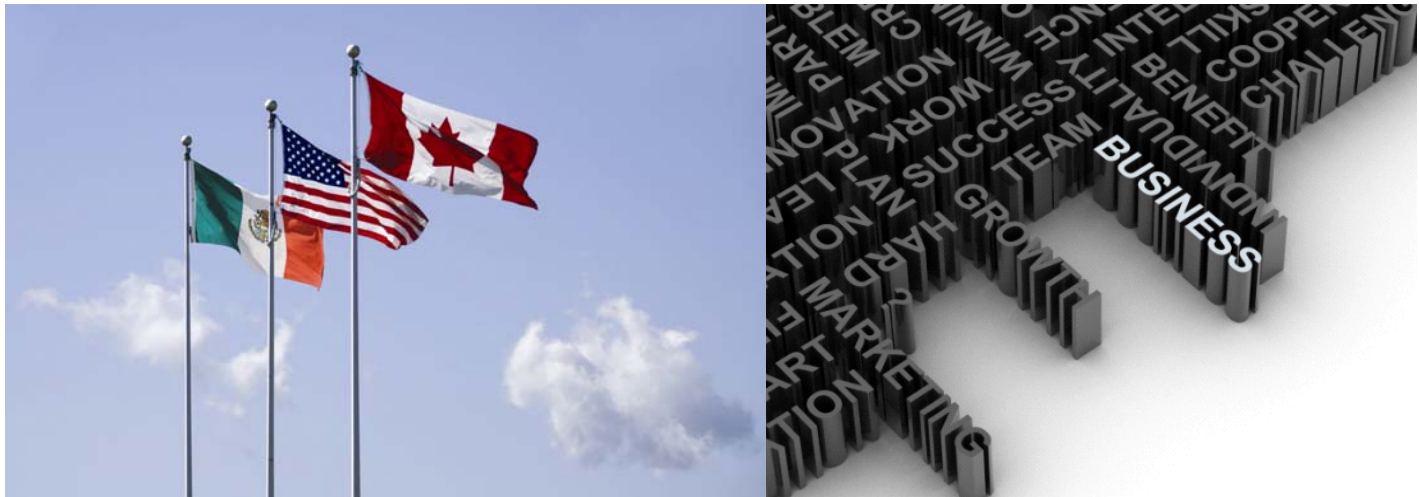




Doing Business In North America



Introduction

The information in this booklet provides an overview of the fundamental legal considerations to be addressed when acquiring or establishing a business in Mexico.

The content is intended to summarize some of the pertinent provisions which apply and is not intended as specific legal advice. Readers are well advised to seek the counsel of specialist professionals in Mexico to advise on compliance with the laws and identify the many planning opportunities.

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Overview

Introduction

Unlike the U.S., Mexico is a civil law country, and the vast majority of its laws are codified. The legal system is based on that of Spain. Although many practices and legal concepts are similar to the U.S., foreigners doing business in Mexico need to be aware of some significant differences. Most of the laws that govern business and commerce are set forth in the Commercial Code and the Civil Code, and are national in scope. Certain local differences may apply in some areas of the law but, in general, laws are the same across all of Mexico.

Mexico's governmental framework is similar to the U.S: there is an executive, a legislative and a judicial branch of government. It is also a federal system, with the federal government and the various states responsible for different aspects of public and private life. However, due to its unique history Mexico is a much more centralized government than the U.S. and the federal government controls much more legal and economic activity than in the U.S. In addition, certain legal formalities must be completed by state and municipal authorities.

Legal practices are quite formalistic; for example, the form of contracts can be quite important. Many documents must be prepared by a Mexican notary and executed in person, and then filed with great formality with public registries. Notary publics serve a more important function in Mexico than notaries in the U.S., have stringent legal requirements they must comply with, and are sometimes a bottleneck for

accomplishing certain activities. Many forms and permits must be filed with agencies in Mexico City, and this can lead to delays if one is not located there. The persons executing a legal document must have a valid power of attorney to do so, and this can also be a cause for delay. Foreign business people are often unprepared for the level of formality required both in normal commercial affairs and in dealing with government agencies in Mexico. An understanding of this aspect of doing business in Mexico will help in planning business activities there.

