calculated following the guidelines used by natural persons, complemented by the contents of S.8.1 of the corporate income tax.

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87 Einkommensteuergesetz. (German Income Tax Law) Section 3, subsection 1.
90 Einkommensteuergesetz. (German Income Tax Law) Section 20, subsection 1.
91 Einkommensteuergesetz. (German Income Tax Law) Section 5 subsection 1.
93 Einkommensteuergesetz. (German Income Tax Law) Section 7, subsection 3.
94 Einkommensteuergesetz. (German Income Tax Law) Section 7, subsection 1.
3.1.1 Determination of corporate revenue and taxable base

Although certain transactions and profits are reflected in company’s balance sheet they are disregarded as accumulative income under tax law provisions, reason for which they are excluded, ultimately resulting in different income results related to both balance sheets. On the other side, there are transactions that even though may qualify as expenses are not to be treated as such due to their nature; thus, disbursements such as the immediate accrual of capital losses and production costs for commercial law purposes, must not be recorded outside the tax balance sheet and are not accounted as an expense for accounting purposes. For liquidity purposes the authorities require advance quarterly payments of the yearly corporate income tax, made in March, June, September and December the 10th, which shall additionally not reduce the corporate profits for the calculation of the yearly tax, even if they were already subtracted from the balance sheet.

In addition to the above, unreasonable payments disbursed by a company to third or related parties are treated as concealed profit distributions, which may not reduce taxable income and must be declared and added back to the tax balance sheet notwithstanding its recognition as expense in the income statement. On this respect S.36 of the Income Tax Guidelines (KStR) enlists the alternative forms of concealed distribution based on the arm’s length compliance of the transaction, establishing that only the resulting price discrepancy between the amount paid and the market value of the transaction is to be added to the corporate income. On the other hand, payments made to a company by a related party without due consideration and pursuant to a close relationship, are deemed as constructive equity contributions and shall not be taken

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96 Handelsgesetzbuch. (German Commercial Code) Section 249, subsection 1.
97 Handelsgesetzbuch. (German Commercial Code) Section 255.
100 Korperschaftsteuergesetz. (German Corporate Income Tax Law) Section 8, subsection 3, paragraph 2.
101 Korperschaftsteuergesetz. (German Corporate Income Tax Law) Section 36.
into account for any increasing when calculating the corporate income.\textsuperscript{102} These types of contributions are rather to be recorded outside the balance sheet rendering the involved parties to a position where the contribution did not take place.\textsuperscript{103} Capital contributions made by a corporation to a related company as in the case of conglomerates are deemed as direct investment earnings, which are exempted from taxation, insofar as the amount distributed originates from an internal source, which has already been taxed at the general corporate level.\textsuperscript{104} Additionally, the income generated out of the disposal of shares in national or international markets is regarded as a total distribution of profits and therefore tax-exempted.\textsuperscript{105} Ultimately both kinds of profits must be reduced outside the commercial balance sheet to decrease tax liability on corporate profits.\textsuperscript{106} 

Company expenses may be deducted when determining its taxable income if it can be proved that such amounts were disbursed in order to cover operative expenses related to the company’s economic activities as described under its articles of association.\textsuperscript{107} Nevertheless, expenses made to cover statutory and tax liabilities cannot be deducted; this, in addition to criminal, civil or punitive fines and fifty percent of the remuneration awarded to the members of the supervisory board (Aufsichtsrat).\textsuperscript{108} The aforementioned expenses should then be increased in the tax balance sheet, as even though they are deemed to be corporate expenses, they are disregarded as such and do not decrease tax liability.\textsuperscript{109} Pursuant to the supplementary application of the EStG further non-deductible expenses arise in addition to the aforementioned; hence, bribes and gifts made by the company to non-employees over an amount of 35 euros per person per year as well as more than seventy percent of the company’s entertainment expenses, are not to

\textsuperscript{102} Korperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 40, subsection1.
\textsuperscript{104} Korperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 8, subsection b, paragraph1.
\textsuperscript{105} Korperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 8, subsection b, paragraph1.
\textsuperscript{108} Korperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section10 subsection C paragraphs 1 to 4.
Furthermore a lump sum of five percent of the amounts allocated among related companies as direct investment as well as any tax-exempt disposal profits related to S.8b.2 KStG cannot be deducted from profits. The calculation procedure for the assessment of the yearly Mexican corporate income tax is described in figure 1:

Figure 1: Calculation chart for the yearly corporate income tax in Germany

<table>
<thead>
<tr>
<th><strong>Commercial balance sheet profit</strong></th>
<th>(+/-) Modifications by special provisions of fiscal profit determination (Secs. 4-7k EStG, Sec. 60 EStDV)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax balance sheet profit</strong></td>
<td>(+) Concealed profit distributions</td>
</tr>
<tr>
<td></td>
<td>(-) Constructive equity contributions</td>
</tr>
<tr>
<td></td>
<td>(-) Tax exempt direct investment income (Sec. 8b (1) KStG)</td>
</tr>
<tr>
<td></td>
<td>(+) Non-deductible expenses (Sec. 10 KStG)</td>
</tr>
<tr>
<td></td>
<td>Expenditures for statutory or other purposes (no.1)</td>
</tr>
<tr>
<td></td>
<td>Personal taxes (no.2)</td>
</tr>
<tr>
<td></td>
<td>Pecuniary penalties (no.3)</td>
</tr>
<tr>
<td></td>
<td>Half of the remuneration for the members of the supervisory board (no.4)</td>
</tr>
<tr>
<td>(=) <strong>Total Income</strong></td>
<td></td>
</tr>
<tr>
<td>(-) Deductible portion of the donations (Sec.9 (1) no. 2 KStG)</td>
<td></td>
</tr>
<tr>
<td>(=) <strong>Total Revenue</strong></td>
<td></td>
</tr>
<tr>
<td>(-) Loss deduction (Sec.8(1) KStG, Sec. 10d EStG)</td>
<td></td>
</tr>
<tr>
<td>(=) <strong>Income</strong></td>
<td></td>
</tr>
<tr>
<td>(-) Tax allowences for certain corporations (Secs. 24, 25 KStG)</td>
<td></td>
</tr>
<tr>
<td>(=) <strong>Taxable Income</strong></td>
<td></td>
</tr>
<tr>
<td>Rate of taxation according to Sec. 23 KStG</td>
<td></td>
</tr>
<tr>
<td>(=) <strong>Corporate income tax to be assessed</strong></td>
<td></td>
</tr>
<tr>
<td>(-) Creditable corporate income tax</td>
<td></td>
</tr>
<tr>
<td>(-) Creditable capital gains tax (interest rebate)</td>
<td></td>
</tr>
<tr>
<td>(=) <strong>Remaining corporate income tax</strong></td>
<td></td>
</tr>
</tbody>
</table>

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110 Einkommensteuergesetz. (German Income Tax Law) Section 4, subsection 5.
111 Körperschaftssteuergesetz. (German Corporate Income Tax Law) Section 8, subsection B, paragraphs 3 and 5.
112 Figure 1 source: Djanani, C., Brähler, G., & Lösel, C. (2007). German Income Tax: Personal Income Tax, Corporate Income Tax and Trade Tax: Verlag Recht und Wirtschaft
Once the previous economic criteria has accordingly increased or decreased the corporate balance sheet the total corporate income will be obtained. The corporate income may be further reduced from the tax balance sheet if the company incurs into operating expenses such as authorized donations given for special purposes. In the light of the above, disbursements made by a company to support non-profit organizations, such as churches, foundations, academic institutions or research facilities can be deducted as long as they don’t exceed up to twenty percent or four parts over a thousand of the company’s annual income before taxes. To this extent, once authorized deductions are subtracted from the company’s corporate income the total corporate revenue will be obtained upon which the yearly tax due can be calculated.

