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## Summary of the Convention between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

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**SUMMARY OF THE CONVENTION BETWEEN THE  
GOVERNMENT OF THE UNITED STATES OF AMERICA  
AND THE GOVERNMENT OF THE UNITED  
MEXICAN STATES FOR THE AVOIDANCE OF  
DOUBLE TAXATION AND THE PREVENTION OF FISCAL  
EVASION WITH RESPECT TO TAXES ON INCOME**

**RAÚL MOREYRA S.\***

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**I. INTRODUCTION**

In September 1992 the governments of Mexico and the United States signed a convention whose purpose was to avoid double taxation and prevent income tax evasion [Convention].<sup>1</sup> The importance of the Convention lies in the fact that the provisions of the Conven-

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1. Convenio Entre el Gobierno de los Estados Unidos Mexicanos y el Gobierno de los Estados Unidos de America para Evitar la Doble Imposición e Impedir la Evasión Fiscal en Materia de Impuestos Sobre la Renta [Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of

tion have substantial differences from the provisions of the Mexican Income Tax Law regarding income obtained by foreign non-residents.

## II. PERMANENT ESTABLISHMENT

For the purposes of the Convention, the term "permanent establishment" means a fixed place of business through which an enterprise wholly or partly carries on its business. The definition includes a place of management, a branch, an office, a factory, or a workshop; and a mine, an oil or gas well, a quarry, or any other place used for the extraction of natural resources.<sup>2</sup>

The term "permanent establishment" also includes a building site, construction, or installation project; an installation, drilling rig, or ship used for the exploration or exploitation of natural resources, or supervisory activity in connection therewith. However, such building site, construction, or activity must last more than six months to attain the status of "permanent establishment."<sup>3</sup>

The term "permanent establishment" does not include the following:

1. the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;
2. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery;
3. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
4. the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise;
5. the maintenance of a fixed place of business solely for the purpose of advertising, supplying information, conducting scientific research, or for the preparations relating to the placement of loans or for similar activities which have a preparatory or auxiliary character for the enterprise; or
6. the maintenance of a fixed place of business solely for any com-

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Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income], Sept. 1992, U.S.-Mex. (on file with *St. Mary's Law Journal*) [hereinafter Convention].

2. Convention art. 5, § 2.

3. *Id.* art. 5, § 3.

bination of the activities mentioned above, provided that the total activity of the combination is of preparatory or auxiliary character.<sup>4</sup>

Notwithstanding any of the definitions mentioned above, where a person, other than an agent of independent status, is acting in Mexico on behalf of a United States enterprise, such enterprise shall be deemed to have a permanent establishment in Mexico for any activities which that person undertakes for the United States enterprise, if such person has and habitually exercises an authority to conclude contracts in the name of the enterprise in Mexico.<sup>5</sup> A permanent establishment also exists if the activities of such person in Mexico are limited to those of a non-permanent establishment or of an establishment that has no such authority but, on behalf of the enterprise, habitually processes in Mexico goods or merchandise maintained by that enterprise.<sup>6</sup> However, such processing must be carried on with assets furnished, directly or indirectly, by that enterprise or any associated enterprise.<sup>7</sup>

### III. INSURANCE ENTERPRISES

Except for reinsurance, an insurance enterprise of the United States of America shall be deemed to have a permanent establishment in Mexico if it collects premiums in Mexico or insures risks situated in Mexico through a representative other than an agent of an independent status.<sup>8</sup>

A United States enterprise will not be deemed to have a permanent establishment in Mexico merely because it carries on business in Mexico through a broker, general commission agent, or any other agent of an independent status, provided that two conditions are met: (1) that such persons are acting in the ordinary course of their business; and (2) that in their commercial or financial relations with the enterprise, conditions are not made or imposed that differ from those generally agreed to by independent agents.<sup>9</sup>

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4. *Id.* art. 5, § 4.

5. *Id.* art. 5, § 5(a).

6. Convention art. 5, § 5(b).

7. *Id.*

8. Convention art. 5, § 6.

9. *Id.* art. 5, § 7.

#### IV. INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

Income derived by a resident of the United States from immovable property (real property) situated in Mexico, including income from agriculture or forestry, may be taxed in Mexico.<sup>10</sup> A United States resident may elect to compute the tax on income for any taxable year on a net basis as if such income were attributable to a permanent establishment in Mexico.<sup>11</sup> Any such election shall be binding for the taxable year of the election and all subsequent taxable years unless the competent authority of Mexico agrees to terminate the election.<sup>12</sup>

#### V. BUSINESS PROFITS

The business profits of a United States enterprise shall be taxable only in the United States unless the enterprise carries on or has carried on business in Mexico through a permanent establishment situated there. If the enterprise carries on or has carried on such business, the business profits of the enterprise may be taxed in Mexico, but only so much of the profit as is attributable to the permanent establishment or to sales in Mexico of goods or merchandise of the same or similar kind as the goods or merchandise sold through such permanent establishment.<sup>13</sup> However, the profits derived from these sales shall not be taxable in Mexico if the enterprise demonstrates that such sales have been carried out for reasons other than obtaining a benefit under the Convention.<sup>14</sup>

In determining the business profits of a permanent establishment, expenses which are incurred for the purposes of the permanent establishment shall be allowed. These allowed expenses may include executive and general administrative expenses, whether incurred in Mexico or elsewhere.<sup>15</sup> However, no such deduction shall be allowed for payments, other than reimbursement or actual expenses, by the permanent establishment to the head office of the enterprise or any of its other offices if such payments comprise any of the following: (1) royalties, fees, or other similar payments in return for the use of patents or other rights; (2) a commission either for specific services per-

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10. Convention art. 6, § 1.

