Distributing Dividends from a Private Company (Mexico)

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A Practice Note explaining how to distribute funds from a private company, Sociedad Anónima (SA) or Sociedad de Responsabilidad Limitada (S de RL) in Mexico by way of dividends.

When shareholders invest in a company, they expect to receive a cash return on their investments. A company can provide returns to shareholders in several ways, but the most popular method in Mexico is by some form of dividend. This Note explains what dividends are under Mexican law and discusses the legal procedure and practice surrounding the declaration and payment of dividends of private companies in Mexico.

For more information on an SA or S de RL, see Practice Note, Trading Vehicles: Overview (Mexico): Corporations and Partnerships: Overview.

The following topics are outside the scope of this Note:

- Specific (statutory) regulations regarding dividends of a listed SA (*Sociedades Anónimas Bursátiles*) and public companies (*Empresas de Participación Estatal Mayoritaria* (EPEM) and *Empresas Productivas del Estado* (EPE)).
- Dividends in kind. Dividends in kind are dividends that are satisfied by the distribution of assets rather than cash or stock dividends (satisfied by the issue of shares).
- Specific (statutory) regulations which apply to dividends of certain particular types of companies. This includes companies that do not have a dividend mechanism but a generic "profit distribution" structure, similar to partnerships under common law.

What Is a Dividend?

The payment of a dividend is one of the main corporate and economic rights of shareholders in a Mexican corporation. Shareholders are considered the beneficial owners of the legal entity, as is the case for other foreign legal entities such as a limited liability company or a corporation in the US.

Shareholders are entitled to exercise the rights and obligations contained in the stock certificates. Under Mexican law, these stock certificates are regulated under the General Law for Business Corporations (*Ley General de Sociedades Mercantiles*) (LGSM) (Articles 111-141, LGSM).

Definition of a Dividend

Stock certificates are the physical representation of a shareholder's stake in the capital stock of a corporation. In principle, any individual or legal entity that holds a stock certificate is considered a shareholder of the corporation. Mexican corporations are also required to have a shareholders' registry book, evidencing a person's recognition as a shareholder of the corporation.

Under Mexican law, stock certificates contain "coupons". These coupons are usually numbered and are attached to the stock certificate. They serve to legitimately transfer by simple delivery and without an entry on the corporate book the rights and empower its holder to exercise the shareholder's right to receive dividend distributions against the delivery of such coupon.

Article 127 of the LGSM and other accessory provisions regulate the distribution of dividends as one of the several rights awarded to shareholders, which can be exercised through the collection against delivery of the coupons, which are accessory securities to the share itself.

A dividend is a distribution of a company's post-tax net profits to its shareholders, which is paid with respect to their shareholding in the capital stock. However, some exceptions exist for paying dividends pre-tax, such as capital distributions taken from the net tax income account (*Cuenta de Utilidad Fiscal Neta*) (CUFIN).

For a company to pay a dividend lawfully, it must have sufficient distributable profits (see How to Determine if a Company Can Pay a Dividend) and have allocated enough funds to the legal reserve account. In some instances, dividends shall first be distributed to preferred shares or founders' stocks. A company that has accumulated losses may not pay dividends.

Although some jurisdictions allow for the payment of interim dividends, under Mexican corporate law, dividends are always final, as they require approval of the shareholder's meeting after the closing of the fiscal year. However, corporations can pay dividends in one or multiple payment dates (see Final Dividends vs Interim Dividends).

Other Forms of Financial Benefits or Returns

Dividends are paid in cash; however, there are other forms of obtaining financial benefits or returns as a shareholder from a corporation. These may include transferring the company's non-cash assets, reducing share capital, issuing preferred or additional ordinary shares, or providing other ways of financial compensation.

These distributions are not proper dividends in the sense of being a distribution of approved profits. However, they are an attractive way in which shareholders and other investors can obtain a flow or participation in the company's profits.

Share buybacks

Certain stock corporations allow share buybacks, such as Investment Promotion Corporations (*Sociedades Anonimas Promotoras de Inversión*) and publicly traded corporations. Under Article 134 of the LGSM, regular stock corporations or SA are prohibited from owning their own shares if not due to a judicial ruling, in which case the corporation must sell the treasury stocks within three months or cancel them.

Reduction of share capital and reimbursements

Reimbursements require the shareholders' approval to reduce capital via the repayment of the par value or book value of the shares to their holders. Moreover, certain reimbursements may include the return of additional investments or securities on shares (Article 78, Section X of the LGSM for S de RL and Article 182, Section III of the LGSM for SA).

Loans

Given the nature of shares as freely circulated securities, shareholders can pledge their stock certificates to guarantee loans or other financial instruments, as long as it is not limited or conditioned under the corporate bylaws. This is also a benefit that shareholders can obtain from participating in Mexican corporations, as it is legal and common for shares to be pledged as guarantees for loans.