3.1.2 Calculation of the total corporate income tax due

In order to determine the assessment basis of the corporate income tax payable on the fiscal year, losses incurred in past fiscal years are to be subtracted from the total corporate revenue generated in the current tax periods with the opportunity to carry them forward and apply them future assessment period until. Pursuant to sections 8.1 KStG in conjunction with 10d EStG, up to 1 000,000 euros may be deducted from the total income in the assessment period preceding the current assessment period for loss carryback purposes. Nevertheless, companies can be deprived from the partial deduction of the remaining carry forward losses to the extent that they have sold or transferred between 25 and 50 percent of their outstanding registered share capital within five consecutive years, in which case losses shall forfeit in a direct proportion to the

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114 Körperschaftsteuergesetz. (German Corporate Income Tax Law) Section 9, subsection 1.
118 Einkommensteuergesetz. (German Income Tax Law) Section 10, subsection D, paragraph 1.
alienation of company shares.\textsuperscript{120} In addition to the above, a full forfeiture shall occur in the event that over 50 percent of the company’s capital shares are transferred within the aforementioned period.\textsuperscript{121} Any transfer of ownership shall not affect the application of carry forward losses if such sale had the purpose to obtain financial resources under turn around business strategy aimed to further preserve jobs under fair conditions.\textsuperscript{122}

Upon the application of the authorized corporate deductions to the corporate’s balance sheet, the \textbf{taxable income} of the company will be obtained and will in turn be subject to \textbf{tax rate} of 15 percent.\textsuperscript{123} The amount resulting from the application of the current tax rate reflects the corporate income tax due, which is generally offset by quarterly advance payments made by the company on the first day of March, June, September and December as mandated by sections 8(1) KStG and 37.1 EStG in order to both secure liquidity for public finances, and to avoid a considerable disbursement in one exhibition.\textsuperscript{124} In connection to the income tax to be paid, German authorities hold the right to withhold source taxes as soon as the activities giving rise to them take place, as in the case of taxes on capital gains, interest rebate, dividend distribution and the personal income tax generated by employees.\textsuperscript{125}

The total amount to pay on \textbf{corporate income tax} ultimately arise from discounting the taxable income by the applicable tax rate, the result of which may be further reduced, by crediting the already covered advance payments of \textbf{corporate income tax and capital gains tax}.\textsuperscript{126} The quarterly advance payments on income tax as well as the aforementioned withheld source taxes are taken into account towards the yearly income tax liability, being thus creditable pursuant to sections 8(1) sent.1 KStG as well as

\begin{itemize}
\item \textsuperscript{120} Körperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 8, subsection C, paragraph 1
\item \textsuperscript{121} Körperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 8, subsection C, paragraph 1
\item \textsuperscript{122} Körperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 8, subsection C, paragraph 1a.
\item \textsuperscript{123} Körperschaftssteuergesetz. (\textit{German Corporate Income Tax Law}) Section 8, subsection C, paragraph 1.
\item \textsuperscript{125} Einkommensteuergesetz. (\textit{German Income Tax Law}) Section 43.
\end{itemize}
36(2) sent.1 EStG, upon which the **remaining corporate income tax** amount will signal the remaining fiscal liability or the amount to be refunded.\(^{127}\)

### 3.2 Mexican corporate income tax model

The Mexican corporate income tax is a direct yearly tax assessed on the company’s accrued profit out of its corporate activities during the fiscal year.\(^{128}\) The features, rates and legal basis for the applicability of corporate income tax is contained within the Federal Income Tax Code (LISR), which also enlists different criteria to relief the fiscal burden by allowing the crediting of authorized deductions, provisional payments and fiscal incentives related to specific economic.\(^{129}\) Corporate income tax is levied on a monthly basis through provisory payments that corporations calculate considering the income that has been generated up to the month of payment, and later multiplying the result by the profit ratio of the last fiscal year.\(^{130}\) The profit ratio is therefore calculated by dividing the amount resulting from the summation of the tax profit (utilidad fiscal), the immediate deductions (deducciones inmediatas) and the advance and return payments (anticipos y rendimientos) by the nominal income corresponding to the the immediate previous tax year.\(^{131}\) Provisory payments must in addition be covered in a monthly basis at the latest on the 17\(^{th}\) of the immediate following month.\(^{132}\)

Mexican corporations are subject to the fulfillment of subjective fiscal obligation in addition to the provisory and yearly tax payments.\(^{133}\) Legal persons must maintain a single entry arranged bookkeeping, which shall be maintained and supplemented by issuing and preserving tax receipts on every commercial operation conducted, which are

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\(^{128}\) Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 6 paragraph 5.


\(^{130}\) Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 14.

\(^{131}\) Victorio Dominguez, Juan Carlos. (2012). Ingresos de las personas morales del Régimen General de la LISR. Talleres PAF, I(1), 11.

\(^{132}\) Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 127.

\(^{133}\) Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 12.
to be presented to the Mexican revenue authorities for audit purposes. Furthermore, corporations shall fulfill declarative obligations by presenting both provisory and final tax declarations containing a fully detailed balance sheet, the calculation procedures used for the assessment of the corresponding tax payments as well as the pertinent financial and inventory statements. The calculation procedure for the assessment of the yearly Mexican corporate income tax is described in figure 2.

Figure 2: Calculation chart for the yearly corporate income tax in Mexico

<table>
<thead>
<tr>
<th>Commercial Balance sheet Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-/+ ) Special Provisions of fiscal determination (Sec.14 LISR)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accumulated Tax Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Workers' share on profits (PTU) (Sec.69 (1) LISR)</td>
</tr>
<tr>
<td>(-) Authorized Deductions (Sec.31 LISR)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Loss Deduction</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tax Fiancial Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>(x) Corporate income tax rate (Sec.10 LISR)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Corporate income tax due</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Provisory monthly payments (Sec.14 LISR)</td>
</tr>
<tr>
<td>(-) ISR withheld by financial institutions</td>
</tr>
<tr>
<td>(=) Remaining corporate income tax</td>
</tr>
</tbody>
</table>


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134 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 58.
135 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 31, subsection IV.
136 Victorio Dominguez, Juan Carlos. (2012). Ingresos de las personas morales del Régimen General de la LISR. Talleres PAF, I(1), 11
3.2.1 Determination of corporate revenue for tax purposes