Its status as a civil law country and the emphasis on a centralized government also has an effect on the judicial system in Mexico. The central government and its agencies are the main force for enforcement of laws; lawsuits are relatively rare, slow and expensive. Judge-made law occurs in the rarest of circumstances, and most decisions do not have precedential effect. With very few exceptions, there are no juries in Mexico for either criminal or civil cases. Judges are both fact-finders and decision makers in a legal dispute, and the U.S. tradition of public trials does not apply in Mexico for either civil or criminal cases. There is a movement underway in certain states to change this with respect to criminal cases but the process of reformation of the judicial system is lengthy.

Types of Businesses and Operations

Overview

In choosing to conduct business in Mexico, businesses based in other countries should bear in mind that business entities are formed in accordance with the Commercial Code, which is national in scope. The choice of the type of legal structure depends on many factors discussed below. Legal and

financial advisors should be consulted in making this decision. In general, the choice of type of entity will be among the following:

- Corporations
- Limited liability partnerships
- Partnerships
- Various joint venture arrangements structured as one of the above
- Branch operations

Some key issues to consider in arriving at an appropriate arrangement include:

- Limited liability protection and risk management
- Funding and financing
- Public image
- Income and other taxes
- Repatriation of profits and capital

Forms of Entity

The most common form of entity in Mexico is the stock corporation with either fixed or variable capital (*Sociedad anónima-S.A.* or *Sociedad anónima de capital variable-S.A. de C.V.*). Other entities include the *Sociedad de Responsabilidad Limitada* (limited liability partnership), *Sociedad en Nombre Colectivo* (general partnership), *Sociedad en Comandita Simple* (partnership with limited and unlimited liability partners), *Sociedad civil* (civil partnership, for professional practitioners), *Asociación en participación* (joint venture contract), *Sucursal de sociedad extranjera* (branch of a foreign corporation), *Comerciante Empresa de persona física* (sole proprietorship), and *Asociación civil* (civil association, for charitable and other nonprofit corporations). The form of entity most often chosen by foreign investors is the stock corporation, with either fixed or variable capital, and the

limited liability partnership with either fixed or variable capital.

Foreign companies and individuals may own any portion of the equity of a Mexican company, with the exception of companies engaged in activities or acquisitions reserved or subject to specific regulation, such as banks, credit unions, oil and gas, electricity, postal services, and other governmental functions.



Stock Corporation

A stock corporation must have a minimum share capital of 50,000 Mexican pesos. The legal maximum amount of capital is fixed by the charter documents and any changes to the fixed capital require amendments to the charter documents and filings with the government, which is a relatively involved process. If there is a variable capital component, the capital can be changed without amending the articles, which simplifies the process of issuing more equity and is a reason this form of entity is favored. Ownership interests are represented by shares. Shares have equal rights unless the charter documents authorize the issuance of different classes of shares.

Stock corporations must have at least two shareholders, who may be individuals or other companies, and may have an unlimited number of shareholders. The liability of

shareholders for the debts and obligations of the corporation is limited to the amount of their equity investment. Under Mexican law, all shareholders must have the right to participate in receiving profits and the right to vote on amendments to the charter documents.

Stock corporations are managed by either a sole administrator or a board of directors, elected by the shareholders. Shareholders must have at least one general meeting on an annual basis within 4 months of the end of the year. Each share may have only one vote.

A stock corporation must set aside 5% of its annual net profits in a statutory reserve until its balance equals 20% of the capital stock.

Foreigners may serve as board members, but to represent the corporation in Mexico, they must have a resident immigration status. In performing their duties, members of the board of directors of a Mexican company have similar duties and liabilities as in a U.S. company. They must act within the limits of their authority and can be held personally liable for exceeding their authority unless the shareholders subsequently ratify such action. They can be held jointly and severally liable if they were aware of illegal or irregular acts of the corporation and failed to report these to the auditor. This joint and several liability can extend to illegal acts taken by other board members or the board as a whole; the liability is not applied if the board member objected to the illegal conduct. Directors have a duty to avoid conflicts of interest.