Amortization of shares

Amortizing shares is another way of creating value for shareholders by providing payment from distributable profits (Article 135, LGSM) and the possibility of the issuance of corporate shares or "*acciones de goce*" in place of the reimbursable shares.

Transfer of coupons

The coupons of a share certificate empower its holder to exercise its shareholder's right to receive dividends once approved by the shareholders. Shareholders can transfer coupons without the need to register it in the shareholder's registry book. This means these coupons can be commercialized separately from the share certificate.

Why Pay a Dividend?

Generally, companies pay dividends as rewards or distributions for the capital investment made by a company. Moreover, it is a measurement of return on their investment and a way to maximize share market value for publicly traded companies. Also, many privately held subsidiary companies of multinational corporations use dividends to repatriate local profits to their parent or holding companies abroad.

In addition to share value, the payment of dividends is one of the primary incentives for investors to invest in a company or diversify income streams.

How to Determine if a Company Can Pay a Dividend

The annual shareholders' meeting must review and approve the financial statements within the first four months of each fiscal year. Under Article 181 of the LGSM, shareholders must discuss and approve these financial statements of the previous fiscal year, which either reflect a net loss or a net profit. Without a provable net profit, corporations cannot pay dividends (Article 19, LGSM).

Before the distribution of dividends, corporations are legally required to fund the legal reserve at twenty percent of the company's total capital stock. Such legal reserve is imperative for new companies, as at least five percent of the net profit of each fiscal year must be allocated into the legal reserve fund until they reach the minimum percentage amount before they can pay dividends. If the abovementioned accounts decrease for any reason, the company must allocate future profits to its refund, limiting the payment of dividends in favor of shareholders until it is once again fully funded at twenty percent of the capital stock minimum share capital (Article 18, LGSM).

In addition, advanced dividends cannot be paid or declared, as payment is only possible once the financial statements reflecting a net profit are approved, and the legal reserve fund is fully funded (Articles 19 and 20, LGSM).

How to Declare a Dividend

During the first four months of each fiscal year, shareholders are legally required to hold an annual shareholders' meeting where, among other subjects, the financial statements presented to the board of directors are approved (Article 181, LGSM). Such financial statements will either reflect a net loss or a net profit, and if the legal reserve fund is funded, corporations may distribute dividends following:

- The LGSM.
- The company bylaws.
- A shareholders' agreement.
- A warranty or security obligation if applicable.
- Any other contractual obligations of the company.

Shareholders should also approve in a corporate resolution the payment method in which the company shall distribute the dividends. It is important to mention that under Article 6, Section X of the LGSM, the rules for profit or loss distribution amongst shareholders or partners must be included in the incorporation articles of any private company in Mexico.

Shareholders' Resolution to Declare a Dividend

In principle, the shareholders' meeting is the competent body to declare and approve dividends (Article 78, Section II LGSM for S de RL). It is a higher authority than the board of directors (Article 178, LGSM). As a corporate governance practice, some companies include intermediate specialized committees that are additional to the board of directors, usually called a compensation and remuneration committee. Such committees are structured under the company's bylaws to discuss and suggest to the shareholders the payment of dividends and other concepts of economic compensation for company directors and employees.

Unless other provisions are outlined in the company's bylaws, indicating a different percentage of shareholder quorum or vote, the annual shareholder meeting requires a minimum quorum of fifty percent of capital share representation for installment and a majority of votes of those present or represented shareholders for approval of resolutions. If the installment quorum is not reached, a second notice can be made, in which case resolutions will be adopted with the majority of the present or represented shareholders, regardless of the capital share they represent. Shareholders' agreement can also deviate from these majority thresholds but only to increase the percentage required for installment or approval.

Board Approval

Shareholders are responsible for approving the distribution of dividends. The approval of the company's board of directors may be required to pay dividends if the board has been granted such powers by the bylaws or a shareholders' agreement. It is also common to have a specialized and duly structured compensation and remuneration committee to evaluate and approve the payment of dividends. Some members of the board of directors or independent members may form this committee.

To obtain approval from the board of directors or its committees, a meeting must be held with the quorum and approval percentages required by the company's bylaws or by a shareholders' agreement. Given that it is not mandatory to obtain the board of directors' approval to distribute dividends, the procedural rules are voluntary and agreed on, in which case, if so required, the approval must be explicit and recorded in the minutes of the corresponding meeting. In some cases, a formalization of the minutes before a Mexican notary public is required, for example, when dividends are distributed through a capital reduction, and thus, an amendment to the bylaws would be required.

As a first step, net profits must be approved previously by the general shareholder meeting (Article 19, LGSM). Once shareholders approve the net profits and the reserve fund is fully funded, the conditional approval can be resolved, pending the resolution on behalf of the board of directors or the corresponding committee.