11. *Id.* art. 6, § 5.

12. *Id.*

13. Convention art. 7, § 1.

14. *Id.*

15. *Id.* art. 7, § 3.

formed or for services performed for management; or (3) interest on monies lent to the permanent establishment, except in the case of a banking enterprise.<sup>16</sup>

## VI. SHIPPING AND AIR TRANSPORT

Profits of a United States enterprise from the operation of ships or aircraft in international traffic shall be taxable only in the United States.<sup>17</sup> For the purpose of the Convention, profits from the operation of ships or aircraft in international traffic include profits derived from the rental of ships or aircraft on a full basis, whether the rental is measured by time or by voyage.<sup>18</sup> Taxable profits also include profits from the rental of ships or aircraft on a bare-boat basis if such ships or aircraft are operated by the lessee in international traffic and such rental profits are associated with the other profits described above.<sup>19</sup> The Convention also states that the operation of ships or aircraft in international traffic by an enterprise does not include transportation by any other means of transport provided directly by such enterprise or the provision of overnight accommodation.<sup>20</sup>

## VII. ASSOCIATED ENTERPRISES

When a United States enterprise imposes conditions between two enterprises in their commercial or financial relations which differ from those that would be typically made between independent enterprises, then any profits which would have accrued to one of the enterprises but for those conditions may be included in the profits of that enterprise and taxed accordingly.<sup>21</sup> However, this calculation only applies if the United States enterprise either participates directly or indirectly in the management, control, or capitalization of an enterprise of Mexico or if the United States enterprise participates directly or indirectly in the management, control, or capitalization of another United States enterprise as well as an enterprise of Mexico.<sup>22</sup>

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16. *Id.*

17. Convention art. 8, § 1.

18. *Id.* art. 8, § 2.

19. *Id.*

20. *Id.*

21. Convention art. 9, § 1.

22. *Id.*

## VIII. INTEREST

The tax as interest which a Mexican enterprise must pay a United States enterprise shall not exceed:

- a) 4.9% of the gross amount of interest of [except for the first 5 years after the effective date of the Convention, during which time a tax rate of 10% will apply]:
  - i) loans granted by banks, including investment banks and savings banks, and insurance companies;
  - ii) bonds or securities that are regularly and substantially traded on a recognized securities market;
- b) 10% of the gross amount of interest [except for the first 5 years after the effective date of the Convention, during which time a tax rate of 15% will apply] if the beneficial owner is not a person described in subparagraph a) and the interest is:
  - i) paid by banks, including investment banks and savings banks;
  - ii) paid by the purchaser of machinery and equipment to a beneficial owner that is the original seller of the machinery and equipment in connection with a sale on credit; and
- c) 15% of the gross amount of the interest in all other cases.<sup>23</sup>

For purposes of the above, interest paid on back-to-back loans will be taxed according to the domestic law of the state in which the interest arises.<sup>24</sup>

The Convention also states that notwithstanding the provisions mentioned above, interest may only be taxed in the United States if the beneficial owner is a resident of the United States and if:

- a) the beneficial owner is one of the parties to the Convention, a political subdivision thereof, or local authority;
- b) the interest is paid by any of the persons mentioned in subparagraph a);
- c) the beneficial owner is a trust, company, or other organization constituted and operated exclusively to administer or provide benefits under one or more plans established to provide pension, retirement, or other employee benefits and its income is generally exempt from tax in the United States; or
- d) the interest arises in Mexico and is paid on a loan made, guaranteed, or insured, for at least three years; or the interest is paid on credit which is extended, guaranteed, or insured for three years by the Export-

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23. Convention art. 11, §§ 2-3.

24. *Id.* § 2.