Limited Liability Partnership

The limited liability partnership is often compared to a limited liability company under U.S. law, as it combines characteristics of stock corporations and

partnerships. The limited liability partnership may also have a variable capital component, in which case it is designated an “S. de R.L. de C.V.” It must have at least two, and may have at most fifty, partners who may be individuals or other entities. As with corporations, liability of the partners for debts and obligations of the company is limited to the amount of capital to which they have subscribed. The minimum amount of capital is 3,000 Mexican pesos. A change in the fixed capital requires similar procedures as for a corporation, while a change in the variable capital is accomplished via partners’ resolutions. Ownership interests are called “equity participations” or “equity interests” and represent a percentage of the capital; they are not certificated and are not transferable except as permitted by law. Current partners have a right of first refusal over any new equity participations to be issued to third parties. The company keeps a register of capital accounts. Partners are the highest authority in an S. de R.L. and the company is governed according to a partnership agreement, similar to an operating agreement for a U.S. limited liability company. There is no requirement that the company have a centralized management, although it may have a board of managers if the partners so determine. Annual meetings are required, as for corporations. This is a “check the box” entity for U.S. tax purposes.

Joint Partnership

The joint partnership is an agreement by which one or more partners provide goods or services to their counterpart, managing partner, in exchange for the right to participate in the earnings of a commercial operation under the control of the latter. The joint partnership is not a separate legal entity. The managing joint venturer has liability to third parties, while the silent partner has no liability.

Branch Office

A foreign corporation may register as a branch office in Mexico by complying with certain formalization and public registry requirements and obtaining approval of the Ministry, the Department of Commerce and Industrial Development and the Industrial Promotion.

Maquiladora

A *Maquiladora* is simply a Mexican corporation or company which operates under a *Maquila* program approved for it by the Ministry of Economy (SE). A *Maquila* program entitles the company to foreign investment and management of up to 100% without requiring special authorization. Recent changes in the law have transformed these into IMMEX companies but the same investment rules apply (see below).

Establishing a Business

Incorporation

After selecting the form of entity, the process of forming the company begins. Depending on the form of entity and who the owners are, it can take 4-6 weeks to form a new company. The first step is to file a request for authorization and provide 5 possible names for the company, listed in order of preference, to SRE (Ministry of Foreign Relations). SRE authorizes the use of one or more of the name options filed. The charter documents are then prepared and must include the amount of share capital, both fixed and variable (if variable capital is included), how much capital must be paid in at formation, who the shareholders are, the company purpose, any limitations on transfers, the names of the board of directors or managers, whether meetings may be held by written consent,

granting necessary powers of attorney to the legal representatives of the company, etc.

As in the U.S., if the new company is a wholly owned subsidiary, the charter document is typically quite simple and formulaic. If the company owners include two unrelated parties, the negotiations of what is included can take time. The formation document is the equivalent of combined articles and bylaws in the U.S., and is prepared in the form of a deed by a Mexican notary and signed in person in front of a Mexican notary. Once the deed is notarized, the charter is registered in the commercial registry of the state where the company is located. The corporate existence is deemed to begin as of the date of the notarized deed of formation. In addition to the governing body of a board, a manager or the members (depending on the form of entity), companies are required to have a statutory auditor who signs off on the annual company accounts for tax purposes. The auditor does not need to be a CPA. Failure to annually approve the accounts and file this information with the government can result in penalties.

If the company has foreign shareholders, it must also register with the Foreign Investment Registry within 40 working days from the date of formation; any subsequent changes to the charter documents must also be notified to the Foreign Investment Registry.

Taxes and Related Matters

After formation, the company must apply for its RFC (tax ID number) with the Finance Secretariat. Depending on the industry in which the company operates, it may be required to file with a branch specific registry, e.g. the Register of Technological Industries. No business should be conducted until all authorizations

are obtained and the company is duly authorized and registered. All companies operating in Mexico pay Value Added Tax (VAT, known by its Spanish acronym IVA “eva”) at 15% on goods sold in Mexico, but not on goods that are exported. Proper administration of VAT records and payments is important. Companies also need to obtain their formal *facturas*, which is a receipt that includes the tax ID number, the VAT amount, the official company name, and so on. The *factura* documents expenses that are tax deductible and subject to VAT. There are a number of requirements on printing the *facturas* – only certain paper is allowed, only certain print shops may print them, the numbering must be consecutive and printed on the form, etc. It is not unusual among smaller Mexican companies or sole proprietorships to ask if a receipt (*recibo*) instead of a *factura* is acceptable; this removes the transaction from the tax rolls but is illegal.