Directors Duties and Liabilities in the Context of Dividends

Under Article 158 of the LGSM, board members may be jointly and severally liable if they do not legally execute the resolutions instructed by the shareholders' meeting; this includes fulfilling the statutory and legal requirements regarding the payment of dividends. Therefore, the board of directors is responsible for the adequate compliance of dividend payments approved by the shareholders. In addition, the board of directors may face a civil liability suit for failure to fulfill a legitimate obligation that resulted in damages to the corporation. This may only apply if a director has undertaken a statutory obligation to pay, declare, or approve dividends.

In the case of high-level executives, their liability is determined under labor law; therefore, certain high-level executives may be subject to certain fiduciary duties under their employment contract. On the other hand, board members who are obligated to participate in the payment of dividends in whichever capacity can mitigate their responsibility by adopting good corporate governance practices, usually through specialized intermediate committees in charge of compensations and remunerations.

Provisions in Articles of Association and Shareholders' Agreement

Before declaring and paying a dividend, the company's bylaws and any applicable shareholders' agreement should be reviewed, as they usually contain express dividend provisions.

The bylaws or a shareholders' agreement (or both) of SAs and S de RLs can and commonly do, contain:

- A provision authorizing another corporate body, such as the board of directors or a specialized committee, to discuss and approve the distribution of dividends (additional to the general shareholders' meeting).

- A requirement for the approval of the supervisory corporate body or the holders of a specific class of shares (or both) for any dividends being paid (where the company has a supervisory corporate body and specific classes of shares).
- Either an obligation to pay dividends where legally permissible or a prohibition to pay dividends altogether (by ensuring that any profits made are added to the company's reserves or due to an existing obligation to limit dividend distribution, for example, under a credit or facility agreement).
- Weighted voting and quorum requirements regarding shareholders' approval to pay dividends.
- Special rights of certain shareholders or classes of shares with respect to dividends, such as an approval right for any dividend for the holders of preferred or founders' shares.
- Shares with (cumulative) preferential rights to any dividend payment (preferred shares).
- A provision that the distributable profit is for the benefit of certain persons (a statutory right to profit).

Amount of Dividend

Dividends for Common Shares

Generally, all shareholders receive the same amount of dividends; however, the company bylaws may provide otherwise. Different series or classes of shares may receive different amounts depending on the characteristics of such series. For example, preferred stocks may receive more than ordinary shares. Moreover, the payment of the dividends does not take into account treasury shares or unpaid shares.

Shareholders may also unanimously resolve to pay a particular dividend differently, for example, that the whole of the dividend is given to a single account or that share premiums are considered when making the calculation.

To calculate the dividend payment amount, the shareholders or the relevant corporate body usually divides the net profits over the total number of issued and paid shares according to their weighted proportion and depending on their class or type. Any preferred right to dividends will also have to be considered beforehand.

The bylaws also typically state that dividends do not carry interest against the company unless otherwise provided by the terms of the issuance or the provisions of another agreement.

If the bylaws are silent on interest rates against the company, a generic commercial interest rate may apply, which for mercantile transactions is set at six percent per year (Article 362, Commercial Code (*Código de Comercio*)). The bylaws may grant the right for shareholders or partners to receive an annual interest of a maximum of nine percent on their equity interests in the corporate capital, for a maximum of a three-year period as general expenses and not against profit (Article 85, LGSM (SA); Article 123, LGSM (S de RL)).

Dividends for Certain Types of Shares

Certain types of shares warrant a different amount of payable dividends or share distribution.

Founder's Shares

These are not strictly shares, as they consist of profit participation that a founder can reserve from itself when incorporating a company, which are limited to a period of ten years from incorporation and are restricted to be payable after shareholders are paid at least a five percent return on their initial investment on shares (Article 105, LGSM). Under Article 107 of the LGSM, the founder's shares are also not taken into account when computing the capital stock of a company, nor do they grant any corporate or economic rights other than the annual participation in profits.

Preferred Shares

Preferred shares usually have limited voting rights but hold a preferred right to receive dividends (Article 113, LGSM). This preference means that ordinary shareholders will receive dividend payments once preferential shareholders have been paid at least a five percent dividend.

Worker's Shares

Founders' shares are not properly shares, as they do not confer any corporate rights, but rather are special securities that are awarded as workers' compensation and which contain their specific terms and conditions, frequently under a worker's compensation or stock option plan (Article 114, LGSM).

Corporate Shares

The "*acciones de goce"* are a special kind of share issued in place of amortized shares under the procedure established in Article 136 of the LGSM. They entitle their holders to participate in the liquid profit of a company after non-reimbursable shares have been paid their corresponding dividend.