In order to determine the initial tax base, companies considered as legal persons resident to the Mexican state must in the first instance determine their accumulated income through the addition of the total revenue obtained in cash, kind, goods and related financial credits during the fiscal year.\(^{137}\) Nevertheless, not all earnings registered in the corporate balance sheet are taken into account for tax purposes, as they don’t represent a direct profit on the performance of the company’s economic activities.\(^{138}\) On spite of the above, section 17 LISR allows for the exemption of the accrual of corporate income obtained though capital raises for related companies, contributions for shareholders’ losses as well as all translatable and indirect taxes paid, in addition to any virtual premium on asset appreciation obtained through revaluation of the capital of assets currently held.\(^{139}\) In a controlling company scenario, the amounts paid under the concept of dividends, capital gains and direct investment by a holding company to a Mexican related legal person, as well as the amounts paid by shareholders as capital raise and as constructive equity contributions, are further exempted from accumulation to the recipient company’s taxable income.\(^{140}\) However, even though Mexican legislation levies taxes on the universal income of resident companies, the taxable base should be limited up to the proportional amount of income generated through the permanent establishments of a foreign company in connection to the direct activities within the country.\(^{141}\)

The accumulated income perceived by the company shall consist on the profits generated through its business and economic activities, donations, prerogatives as well as any contributions whether in cash or kind, amounts which shall be added up to the corporate’s tax balance sheet in order to calculate the extent of its tax liability.\(^{142}\) Profits obtained by a corporation shall accumulate at different points pursuant to the nature of the income, in the specific case of profits generated through the sale of goods or

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137 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 17.
138 Mexican Supreme Court’s Jurisprudence; Renta. Qué debe entenderse por “ingreso” para efectos del título II de la ley del impuesto relativo. Thesis 1a. CLXXXIX/2006, 9a.Tomo XXV, Enero 2007; PP. 483
139 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 28.
140 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 17, paragraph 4.
141 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 17.
142 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 18.
performance of services, as an illustrative example, the resulting amounts shall accumulate and be added up to the tax balance sheet once a tax receipt of the transaction has been issued, the price has been paid partially or in full, or upon delivery or performance of the service or good.\textsuperscript{143}

Corporations must incur into a number of operating and administrative expenses in order to generate the profits to be taken into account for the calculation of the taxable base, reason for which they are entitled to \textbf{deduct corporate expenses} to the extent that they were disbursed for the fulfillment of its commercial purpose pursuant to its articles of association.\textsuperscript{144,145} Such deductibles expenses shall nevertheless be accumulated and registered under a single off-tax accounting system;\textsuperscript{146} in addition to be backed by tax receipts describing the amounts deducted.\textsuperscript{147} Moreover, the amounts contributed as non-remunerative donations made to qualified recipients and not exceeding 7 percent of the company last years’ taxable income are proportionally exempted from taxation.\textsuperscript{148} Corporations can hence deduct a number the specific expenses, being entitled to subtract the loss of revenue arising from discounts or refunds on merchandise and well as any expenses related to the sale of goods, social security quotas paid on behalf of employees, in addition to any complementary economic assistance granted to the workforce through the creation of parallel retirement, health or housing funds.\textsuperscript{149} Deductions may nevertheless, only be applied against the payment of the final annual tax as its application in provisional payments is not possible.\textsuperscript{150}

The \textbf{taxable income} shall be obtained by subtracting any applicable authorized deductions in conjunction to the amounts paid to the workforce as \textbf{share participation}

\begin{footnotesize}
\begin{enumerate}
\item[143] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 18, subsection I.
\item[145] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 31, subsection I.
\item[146] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 31, subsection 4.
\item[147] Código Fiscal de la Federación. (\textit{Mexican Fiscal Code}) Section 29 y 29 A.
\item[148] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 31
\item[149] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 29
\item[150] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 9a, subsection 2.
\end{enumerate}
\end{footnotesize}
on corporate profits pursuant to the constitutional right established in section 123. Additionally, the pending carry forward losses of the previous fiscal years arising from a negative a balance related to a greater number of deductions in respect to accumulated profits, shall also be subtracted from the taxable income. Distancing from the German legal frame, Mexican authorities limit the carry-loss period up to ten fiscal years; therefore, compelling corporations, when having a loss surplus, to apply the proportional deductible amount of losses during every possible consecutive fiscal year in order not to definitely forfeit the potential creditable amount. Deductions are a personal right of the company, reason for which its transmission to another legal person though merger, forfeits the losses; however, the possibility of proportionally allocating them pursuant to revenue and risk distribution remains feasible in case of a split-up.

The corporate income flat tax rate of 30 percent, applicable for the fiscal year of 2013, is then applied to the financial tax result obtained after subtracting the proportional deductible carry forward losses. As an exemption to the flat rate approach, a preferential tax rate reduced by 25 percent is applicable to companies that generate the totality of their profits primary economic activities such as farming, forestry or agriculture. The corporate income tax due will be obtained once the applicable tax rate has been discounted. The advance payments already covered by the company, in addition to any withheld taxes by financial institutions must be subtracted to the amount due in order to obtain the remaining corporate income tax be paid or the extent of the tax credit held if the corporation incurred into losses. Upon calculation of the total due tax, the company must submit the pertinent tax statements and fulfill his financial

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151 Constitución Política de los Estados Unidos Mexicanos, *Constitution of the United Mexican States*. Section 123, subsection X.
152 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 61, paragraph 1.
153 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 63.
154 Código Fiscal de la Federación. (Mexican Fiscal Code) Section 76.
155 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 61.
156 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 10.
157 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 11.
159 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 12.
liabilities through payment to the Mexican Tributary Administrative System (SAT) within the first three months of the immediate following year.  

4. International Treaties in National Tax Legislation

The German Fiscal Code acknowledges the primacy of the taxation agreements subscribed between the federal government and a foreign State over German federal laws, delegating its interpretation to the Ministry of Finance. The application of international tax treaties is deemed to be hierarchically superior to national legislation, restraining German tax provisions that conflict with the treaty’s scope of application once it has been ratified and has entered into force. In case of overlapping interests or ambiguity in their provisions or wording, Treaties may be subject to interpretation through ordinances issued by the Ministry of Finance, aiming to achieve a correct and fair allocation of taxation rights. On the other side the Mexican Tax Code punctually ranks the application of international tax agreements au pair to that of federal legislation; nevertheless, it still refers to the complementary application of its statutes “...in defect and without prejudice to what the international treaties, in which Mexico participates, may state.” It further states that Mexican authorities hold the faculty to regulate procedures that attain to the correct application and interpretation of a tax treaty in the event of conflicts arising from an accreditation request.
THIRD CHAPTER

Treaty Mechanisms for the Avoidance of Double Income Taxation

3.1 Scope of Applicability and General Definitions

Any corporation based in a contracting State, which conducts business and economic activities on the territory of the other contracting State, shall be deemed resident of both States and therefore be subject to tax obligations on its universal income under the statutes of both jurisdictions. As this clearly represents a financial disadvantage and discouragement to foreign investment, States strive to formulate mutual strategies on the allocation of taxation rights pursuant to the model provisions of the OECD Model Convention. As a general approach, business profits are first taxed by the source jurisdiction, which is understood as “… the place of existence or generation of revenue transmissible from a person to another, regardless of the place of celebration of any underlying legal act.” Foreign jurisdictions may nevertheless claim tax rights under different circumstances such as managerial activities conducted within its territory, or if the effective beneficiary in the event of profit distribution is resident to the aforementioned jurisdiction. As a result of this conflict of economic interests, corporate profits may be subject to double taxation, issue which is ultimately addressed by contracting States through international agreements in order to achieve a fair allocation of levying rights and incentivize the growth of economic and political relations.