Bank Accounts, Permits and Other Filings

Once the RFC number has been obtained, the company can proceed to open a bank account (a sometimes lengthy process), enter into contracts with utility companies and landlords, begin to hire workers and complete the rest of the administrative requirements for operating a business. The company can also apply for all necessary permits and make all necessary filings with the various social security agencies for

employees (discussed below) once it has its RFC number.

Foreign companies may lease properties and purchase real estate directly, except in a restricted area along the coast and borders. If a foreign company wishes to purchase real estate along the coast, a form of Mexican trust is used for this purpose. This process is relatively cumbersome and the assistance of effective local counsel is very important.

Recent Government Change in Corporation Formation

The Mexican government recently announced a new expedited process for forming companies, which should only take a few hours. The initial steps to incorporate a company – obtain the required approval of the company name, obtain the tax ID number, make the required filing with the Social Security Employer registry, and file the incorporation documents with the public registry – may now be done via the internet and should take no more than 2 hours if all necessary information is provided with the application. The required fees can be paid online. Note, however, that this option is currently available only for the formation of two types of company: an S.A. de C.V. and an S. de R.L. de C.V. This process presupposes that the articles of incorporation and company bylaws will be basic standard forms. The government website is www.tuempresa.gob.mx.

Once the online registration is complete, the articles of incorporation produced by this new system must still be formalized before a Mexican notary, which requires a personal appearance to sign the necessary documents and will continue to add time to the formation process. Nevertheless, the new system should streamline formation of companies that do not need specially drafted bylaws and articles, such as wholly owned

subsidiaries or smaller companies. It will also be of benefit to persons who need to form a company quickly, as the simple form of articles and bylaws can always be amended once the company is formed. Despite simplification of the process, we nevertheless advise consulting Mexican counsel prior to organizing a company in order to ensure that all necessary formalities are properly observed.

IMMEX and Shelter Operations

***Maquila* and IMMEX Companies**

Maquila operations date back to the '50s and '60s, and have gradually changed over the years with the advent of NAFTA and the opening of the Mexican market. In its simplest form, a *Maquila* operation is a Mexican subsidiary wholly owned by a foreign parent for the purposes of contract manufacturing in Mexico. The program permitted companies to import equipment, machinery, raw materials and semi-finished goods into Mexico duty-free, perform value-add operations on them, and export the goods back to the U.S. The equipment and machinery could be held in Mexico on a bailment basis while the *Maquila* program was in effect, after which it had to be re-exported or sold for its then-current value. The advantages also included a streamlined process for company formation, a lower income tax rate and the ability to have the work performed by lower-wage Mexican workers. The relationship between the U.S. parent and the Mexican subsidiary is memorialized in a *Maquila* agreement, which must be filed with the government as part of the approval process. At the outset, goods manufactured under this program could not be sold in Mexico but this has changed over the years due to NAFTA and changes in Mexican policy.

The Mexican government changed the program in recent years to combine it with a similar one that applied only within Mexico, and the current program is called IMMEX. It functions essentially the same way as the *Maquila* program did: foreign companies can set up a Mexican subsidiary, can import equipment, machinery and raw materials duty free, contract manufacture goods and export them. One difference is that the IMMEX company is now also permitted to sell its goods within the Mexican market; this has assisted the expansion of the internal Mexican market. An IMMEX company may further sub-contract parts of its operation to other IMMEX companies in Mexico, which helps broaden the manufacturing base also. The IMMEX application is filed with and approved by SE, and many of the formalities of forming the Mexican IMMEX company that will contract manufacture are similar to formation of any other enterprise (see above).