Import Bank of the Overseas Private Investment Corporation. . . .<sup>25</sup>

### IX. ROYALTIES

The tax on royalties which a Mexican enterprise must pay a United States enterprise shall not exceed 10% of the gross amount of the royalty.<sup>26</sup> According to the Convention's provisions, the term "royalties" means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including motion picture films and works on film or tapes or other means of reproduction for use in connection with television. The Convention also includes in its definition of royalties payments for the use of the following: any patent, trademark, design, model, plan, secret formula, process, or any other similar right or property; information concerning industrial, commercial, or scientific experience; and the use of or the right to use industrial, commercial, or scientific equipment not constituting immovable property.<sup>27</sup> The term "royalties" further includes income from the alienation of any such right or property that is contingent upon the productivity, use, or disposition of such right or property.<sup>28</sup>

### X. CAPITAL GAINS

A resident of the United States who earns a capital gain from the alienation of immovable property situated in Mexico may be taxed in Mexico.<sup>29</sup> The term "immovable property" includes property interests such as interests in a partnership, trust, or estate to the extent that the assets of such interests consist of immovable property situated in Mexico. The Convention also includes as immovable property shares or comparable interests in a company or other legal person that is or is treated as a resident of Mexico, the assets of which company include at least 50% immovable property located in Mexico. The Convention also considers as immovable property any other right that allows the use or enjoyment of immovable property situated in Mexico.<sup>30</sup>

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25. *Id.* art. 11, § 4.

26. Convention art. 12, § 2.

27. *Id.* art. 12, § 3.

28. *Id.*

29. Convention art. 13, § 1.

30. *Id.* art. 13, § 2.



A resident of the United States who derives capital gains from the alienation of stock, participation, or other rights in the capital of a company or other legal person which is a resident of Mexico may be taxed in Mexico if the recipient of the gain during the 12-month period preceding such alienation had a participation, directly or indirectly, of a least 25% in the capital of that company or other legal person.<sup>31</sup>

#### XI. INDEPENDENT PERSONAL SERVICES

A resident of the United States who earns income from performing personal services or other activities of a similar nature in an independent capacity will have that income taxed only in the United States except in two cases. The first case involves a United States resident who has a fixed base in Mexico which he or she regularly uses in the course of performing his or her activities.<sup>32</sup> In such case, Mexico may tax the income from services performed in its territory which is attributable to that fixed base.<sup>33</sup> The second case involves a United States resident who is present in Mexico for a period of at least 183 days within a 12-month period.<sup>34</sup> In such a case, Mexico may tax the income attributable to activities performed in its territory.<sup>35</sup>

The Convention defines "personal services" to include independent scientific, literary, or artistic activities; educational or teaching activities; as well as independent activities of physicians, lawyers, engineers, architects, dentists, and accountants.<sup>36</sup>

#### XII. DEPENDENT PERSONAL SERVICES

A United States resident will be subject to taxation in the United States on only his or her salaries, wages, and other similar remuneration from employment unless the United States resident engages in such employment in Mexico.<sup>37</sup> If the employment does occur in Mexico, remuneration for the employment may be taxed in Mexico. However, a United States resident who earns remuneration from

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31. *Id.* art. 13, § 4.

32. Convention art. 14, § 1(a).

33. *Id.* art. 14, § 1(a).

34. *Id.* art. 14, § 1(b).

35. *Id.*

36. Convention art. 14, § 2.

37. Convention art. 15, § 1.

employment in Mexico will find his or her earnings taxed in the United States in the following circumstances: when the recipient is present in Mexico for a period or periods not exceeding in the aggregate 183 days in a 12-month period; the remuneration is paid by or on behalf of an employer who is not a resident of Mexico; and the remuneration is not borne by a permanent establishment or a fixed base which the employer has in Mexico.<sup>38</sup>

### XIII. DIRECTORS' FEES

Directors' fees and similar payments may be taxed in Mexico if they are earned by a resident of the United States for services performed outside the United States in his or her capacity as a director or overseer of a company that is a resident of Mexico.<sup>39</sup>

### XIV. EXCHANGE OF INFORMATION

The Convention provides that the competent authorities shall exchange information as stated in the Agreement Between the United Mexican States and the United States of America for the Exchange of Information with Respect to Taxes, which was signed on November 9, 1989.<sup>40</sup>

### XV. ENTRY INTO FORCE

The Convention further provides that each country shall notify the other when its constitutional and statutory requirements have been satisfied for the Convention to enter into force. The Convention will become effective on the date the parties receive the later of such notifications.<sup>41</sup>

The provisions of the Convention that concern taxes on dividends, royalties, and profits have effect on or after the first day of the second month following the date on which the Convention enters into force if the Convention enters into force prior to July 1 of that year.<sup>42</sup> Otherwise, these provisions will take effect on the first day of January of the year following the year in which the Convention enters into force.<sup>43</sup>

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38. *Id.* art. 15, § 2.

39. Convention art. 16.

40. Convention art. 27, § 1.

41. Convention art. 29, § 1.

42. *Id.* art. 29, § 2(a).

43. *Id.*

For other taxes, the Convention's provisions take effect for taxable periods beginning on or after the first day of January of the year following the year in which the Convention takes effect.<sup>44</sup>

Once the Convention takes effect, it will terminate the existing agreement between the United Mexican States and the United States of America for avoiding double taxation of income derived from the operation of ships or aircraft in international traffic, which the two countries concluded by exchange of notes on August 7, 1989.<sup>45</sup>

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44. *Id.* art. 29, § 2(b).

45. Convention art. 29, § 3.