166 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 1, subsection I.
167 Korperschaftssteuergesetz. (German Corporate Income Tax Law) Section 1, subsection I.
171 Alfaro Rodriguez, Natalia, & Salgado Riquelme, Viviana. (2003). La doble tributación internacional y su relación con los tratados de libre comercio. (Ingeniero en Información y Control de Gestión), Universidad de Chile, Santiago de Chile.
3.1.1 International Tax Residence

The in-force version of the tax treaty subscribed between the Federal Republic of Germany and the United Mexican States disregards nationality as a key factor to primarily determine tax liabilities to a corporation, States rather impose fiscal burdens to “...any person who, under the laws of that State, is liable ... by reason of domicile, residence, place of residence...”172. As previously stated, a corporation constituted in accordance to Mexican laws and having its main center of interests within Mexican territory shall henceforth become liable under such jurisdiction, as it becomes a national resident.173 In parallel, pursuant to the applicable German legislation, a corporation shall be deemed a national resident if it holds a fixed seat, was registered, or has its effective place of business administration within German territory.174 In spite of the above, the author is of the opinion that double taxation mainly arises when a corporation who is resident in a contracting State holds an important social participation on, or conducts business activities through a corporation allocated in the other contracting State.

The tax treaty establishes a set of tiebreaker rules that assist in the correct assessment of the concept of residence should a corporation be subject to fiscal obligations in both jurisdictions.175 The preponderant approach to determine corporate residence is bound to the place where the company holds its center of vital interests, being a combination of managerial and economic activities.176 In the event that the corporate’s center of economic interests be ambiguous, the treaty suggests the application of a territorial approach pursuant to the jurisdiction where corporate registration was performed or where the majority of the corporate immovable assets are allocated,

174 Abgabebestimmung. (German Tax Code) Sections 8, 10 and 11.
175 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 4, subsection I.
176 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 4, subsection 2.
pursuant to the treaty’s section 4, subsection 2c. In the unlikely event of uncertainty, section 4, subsection 3 gives express authorization to the competent national authorities to mutually determine the residence of a legal person on a discretionary basis.

### 3.1.3 Permanent Establishment

In accordance to the bilateral tax treaty’s statutes, a corporation will be tax liable in the second jurisdiction if it operates on its territory through a permanent establishment, which is defined as “… a fixed place of business through which the business of an enterprise is wholly or partly carried on.”

Therefore, companies conducting business and/or economic activities in both jurisdictions through a physical location, including but not limited to, branches, offices, factories or an agent acting beyond an independent status will be subject to double taxation. Nevertheless, the sole ownership of facilities does not represent a permanent establishment, under the following specific circumstances:

- “Use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise.
- Maintenance of a stock of goods or merchandise belonging to the enterprise for storage, display or delivery.
- Maintenance of a stock of goods for the purpose of being processed by another company.
- Maintenance of a fixed place of business for the purpose of purchasing goods or collecting information for the company.

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177 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 4, subsection 2C.
178 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 4, subsection 3.
179 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5, subsection 1.
180 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5, subsection 2.
- Maintenance of a fixed place of business to conduct any preparatory or auxiliary business activities.” 182

Under the treaty’s provisions, a permanent establishment may exist even in absence of a fixed business location, in the event that the foreign corporation conducts business activities within the territory of the other contracting state an agent of a non-independent status. 183 Hence, whenever such agent holds the authority to “…conclude contracts in the name of the enterprise, such enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes.” 184 Nevertheless, the participation of a dependent agent in the business activities of a company will not immediately represent a permanent establishment for the if the activities conducted by him are limited to those described by section 5, subsection 4 TTGM, which include but are not limited to the storage, display or purchase of goods on behalf of the represented company. 185

Additionally to the above, in the specific case of the commercial operations conducted by a insurance company in the State to which it is not a resident, a permanent establishment will be presumed if premiums are collected the territory of the other jurisdiction or if any risks are insured therein. 186 In the light of the above, it can be argued that even if a corporation holds total or partial control of a company resident in the second jurisdiction, this shall not be reason enough to constitute a permanent establishment in the foreign State if no income generating activities are conducted within its territory. 187 In the event of any ambiguity, the contracting States reserve the right to determine in which cases a permanent establishment shall be constituted, taking into

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183 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5 subsection 5.
184 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5 subsection 5.
185 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5 subsection 5.
186 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5 subsection 6
account a variety of elements such as the existence of a fixed place of business and the proportion of commercial activities conducted therein.\textsuperscript{188}

3.2 Generalities of International Corporate Income Tax

3.2.1 Business Profits and Capital Gains

As a general rule, the treaty grants exclusive levying rights on business profits and capital gains to the State where the effective beneficiary\textsuperscript{189} or alienator has its residence.\textsuperscript{190} However, when a company resident to a contracting State holds a permanent establishment abroad, the other contracting State to which the establishment is resident becomes entitled to tax the conglomerate’s profits proportionally to the extent that they where generated out of the economic sources located within it territory.\textsuperscript{191} Pursuant to the legal fiction scheme applied by the treaty, the holding company and its permanent establishments will be considered as independent and non-related legal persons, in order to calculate revenue and determine the allocation of taxation rights among States.\textsuperscript{192} By using the same approach however, capital gains obtained from the sale of either immovable property or more than fifty percent of the share capital of a company located in the other contracting State, are subject to taxation in the later as source jurisdiction.\textsuperscript{193}

Pursuant to special tax avoidance provisions, the contracting State in which the controlling company resides shall eliminate double taxation by completely renouncing to levy taxes on the profits generated by a foreign permanent establishment that have already been taxed by the other contracting State.\textsuperscript{194} Alternatively taxes already levied on corporate profits may be credited against the total corporate income tax

\begin{itemize}
\item[\textsuperscript{188}] Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 2.
\item[\textsuperscript{189}] Vega Borrego, Félix Alberto. (2005). El concepto de beneficiario efectivo en los convenios para evitar la doble imposición. Documentos-Instituto de Estudios Fiscales\textsuperscript{(8)}, 3-20.
\item[\textsuperscript{190}] OECD Model Tax Convention. Commentary on section 7.
\item[\textsuperscript{191}] OECD Model Tax Convention. Commentary on section 7 paragraph 1.
\item[\textsuperscript{192}] Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 7 subsection 2.
\item[\textsuperscript{193}] Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 13 subsections 1 and 2.
\item[\textsuperscript{194}] Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Sections 23 A.
\end{itemize}
assessed by the second jurisdiction, in the event that exemption impossibility. In connection to the above, expenses incurred by the holding company to maintain and operate its permanent establishment, including managerial and executive expenses, shall be allowed as deductions disregarding the jurisdiction in which they were disbursed.