Not unexpectedly, the IMMEX application process is somewhat bureaucratic and while not difficult, the application must be prepared properly to avoid delays. A great deal of operational data is required (goods to be imported, materials used, length of time equipment will be used, copies of purchase orders, etc.) as well as the formation documents of the Mexican entity, the intercompany *Maquila* agreement and any other intercompany agreements such as management services. Good U.S. and Mexican customs broker are essential to ensure that all import-export paperwork is completed properly on both sides of the border.

Operating an IMMEX program properly also requires diligence on the part of both the foreign and Mexican affiliate. Each item imported into Mexico receives a *pedimento*,

a paper which documents the import. Upon export of the good or its transfer to another company, the *pedimento*, the certificate of origin and the invoice (*factura*) must accompany the item being transferred. The Mexican tax authorities audit IMMEX companies to determine whether all the papers are in order, that all the *pedimentos* match, and duty owed has been properly paid. Companies that are lax about their procedures and documentation have found to their distress that in addition to hefty tax fines for unpaid duty, the Mexican tax authorities can open an administrative process to investigate the company's customs filings, and impound machinery or equipment until the company can demonstrate that it was properly imported under an approved IMMEX or *Maquila* program.

Shelters

Shelter operations, also known as "instant *Maquilas*" or "rent-a-*Maquila*," are programs offered by companies that already have a *Maquila* operating and permit new companies to operate under their umbrella. Shelter companies offer a range of services, including HR services and employee leasing, facilities leasing or sub-leasing, customs brokerage, contract manufacturing, and general administrative services. The advantages for a new entrant into the Mexican market are clear: the company can set up quickly, without many of the legal burdens that may be difficult or time consuming at the outset. The shelter company is the legal employer of the employees, the tenant on the lease, and responsible for the taxes and other administrative burdens related to the shelter company. There is usually no long-term commitment required, and the program offers a new company time to organize, become familiar with the environment in which it is located in Mexico, and determine

where and when to set up its own IMMEX program.

Another advantage some American companies see in the program is that the shelter company is also a U.S. company, and the legal arrangements are subject to U.S. law. A new development that may affect shelter companies is an announcement by the IMSS (social security) that it has modified its regulations and laws to tighten control over the practice of outsourcing. These regulations increased the obligations of companies providing outsourcing services and those receiving the benefits of such services, and make the companies receiving the services directly liable for all IMSS quotas not paid by the outsourcing companies. In addition, both service providers and receivers must provide quarterly notices of their outsourcing relationships and agreements. Companies using these outsourcing services will have to improve their control over their outsourcing providers to avoid unnecessary disruptions in their work process.

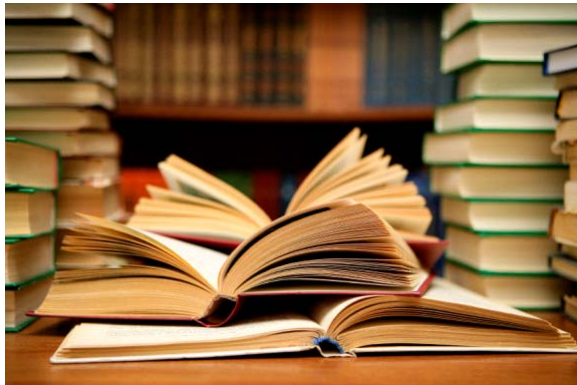
Labor And Employment

Employment Regulation Overview

Mexican labor law is based on the Constitution of the Mexican United States, specifically Art. 123; the federal government has exclusive power to issue special labor regulations. The Federal Labor Law (FLL) governs labor and employment, and is based on the principles of Art. 123 of the Mexican Constitution. State authorities apply the FLL within their jurisdictions, but certain industries, including regulated industries and those operating in multiple states, are subject to the exclusive jurisdiction of federal labor authorities and courts. The legal framework consists of formally adopted rules (e.g. laws and treaties) and supplementary standards. Labor laws are

implemented by various government agencies and tripartite commissions, and enforced by various judicial tribunals.

Once a “work relationship” is established between an employer and employee, the laws governing the rights of workers apply automatically. There is a presumption that a contract exists until proved otherwise, and the burden of proof is on the employer. While a labor contract can be modified after its creation, the changes cannot lead to a permanent reduction in the worker’s rights guaranteed by law, e.g. lower salary or work conditions. An employment contract is presumed to be indefinite unless it was entered into for a fixed term. While it is not required that an employer have a written employment contract with each worker, many companies do to simplify their burden of proof.