Right to a Dividend

Generally, all shares grant the same rights and obligations to their holders. However, companies' bylaws may allow the company to issue different series or classes (used indistinctively) of shares with specific rights to dividends and limit any other financial benefit from the company, if they are the same series (Article 112, LGSM).

Bylaws can also provide for different series of shares that do not award corporate rights, such as voting rights, but rather a priority in dividend distribution.

All holders of shares on the shareholder registry book of a company at the time of the resolution to pay a dividend will be entitled to a dividend. Under Mexican law, physical possession of the share certificate is necessary to prove ownership as well as the entry in the shareholders registers that proves the holder as owner, recognizing their status as a shareholder of the company. Under Article 129 of the LGSM, the issuer of share certificates is not bound to recognize holders of certificates as legitimate if they do not appear as such in their shareholders' registry book.

Final Dividends vs Interim Dividends

A prerequisite for the payment of dividends is the approval of the financial statements of the previous fiscal year during the first four-month period of the ongoing fiscal year. Therefore, all dividends are final. An advancement on future dividends based on predictions or mid-year profits is not allowed under Mexican law, as determined under Article 19 of the LGSM, which also contains a prohibition for shareholders to receive advance payments on dividends or even to include such a possibility in the bylaws. Under the same Article 19 of the LGSM,if an advance payment on dividends is made, the company's affected shareholders and other creditors reserve their right to recourse against the benefited shareholders or for reimbursement of such advances against the board members.

Currency

Commonly, dividends will be paid in Mexican pesos (Article 8, Mexican Monetary Law). In such cases where the payment of the dividend is payable under statutory obligation in foreign currency, it will be paid in the equivalent to the current exchange rate at the time and place of payment. The exchange rate is usually based on the Official Federal Gazette (*Diario Oficial de la Federación*) in the previous day's publication to the payment date.

A company's bylaws or a shareholders' agreement (or both) may hold provisions in this respect.

Method of Payment

Most cash dividend payments in privately held corporations are made through an electronic transfer, proof of which is typically annexed to the minutes of the shareholders' meeting in which dividends are declared. To this end, shareholders must inform the company of their banking details.

While the LGSM does not hold provisions in this respect, a company's bylaws or a shareholders' agreement (or both) may do so. Furthermore, the possibility for payment through any other method can also be agreed on, as there is no provision limiting such form of payment.

Tax Treatment of Dividends

Mexican entities are required to keep an account that records post-tax earnings and profits (the so-called net earnings and profits account (CUFIN)).

If a company distributes dividends above its CUFIN balance, the distributing entity is required to pay income tax for such distribution. In this case, the company has to gross up the amount of the dividend by multiplying the dividend by a gross-up factor (as of 2024, this is 1.4286), and it has to apply the corporate income tax rate (30%) on the resulting grossed-up amount. As a result of the foregoing, the company pays taxes at the corporate level upon deemed taxable income (grossed-up dividend) when the dividend is distributed to the shareholders. Income tax paid by the distributing entity may be carried forward for two years.

As of 2014, an additional 10% income tax withholding is levied on dividends (CUFIN and non-CUFIN) paid to Mexican individuals and non-residents (corporations or persons) to the extent that the dividends result from profits generated after 31 December 2013. Conversely, if the dividends are distributed out of pre-2014 CUFIN, then the 10% withholding tax rate does not apply.

Also, tax treaties executed and adopted by Mexico may provide a reduced withholding tax or a relief, including international taxation and accounting standards.

Recent Developments

There have not been any relevant reforms regarding dividends in recent years, nor are there any expectations for the Mexican congress to modify the legislation applicable to dividend distribution. However, Mexican corporate practice is to reinvest profits and distribute or financially compensate shareholders through other, more tax-efficient methods.

Summary

- A dividend is a distribution of a company's post-tax net profits to its shareholders, which is paid with respect to their shareholding in the share capital. However, some exceptions exist for the payment of dividends pre-tax.
- The annual shareholders' meeting approves the distribution of dividends withing the first four months of each fiscal year, as long as there are net profits, and the corporation has previously funded the legal reserve account. In certain cases, dividends are first distributed to preferred shares or founders' stocks.
- The approval of the company's board of directors may be required for the payment of dividends when such power has been granted to them by the bylaws or a shareholders' agreement. It is also common to have a specialized and duly structured compensation and remunerations committee, to evaluate and approve the payment of dividends.
- Board members may be joint and severally liable if they do not legally execute the resolutions instructed by the shareholders' meeting, this includes the fulfilment of the statutory and legal requirements in regard to the payment of dividends.
- Generally, all shareholders receive the same amount of dividends; however, the company bylaws may provide otherwise. Different series or classes of shares may receive different amounts depending on the characteristics of such series or class.

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