The Model Contract on which the tax treaty is based, proposes a two-step tiebreaker rule to determine the correct allocation of profits between parent and controlled companies, firstly focusing on the proportion of the allocation of rights, obligations and risks between both companies. In a second instance, the adherence of intra-company transactions to the to the arm’s length principle is taken into account, meaning that the transactions made between related companies must observe market prices, in addition to observe the OECD’s transfer pricing guidelines. Both contracting States retain the faculty to determine the profits attributable to a permanent establishment of a foreign corporation pursuant to the mutual agreement procedure described in article 25 of the TTMG and the application of the arm’s length principle on transfer prices. It must however be considered that discrepancies in the tax calculation processes of the contracting States may hinder the complete elimination of double taxation on profits due to differences in “depreciation rates, timing of recognition of income, and restrictions on deductibility of certain expenses.”

3.2.2 Associated Enterprises

Association will arise when a company of a contracting State, “participates directly or indirectly in the management, control or capital” of a company in the

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195 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Sections 23 B.
196 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 7 subsection 3.
197 OECD Model Tax Convention. Commentary on section 7 subsection 3
198 Aguilar Perez, Araceli, Del Carmen Diaz Vazquez, Maria, & et.al. (2005). Tratado para evitar la doble tributación México Bélgica. (Contador Público), Instituto Politecnico Nacional, México D.F.
199 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 5 subsection 4.
201 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 9, subsection 1, paragraph A.
residents to the second contracting State. Arrangements made between related companies seeking to take advantage of their association with the purpose of allocating business profits or accruing them disproportionately shall be adjusted and taxed by the authorities of both States pursuant to a proportional distribution and market transfer prices.\textsuperscript{202} In the event of double taxation on business profits belonging of associated enterprises, the State that would have had no taxation rights if the economic transactions had made between unrelated companies, shall make a tax adjustment pursuant to the mutual agreement procedure of S.25 TTGM.\textsuperscript{203}

3.2.3 Dividend Distribution

Under the OECD convention, dividends are understood as the profits distributed by joint stock companies (companies on shares, limited liability companies and partnerships on shares) to their shareholders in proportion to their capital participation in the company.\textsuperscript{204} The amounts distributed as dividend by a company resident to a contracting State to a second corporation resident in the other contracting State or its shareholders are subject to taxation in both the State source of the income and the State in which the beneficial has its residency.\textsuperscript{205} For treaty purposes, the concept of beneficial owner, regarded as the person who holds the effective economic rights of the amounts paid, is applied in determining the extent of double taxation relief mechanisms.\textsuperscript{206} In the event that taxes on dividends be levied by the tax authorities of both jurisdictions, the State source of the amounts paid will only be entitled to levy a maximum of 15 percent tax right over the gross dividend distributed, amount which shall be further reduced to 5

\textsuperscript{202} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 9, subsection 1.
\textsuperscript{203} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 9, subsection 2.
\textsuperscript{204} OECD Model Tax Convention. Commentary on section 7.
\textsuperscript{205} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 10, subsection 1.
percent in the event that the beneficial owner is a corporation which has the control ten or a higher percent equity of the corporation distributing the dividends.207

The aforementioned limitations shall not apply if the beneficial owner, despite fulfilling the required thresholds, conducts business activities through a permanent establishment, receives income out of the performance of independent personal services or conducts economic activities within the State where the company distributing the divides has its residence.208 Furthermore, section 10.5 TTGM denies the possibility that a State shall be able to levy taxes on dividends distributed by a company resident of the second State exclusively on the basis of being the source of the corporate profits distributed as dividends.209 Hence, the dividend distributing company will only be subject to double taxation under the rules of section 7 TTGM if it holds a permanent establishment in the other State, or distributes profits to a resident of the aforementioned State.210

Dividends paid by a German corporation to a Mexican one can be credited by the later on the proportion corresponding to the distributed amount, under the requirement that the corporate income tax withheld by the German authorities be treated as an accumulated profit during the correspondent yearly tax declaration in Mexico.211 The Mexican company will then enjoy the benefit of crediting the taxed amounts in up to 10 fiscal years, in the event that it holds the control of at least ten percent equity of the German company, threshold which must at least have been acquired six months prior to the dividend distribution.212 Mexican legislation denies the right to credit distributions arising from business profits obtained out of national sources by the foreign corporation,213 approach which is overridden by the application of the tax treaty.214

207 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 10, subsection 2.
208 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 10, Subsection 4.
209 OECD Model Tax Convention. Commentary on section 10, subsection 5.
210 Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 10 subsection 5 Section.
211 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 6 paragraph II.
212 Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 6.
In any case, the corporation must present a withholding certificate issued by the German authorities detailing the amounts subject to corporate income tax, which shall be adjusted to the factors and rates of sections 10 and 11 LISR in order to be credited.\textsuperscript{215} Dividend distributions in Mexico are taxed on a source base model on the underlying business profits to be distributed and not the dividend per se, by withholding 50 percent of the distributed profits pursuant to the tax rate established in section 130 LISR, which shall in turn be creditable by shareholders on their personal level.\textsuperscript{216}

German authorities tax dividends on a half-income accounting method, upon which, the distributed amount is to be be taxed on the corporate and shareholder levels independently.\textsuperscript{217} While the current corporate tax rate applicable to dividends, fixed 25 percent, may seem lower than its Mexican counterpart, the final rate on the distributed profits raises significantly as it is subject to internal double economic taxation at the shareholder level.\textsuperscript{218} In the event the dividends be paid to natural persons, the amounts distributed would be classified as income arising from capital assets\textsuperscript{219}, and may thus exempted from taxation in up to 60 percent of the applicable rate pursuant to Section 3C, paragraph 2.\textsuperscript{220} As for dividends distributed at the corporate level between related companies, the allowed exemption of the amounts paid shall nevertheless be topped to 95 percent, as the remaining 5 percent of the gross distributed amount cannot be deducted as an operative expense pursuant to section 8b, subsection 3 KStG.\textsuperscript{221}

In addition, dividends distributed between corporations resident in Germany are exempted from further taxation, in the event that taxes on the underlying business profits

\textsuperscript{214} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 10, subsection 5.
\textsuperscript{215} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 5.
\textsuperscript{219} Einkommensteuergesetz. (\textit{German Income Tax Law}) Section 20, subsection 1.
have already been paid, until they are forwarded to the shareholder level without consideration of the source of the distributed amounts.\textsuperscript{222} To the extent that the dividend distribution is subject to higher tax rates under Mexican tax law, the distributing company shall be entitled to credit the profits already taxed against German corporate income tax or have them reimbursed in the event of double taxation.\textsuperscript{223}

3.2.4 Corporate Interests

Interests arising from corporate loans are in principle not subject to economic double taxation ever since taxes are only levied on by the State to which the effective beneficiary is resident.\textsuperscript{224}225 However, accrued interests arising from governmental issued instruments such as securities or bonds may be subject to taxation by both the State source of the income and State where the owner of the economic surplus has its residence.\textsuperscript{226} In the event that the source State were entitled to collect taxes on interests, the tax base must not exceed more than 10 percent of the gross amount of the interest paid under normal circumstances, or 5 percent in case that the loan was granted by a financial institution.\textsuperscript{227} The residence State shall hold exclusive tax rights on interests if the beneficial owner to these is one of its governmental or financial institutions including its Central Bank, as long as these entities do not perform economic activities directly or indirectly within the other State.\textsuperscript{228}