Pre-Hire Issues

It is standard practice in many Mexican companies to conduct pre-employment screening, including drug testing and a medical exam. Many companies also test for conditions that would be prohibited in the U.S., such as pregnancy or AIDS. It is advisable to ensure that HR personnel and local counsel experienced in employment law are involved in setting up pre-employment screening for a new Mexican operation.

Mandatory Employee Benefits

In addition to the statutory minimum wage, employers in Mexico are obligated to pay a number of statutorily mandated employee benefits, which at first glance support the reputation of Mexico as a very employee-friendly place. However, note that employers do not pay certain benefits that are common in the U.S. There is no generalized system of unemployment insurance as in the U.S.; workers who lose their jobs have no expectation of receiving unemployment benefits from the state. Employees are also not paid for sick days, nor for short or long-term disability. This is covered by the IMSS (Mexican social security agency). Not all companies offer private health insurance; there is a system of public health clinics and hospitals that provide care. Benefits and payroll taxes that are required by law include:

- PTU (profit sharing) of 10% of company profit annually
- IMSS (social security) of approximately 17% of wages but varies depending on various factors for each employee. This also covers disability pay and government health clinics
- SAR (pension) of approximately 2% of wages
- INFONAVIT (housing fund, which provides low-cost loans to workers to purchase a home) of 5%
- Paid vacation, which varies by seniority. After one year of service, 6 days is mandatory
- Overtime - double time for regular overtime and more on Sundays
- Seven paid legal holidays (although many companies offer other paid holidays)

- *Aguinaldo* (Christmas bonus, payable no later than December 20 each year) of a minimum of 2 weeks pay.
- Severance pay (see below)

Compensation and Fringe Benefits

In addition to the statutory requirements, in areas where it is difficult to obtain good workers or very rural areas, employers may also offer such benefits as transportation to and from work, free or reduced price lunches on site, medical care on site, or a monthly basket of house-hold necessities.

The minimum required daily wage in Mexico is 50 pesos, or approximately \$4.00. Obviously in wealthier or more urban areas such as large cities, benefits tend to be mostly financial; manufacturing companies outside of large population centers need to offer different incentives to find a good workforce. Note that many foreign companies have set up a separate company that holds the employees and leases them to the operating company, in an effort to restrict the amount of profit sharing that must be paid to Mexican employees. Care must be taken in structuring such dual companies to ensure they comply with the law.

Unionization

Art. 123 of the Constitution provides both workers and employers the right to associate. A union (“*sindicato*”) may be formed by workers or employers. A company with 25 workers or more is obligated to enter into a collective agreement with a union representing its workers. It is permitted, and often advisable, to enter into a contract with a union prior to reaching the 25-employee threshold, as this permits the company to select the union, rather than leaving it at the

mercy of an organizing drive. Labor unions may be:

- Trade unions: workers of the same profession or skill
- Enterprise unions: workers of the same enterprise
- Industrial unions: workers who work in 2 or more enterprises in the same industry
- National unions: workers in the same industry and located in different states
- Multi-craft unions

Different classes of workers (“positions of trust” or white collar vs. blue collar workers) may not be in the same union, but may form separate unions in the same enterprise if the white collar workers so choose. However, employees in a position of trust rarely form unions.

Collective Agreements are between a union and an employer and if requested by a union, the employer must enter into one. The general terms (e.g. paid holidays, overtime) are subject to review every 2 years, while salaries may be reviewed annually. To be effective, the Collective Agreement must be filed with the Federal or State Conciliation and Arbitration Board which has jurisdiction in that area. The Collective Agreement may be for an indefinite or a definite time period.