Interests paid will arise and be linked to the State in which the payer is resident, and in absence of this, the jurisdiction where indebtedness arose whether through a permanent establishment or a controlled company.\textsuperscript{229} The treaty benefits shall only apply to related companies if the transactions conducted between them complied with the arm’s

\textsuperscript{222} Körperschaftsteuergesetz. (German Corporate Income Tax Law) Section 8, subsection, paragraph 1.
\textsuperscript{223} Einkommensteuergesetz. (German Income Tax Law) Section 50, subsection D, paragraph 1.
\textsuperscript{224} Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 20, subsection X.
\textsuperscript{225} Einkommensteuergesetz. (German Income Tax Law) Section 4h, subsection 1.
\textsuperscript{226} OECD Model Tax Convention. Commentary on preliminary remarks and section 11.
\textsuperscript{227} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 11 subsection 2.
\textsuperscript{228} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 11 subsections 3 and 5.
\textsuperscript{229} OECD Model Tax Convention. Commentary on section 11, subsection 5.
length principle, being any adjustment made outside the market transfer prices taxable under the laws of the State where the debt first arose.\textsuperscript{230}

### 3.3. Proceedings for Tax Exemption and Accreditation

Double taxation may be eliminated through the application the exemption principle, according to which the residence State of a corporation unilaterally refrains from levying taxes on income generated and taxed within the second contracting State through a permanent establishment\textsuperscript{231}. Alternatively, a contracting State may grant a tax credit up to the amount corresponding to the tax paid in the second contracting State on business profits generated within its territory.\textsuperscript{232} The exemption method is applied regardless of the legal frame, rates or characteristics upon which the second jurisdiction taxes profits or transactions, proving to be an effective approach to avoid double taxation without further formalities.\textsuperscript{233}

As a general rule, German residents shall be exempted from tax liabilities claimed by German authorities on income or capital assets already taxed by Mexican authorities, arising or located within its territory.\textsuperscript{234} Dividends received by German companies other than partnerships shall also be tax exempted in their residence State provided that they control over 10 percent of the Mexican company distributing profits.\textsuperscript{235} The amounts taxed by Mexican authorities can nevertheless be credited against German tax in the event that the ownership percentage of the foreign company falls below the 10 percent threshold, an approach that also covers interest payments, royalties, capital gains and managerial remunerations.\textsuperscript{236}

\begin{flushleft}
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\textsuperscript{230} OECD Model Tax Convention. Commentary on section 11, subsection 6.
\textsuperscript{231} Avi-Yonah, Reuven. (2004). International tax as international law. Program in Law and Economics, University of Michigan Law School, 7, 30. PP.28
\textsuperscript{232} Vogel, Klaus. (1986). Double tax treaties and their interpretation. Int'l Tax & Bus. Law, 4, 1.23
\textsuperscript{233} Vogel, Klaus. (1986). Double tax treaties and their interpretation. Int'l Tax & Bus. Law, 4, 1. 23
\textsuperscript{234} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23, subsection 1A paragraph I.
\textsuperscript{235} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23, subsection 1A paragraph II.
\textsuperscript{236} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23 subsection 1B.
\end{flushleft}
In order to exempt, and not only credit, foreign business profits from German corporate income tax, German corporations must proof to local authorities that the gross income generated by its Mexican permanent establishment during the applicable business year has already been taxed and follows to the guidelines set off by the Law on Foreign tax in strict adherence.\footnote{Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23, subsection 1C.} In spite of the above, income must originate almost exclusively from a set of specific economic activities described under section 8 subsection 1\footnote{Außensteuergesetz. (German International Tax Law) Section 8, subsection 1.} subsection 1\footnote{Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23, subsection 1D.} AS\footnote{Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23, subsection 2B.}tG, which include but are not limited to agriculture, forestry, production and processing of goods, financial and insurance activities as well as trade and services with the exemption of rental and leasing activities.\footnote{Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 6.} The aforementioned limitation on tax exemption is also applicable to profits generated through the lease, alienation or transfer of immovable and movable property belonging to a German permanent establishment in Mexico pursuant to sections 6 subsection 4 and 13 subsection 1 AS\footnote{Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Sections 5 and 6 paragraph 1.}tG.\footnote{Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Sections 5 and 6 paragraph 1.}

As Mexican authorities favor the credit method over the exemption approach contemplated by the treaty, taxes collected by German authorities on revenue or capital assets arising or located within the German territory shall be credited against the Mexican tax due on the same profits, up to an amount that doesn‘t exceed the national corporate tax rate.\footnote{Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Section 6.} In addition, the German withholding tax levied on dividends distributed by a German company to a Mexican one shall only be creditable if the later owns more than 10 percent of the distributing company.\footnote{Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 23, subsection 2B.} In order to be eligible to credit taxes paid by an associated company resident in Germany, Mexican corporations are required by law to provide a tax withholding statement and to accumulate the received income to its tax balance sheet.\footnote{Ley de Impuesto sobre la Renta. (Mexican Income Tax Law) Sections 5 and 6 paragraph 1.} Nevertheless, the credit allowance granted by section 6, paragraph 2
LISR on dividend distribution apply in direct proportion to the participation that the Mexican corporation had on the total amount of distributed profits.\textsuperscript{243}

FOURTH CHAPTER
Bilateral Commercial Influence of the Treaty

4.1. Economic and political overview

During recent years Mexico and Germany have strived to strengthen their social, political and economic ties by incentivizing mutual investment and development programs as well as academic and economic integration though international agreements.244 As a commercial partner, Mexico enjoys a privileged economic position within the Latin-American market, possessing a vast array natural resources, skilled workforce and a well diversified industry which altogether pose a unique opportunity for German capital to investment in business opportunities, particularly in the chemical, pharmaceutical, alimentary and automotive industries. 245 On this regard, studies conducted by the Mexican-German Chamber of Commerce and Industry (CAMEXA) in conjunction with the German Ministry of Economy establish that by the end of 2009 the total capital of German companies operating in Mexico through permanent establishments amounted up to 25 billion dollars, representing the presence of over 1200 companies which altogether employing a total workforce amounting up to 120,000 skilled employees. 246 The strong presence of German corporations and capital represented through its operations over seven percent of the aggregated Mexican industrial gross domestic product.247

Germany is a strategic commercial partner for Mexico in terms of global trade, representing the fourth most important market in terms of imports and seventh in terms of

the exports as of 2012 (figures 3 & 4). Additionally, Germany is the foremost trade partner among the European Union, which also ranks to ranking among the top ten countries that invest the most in business opportunities in Mexico.

**Figure 3: Mexico’s export market in 2012**

![Pie chart showing export market share of Mexico in 2012]

**Figure 4: Mexico’s import market in 2012**

![Pie chart showing import market share of Mexico in 2012]


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In spite of the substantial mutual commitment for economic cooperation and development, both States have striven to adjust their economic, fiscal and trade entry barriers to their markets through the subscription of international agreements aiming to boost foreign investment in diverse industry sectors.\textsuperscript{250} As result of an initial commitment to maximize mutual trade and to facilitate the movement of goods and capital between countries, the first enforceable version of the agreement to avoid double income taxation between the Federal Republic of Germany and the United Mexican States was ratified and adopted on February the 23th, 1993.\textsuperscript{251} The legal instrument, which remained enforceable during more that fifteen years, was replaced on July the 9\textsuperscript{th} 2008 by a revised version of the same, which included reforms on the tiebreaker provisions that determine residence of both legal and natural persons as well as the principles for the allocation of taxation rights on interests, capital gains and assimilated income.\textsuperscript{252}

4.2 Impact on Foreign Direct Investment

Through the harmonization of the taxation schemes and anti-tax evasion provisions, tax treaties play a significant role in promoting a globalized economic environment through foreign direct investment, aiming to achieve mutual economic, commercial and political development.\textsuperscript{253} A research conducted by Blonigen and Davies nevertheless concludes that the entry into force of a tax treaty may not necessarily, at least on the short run, improve foreign direct investments, this due to the fact that the general and anti-tax avoidance regulations may limit preferential tax structures and


\textsuperscript{251}Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 31.


treaty-shopping practices, hindering economic advantages for potential investors.\textsuperscript{254} Despite of the fact that tax treaties subject international transactions and taxation schemes to rigorous regulations, the possibility to relief double taxation by itself is an important incentive for investors to consider allocating capital in business opportunities within the markets of the subscribing States.\textsuperscript{255} Moreover, the legal certainty granted to investors of capital exporting nations, that taxes already paid will be exempted or credited by the second contracting State, is likely positively influence foreign direct investment in capital import countries such as Mexico.\textsuperscript{256}

It is feasible that the subscribing States may proportionally lose tax revenue on profits due to treaty limitations on taxation rights; however, the withholding rights on dividends, paired with the mutual assistance and information exchange procedures described on section 25 TTGM offset such issues to a certain extent.\textsuperscript{257} In absence of a treaty, transnational corporations may be subject to the impossibility of crediting paid taxes in the foreign jurisdiction, resulting in unsuccessful tax relief and discouraging investment opportunities.\textsuperscript{258} In spite of the above, the subscription of an agreement on the avoidance of double taxation is deemed to exert an important influence on potential investors regarding the allocation of their financial resources and willingness to conduct transnational business activities.\textsuperscript{259}

While it is argued that the relief of double taxation may not pose a direct economic decisive impact on foreign investments due to the presence of investment

\textsuperscript{255}Neumayer, Eric, & Spess, Laura. (2005). Do bilateral investment treaties increase foreign direct investment to developing countries? \textit{World development}, 33(10), 1567-1585. PP.44
\textsuperscript{256}Neumayer, Eric, & Spess, Laura. (2005). Do bilateral investment treaties increase foreign direct investment to developing countries? \textit{World development}, 33(10), 1567-1585.pp. 12
\textsuperscript{259}Desai, Mihir A, Foley, C Fritz, & Hines Jr, James R. (2003). Chains of ownership, regional tax competition, and foreign direct investment: Springer. PP.4
alternatives in tax heavens and in States with lower tax rates, its non-financial benefits may have a decisive impact on bilateral economic integration between the both contracting States. On a first instance, treaties signal financial and sovereign certainty regarding the economic interests of potential investors by assuring them fair treatment under national laws as well as protection against possible unilateral discriminatory measures not applicable to residents of the other contracting State. By facilitating foreign direct investment, contracting States ultimately improve their overall economic development, for despite sacrificing full taxation on the universal income of resident companies; they acquire intangible benefits from foreign direct investment “such as knowledge and technology spill-overs, higher economic growth, employment and living standards”. The tax treaty subscribed between Mexico and Germany not only represents an economic and sovereign guarantee to investors in both States, it may also serve as a platform of legal integration with third-party States through international trade or economic agreements.

The OECD model’s approach on taxation based on residence is likely to benefit capital exporting countries to a greater extent than capital import States, as the capital flow between them is mainly composed by investments coming from developed to developing countries which increases the “net positive foreign asset positions.” In spite of the above, Mexico, as a developing country strives to attract foreign direct investment securing investors with financial stability and security comparable to national investments to the sense that foreign capital will not be subject to disproportionate

burdens or special prerogatives. On the other hand, Mexican corporations hold the incentive to internationalize their activities and to seek market diversification as the credit tax avoidance counters European high taxation rates, in addition to Germany being a privileged business environment, with high profit expectations.

Economic uncertainty may arise among investors considering an internationalization strategy through an independent self-financed subsidiary rather than having a permanent establishment transferring capital to the parent company and triggering foreign withholding taxes. The tax treaty however, allows foreign corporations to establish holding companies within the Mexican and German markets, in order to gain additional economic advantages through the application of local beneficial legal provisions and subscribed international trade agreements which mitigate trade barriers with third-party States. In spite of the aforementioned economic advantages, the treaty can’t be regarded as decisive factor in foreign direct investment placement as investors consider factors such as national regulatory policies as well as the “cost and local availability of supplies (and) proximity to final markets.”

4.3 Impact on the Multilateral Economic Development.

Due to geographical and political reasons Mexico has strongly relied on the United States as its main import and exports trade partner through the recent years. While the American economy remains strong, the necessity to diversify commercial relations with other trade partners arises, for it has recently suffered important financial

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downturns as demonstrated during the 2009 economic crisis. Mexico’s limited trade policy concentrated at one point, up to 80 percent of its trade output in American market, a decision that proved to be inaccurate as the economic recession experienced in the USA during 1994 backlashed, contracting the Mexican economy in 6 percent as a result. The Mexican government has acknowledged the fact that its economy heavily relies in the trade balance held with the North American countries, reason for which it aims to diversify trade opportunities and global integration through international treaties. Mexico currently participates in a wide array of both global and regional free trade agreements that encompass the Latin- and North American States as well as Japan and, the European Union, strategy which has in part allowed the Mexican economy to have a steady annual growth percentage since 2010.274

Within the European economic area, Germany represents the most important trade partner of Mexico, particularly in the automotive, oil refining, motor vehicle and parts manufacture, as well as in the chemical and pharmaceutical industrial fields. However, the issue of double taxation had a negative repercussion on foreign direct investments and the business activities between States. On this regard, the treaty subscribed between the States promotes capital export neutrality as it cancels potential double taxation liabilities whether through the exemption or crediting approach, which eliminates the concern of investment allocation since taxation no longer biases the investor’s decision to allocate its

capital. On the other hand, though promoting capital import neutrality, the source country limits his tax rights through accreditation of the income tax paid in the residence State at its normal tax rates. During 2012 Germany consolidated as Mexico’s mayor commercial partner in Europe and the world, with a combined trade balance exceeding 18.000 million dollars. In addition to the above, Germany ranks as the seventh most prominent foreign direct investment investor in Mexico, allocating more than 1,400 million dollars and establishing over 300 new companies in the last five years.