Unions may:

- Challenge the annual tax declaration (significant for the mandatory profit sharing requirement) and determine participation of individual workers in profit sharing
- Initiate a collective dispute on economic issues

- Sign collective agreements on behalf of workers
- Other, typical union activities, such as training, establish seniority and work rules, and monitor health and safety

Employer unions may be:

- Formed by numerous employers in a locality
- National associations comprised of numerous employers in multiple states

Mandatory Just Cause Termination

Although most Mexican employees are the equivalent of “at will” employees, meaning they may be terminated at any time, the process of terminating the employment contract is not simple and in many cases subjects the employer to liability for severance payments. It differs depending on whether there is a union or individual labor agreements. Dismissal (“*rescisión*”) of individuals must be for “just cause”; causes for dismissal are listed in Art. 47 of the FLL. The intent of the law is to protect workers and society against unemployment. If the employer terminates a worker without just cause, the worker has a right to demand either mandatory reinstatement or indemnification. However, workers in a “position of trust” and certain other categories of workers may not demand mandatory reinstatement because of the nature of their work. The employer must notify the worker in writing of the termination and the cause. Failure to do this means the termination is deemed “without cause” thus triggering the indemnification provisions.

Indemnification for workers dismissed “without just cause” includes:

- 3 months’ salary AND
- 20 days’ actual salary for each complete year of service AND
- accrued salary and bonuses AND
- “Seniority premium” of 12 days’ pay for each year of service rendered, which is set at twice the minimum daily wage (minimum is currently \$50 pesos, so \$1200 pesos per year of service would be owed)

There is no established procedure required for notification of termination or payment of the severance.

Higher indemnification is required for those hired for a fixed term who are terminated without cause: half the amount owed for the term if terminated in the first year, and 20 days’ salary per year for those agreements exceeding a 1-year term.

If workers are covered by a collective agreement, the termination process is different. The FLL governs the suspension or termination of a collective agreement, both of which require a procedure before the appropriate Conciliation and Arbitration Board. Consultation with the union during the entire process is required, as it serves as the attorney in fact for the affected workers. Termination of a collective agreement may be made for a number of reasons, including *force majeure*, unprofitability, or bankruptcy of the company. Prior approval of the Conciliation and Arbitration Board is required to terminate a union contract, which is obtained by filing a written request. The union must be involved with all aspects of the planned termination, as the representative of the workers. Upon termination, the workers have the right to:

- 3 months’ wages AND

- Seniority premium of 12 days pay, capped at twice the daily minimum salary, for each completed year of service

Despite the statutory requirements, as in the U.S., terminations and severance in Mexico are often negotiated and a release of all claims is signed by the employee upon payment of the agreed-upon amount. However, due to the statutory protections, care must be taken to ensure that any terminations are properly documented and able to withstand scrutiny by the Conciliation and Arbitration Board. A good union is also valuable in such situations, and this further reinforces the advantage of selecting a union at the outset of operations.

Recent Trend

A recent phenomenon is U.S. citizens claiming both U.S. severance and protection under the Mexican labor laws if they are terminated by their employer. These are employees who are hired and paid by the parent company in the U.S. but work across the border in Mexico at the foreign operation. As a matter of public policy, any employee who works in Mexico is deemed to fall under Mexican employment law and is subject to its protection. To avoid “double-dipping” severance pay by U.S. employees, a carefully-drafted employment agreement with indemnification provisions, and a services agreement between the U.S. parent and Mexican subsidiary, are necessary.

Workplace Safety

Mexican law requires all employers to meet minimum health and safety requirements within their establishments. Due to these requirements, the FLL allows for the creation of health and security committees. These committees are composed of

management level employees and the workforce they oversee. The committees, along with the labor authorities, have the duty of investigating work-related incidences and illnesses, determining their causes and developing safer procedures which they in turn implement and then oversee compliance.

The labor authorities and IMSS have the power to establish safety regulations and to inspect workplace premises to determine compliance with minimum safety standards and other industry specific standards. Employers may be sanctioned for noncompliance.

Record Keeping Requirements

Employers are legally responsible for maintaining accurate records regarding all social security benefits paid to workers, for making all required payments to the relevant government agencies, and withholding all taxes required by law. There may be personal or criminal liability if the withholding is not done or is done incorrectly. In addition, employers must keep copies of the employment contracts.