Since 2011 both countries have established a financial and technical cooperation plan has represented a continuous direct investment of over 118.1 million euros destined to build manufacture plants for diverse companies within Mexican territory. In addition, German corporations have directly invested over 6,394 million dollars in business development opportunities within Mexico since 1991, representing a stable mutual economic growth of 9.6 percent between 2002 and 2012. During the last ten years, Mexican exports to Germany have grown over 288 percent, reaching 18,005 million dollars and representing a 14.5 annual export growth rate within the market, while on the other side, Germany’s exports grew 123 percent reaching 13, 508 million dollars at 8.3 percent growth rate in the Mexican market. The trade balance corresponding to the trade activities conducted between the two States still favors

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Germany however, which holds an export surplus of 9,011 million dollars.\textsuperscript{284} Mutual cooperation is expected to increase after 2013, as the representatives of both States have expressed their strong willingness to improve their scientific, academic and trade activities through the creation of a special economic fund.\textsuperscript{285}

\textbf{4.4 Commitment for Mutual Assistance and Non-discrimination}

To assure the correct application of the treaty provisions as well as to counter tax avoidance schemes and treaty shopping practices, the Mexican and German tax authorities have mutually agreed to assist each other in their tax collecting activities, by withholding and later repatriating the corporate income tax due by its resident companies.\textsuperscript{286}\textsuperscript{287} In addition to the above, both States have agreed to exchange any kind of information insofar as it is related to the enforcement of either the treaty provisions or their national tax laws.\textsuperscript{288} Contracting States are also committed to share information of the financial and commercial operations of their resident corporations even in the spite of the principle of financial secrecy,\textsuperscript{289} to the extent that in doing so, no “trade, business, industrial, commercial, professional or trade secret”\textsuperscript{290} is revealed. In the event of a treaty application conflict national authorities may directly initiate, pursuant to a 3 year statute of limitation, a mutual agreement procedure in order to either interpret the scope of a treaty provision or to address a tax scenario not covered by the agreement.\textsuperscript{291}

\begin{itemize}
  \item \textsuperscript{286} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 27, subsections 1 and 2.
  \item \textsuperscript{288} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 26, subsection 1.
  \item \textsuperscript{289} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 26, subsection 3c.
  \item \textsuperscript{290} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 26, subsection 5.
  \item \textsuperscript{291} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 25, subsection 1.
\end{itemize}
The Mexican and German governments strive to provide a stable legal environment to all corporations and investors interested in conducting business activities within their territories by granting them the same prerogatives and rights that their residents enjoy under their national legislation.\textsuperscript{292} Taking this into account, a foreign permanent establishment resident in either contracting State shall enjoy an equal treatment as national corporations would do without any further prerogatives, being thus entitled to any incentives, requirements or preferential tax rates given by foreign authorities to their residents.\textsuperscript{293,294} The non-discrimination principle is also applicable for royalties, interests paid by a company to a resident of the second jurisdiction as well as any related amount contributed to a permanent establishment,\textsuperscript{295} as they shall be deductible under the national tax rules contracting State.\textsuperscript{296}

\begin{thebibliography}{9}
\bibitem{} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 24, subsection 1.
\bibitem{} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 24, subsection 3.
\bibitem{} OECD Model Tax Convention. Commentary on section 24.
\bibitem{} Agreement between The Federal Republic of Germany and The United Mexican States for the Avoidance of Double Taxation. Section 24, subsection 4.
\end{thebibliography}
CONCLUSIONS

The increasing global economic integration between strategic financial and trade partners has brought up the necessity to counter the different market barriers arising from legal discrepancies through international agreements. The treaties subscribed between commercial partners aim to make their trade and financial activities more efficient through the harmonization of their national legal provisions on foreign trade and investment as well as in tax related matters in order to maximize their profits. States face the issue of double taxation when their tax legislation, containing the applicable rates and calculation methods is not harmonized, directly affecting corporations that conduct business activities within two different jurisdictions. The issue of double taxation arises due to the fact that States claim tax right on the universal income of their residents disregarding the source of the income, while on the other side, the jurisdiction in which profits were originated also claim the faculty to collect taxes on the earnings obtained out of resources located within its territory. Therefore, if no crediting system operates within the involved States, corporations would suffer important dilution of revenue due to the fiscal obligations acquired in both territories.

Now, even though States can collect a higher tax revenue through these approaches, foreign direct investment and national economic development suffer a substantial impact as foreign corporations will not be encouraged to expand operations beyond their jurisdiction of residence due to the fiscal burdens that this would represent. On spite of the above the OECD undertook the task of drafting a model tax convention, which strives to eliminate double taxation as well as tax evasion by fomenting a capped system of tax levying right, accreditation and exemption schemes as well as mutual information exchange agreements and revenue collecting assistance practices. Such agreements are based on the credit and exception methods distributed among the contracting States pursuant to which the tax on profits already paid in one State can offset to a certain extent against the tax to be paid on the other jurisdiction.
The relief of double taxation has therefore a substantial impact on the economic relationship of both contracting States as it provides foreign investors with the legal certainty that their capital allocated to international business opportunities will not be diluted to discrepancies or unequal treatment by the tax authorities of both countries. It is nevertheless unclear up to which extent does a tax treaty incentivize foreign direct investment among its contracting States for if it is true that legal certainty on equal treatment and double tax avoidance schemes is provided, investors take into consideration different factors such as salary costs, preferential regulatory frames, geographical location, or cheap access to raw material or components may make a market more attractive to investors than the plain assurance that their profits will not be subject to arbitrarily taxation schemes. However, in the event that the presence of a tax treat would in fact have a positive influence on foreign direct investments, it would be translate into a steady economic growth of the subscribing States incentivized in part by its economic benefits and the market consolidation gained through the access to a number of international trade instruments, which would have, otherwise are unavailable to them.

Mexico and Germany, in spite of their strategic economic and trade partnership saw the necessity to subscribe an agreement to avoid double income taxation which has helped them to achieve an even stronger economic integration particularly in the automotive, chemical, pharmaceutical and technology sectors. This treaty is aimed to coordinate the tax authorities of both contracting States in respect of the allocation of taxing rights generated and distributed among corporations resident to both States. The economic relation between both countries has seen an important development during the last decade, with an increasing number of investments in the manufacture, educational and service sectors of each jurisdiction. Germany as capital export country has harnessed the legal certainty given by its tax treaty with Mexico in order to strengthen its position within the territory of the later State, resulting in a significant integration into their market, both at an economic and legal level.

Mexico on the other side is presented with the opportunity to diversify its current distribution of trade partners, which is strongly dominated by the United States which
makes its economy vulnerable against financial recessions felt in North America, as already experienced during 1994 and 2008. Mexico’s recent aperture to a globalized system and external policy has been strongly backed by Germany as a key trade partner within the European Country. Although foreign direct investment from German capital has consistently grown through the expansion of already existing companies and the creation of new production facilities within its territory, Mexico position as a developing country does not allow for such an aggressive market expansion and consolidation, which is reflected in the deficit that the Mexican economy has in respect to their bilateral trade balance.

In spite of the above, so far there has been no exponential increase in the German-Mexican trade balance, which may be explained by the economic crisis lived during 2008 and the rooted economic dependency in which Mexico bases its export policy mainly to the United States. It must me then taken into account that although treaties do create legal certainty as well as protection to potential investors under national laws, they are not yet proved to be a major cause attracting foreign direct investment. To this extent, Mexico has the opportunity to potentiate national development through foreign investment as well as to correct its trade balance and to position its exports within one of the major global markets as Europe is through Germany, which is beginning to exploit the benefits from the favorable economic conditions of the Mexican market. Therefore, in order to be able to fully seize the economic and legal benefits granted by an agreement to avoid double taxation, the subscribing countries must strive to achieve mutual economic competitiveness and market diversification.
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