Discrimination, Harassment and Retaliation

The Federal Law to Prevent and Eradicate Discrimination, enacted in 2003, provides that no person may be discriminated against or denied access, maintenance or promotions in the workplace on the basis of sex, race or religion. This is a relatively new statute and enforcement remains weak. Individuals may not sue directly but must rely on government agencies to investigate and enforce. The National Board for the Prevention of Discrimination and the Secretariat of Labor are two agencies tasked with enforcement of the anti-discrimination statute.

Immigration

Overview

The continuing liberalization of the Mexican market, combined with NAFTA membership, have facilitated immigration for work purposes for citizens of the U.S. and Canada. Immigration is governed by the federal Mexican Immigration Code. The Secretariat of Interior (*Secretaría de Gobernación*) administers and enforces the Immigration Code. In addition to the Immigration Code, administrative regulations and internal policies also apply to immigration issues. Internal policies are set by the Secretariat of Interior, the General Bureau of Population (*Dirección General de Población*) and the Department of Immigration (*Instituto Nacional de Migración*). Generally speaking, Mexico distinguishes between visitors and immigrants (those who wish to take up permanent residence). The discussion below focuses on the types of visas most frequently required by business people.

Visitors

Visitors' (*visitantes*) permits allow foreigners to enter the country to carry out certain specified types of work. They are typically granted for one year, with four extensions of up to one year each permitted. Two types of visitors' permits are issued, depending on the type of work to be performed by the visitor while in Mexico. In all cases involving immigration matters, prior consultation with experienced local immigration counsel to assist with application is advised.

Visitante FMIII is the type of permit generally issued for those who have been authorized to temporarily engage in work in Mexico which is more extensive than that permitted under the normal visitor's permit

and for which the individual will receive compensation from Mexican sources. Reasons for obtaining this type of permit may include: to conduct business with the ability to exceed beyond talks, potentially negotiating and/or forming contracts; to participate in gainful employment within Mexico subject to the limitations of one's immigration papers; to participate in a Mexico-based corporation's board of directors and/or shareholder's meeting. Requests for this type of permit must be filed with the Ministry of the Interior in Mexico City. This second type of permit should be requested when the anticipated activity in Mexico is more long-term. This type of permit will not allow permanent transfer of residency to Mexico. Often, the time required for processing the application for this type of permit is much longer than the time period for processing a permit under which Mexico-based compensation is not allowed.



Consultants and NAFTA

The law establishes a separate category of permits for foreigners who only wish to attend shareholder or board of director meetings in Mexico. Such individuals may be granted a permit under a separate classification for visiting board members or visiting consultants (*Consejero*). These permits are valid for a period of one year and like the visitor's permit may be extended for an additional four years granted

in one-year periods. However, under this permit no visit to Mexico may exceed thirty consecutive days.

NAFTA allowed for the creation of a status known as *FM-N* (N standing for NAFTA). This status was developed for people from Canada and the U.S. who are doing business in Mexico. It allows individuals, for a period of thirty days, to conduct business and negotiations in Mexico, so long as the individual does not earn money from Mexico sources.

Immigrant Status

As in the U.S., obtaining immigrant status is more difficult than a temporary visitor's permit, and depends on many factors such as the type of business involved, how long the company has been in existence, its effect on the Mexican economy and employment, and similar matter. Investors, executives or specialists who intend to become permanent residents of Mexico must apply directly to the Ministry of the Interior in Mexico City for an immigrant visa (*Inmigrante FMII*). If an immigrant visa is issued, it must be renewed each subsequent year. After five years of continuous renewal, permanent residence status may be requested (*inmigrado*, meaning one who has immigrated and obtained the right to permanently reside in Mexico). Petitioning for immigrant status can be an onerous and time-consuming task; generally one must demonstrate that the purpose he/she seeks to fulfill in Mexico justifies the immigrant status being granted.

There are multiple sub-categories under the category of "immigrant." These sub-categories include: Investor (*Inversionista*); Professional (*Profesional*), Confidential Personnel (*Cargos de Confianza*), Scientist (*Científico*) and Technician (*Técnico*).

Investor status is issued to persons who plan to become permanent residents of Mexico and plan to invest in Mexico industry. The Ministry must determine that this investment will aid economic and social development before Investor status is granted.

Professional status is rarely granted. This status allows one to practice his/her profession in Mexico. In order to obtain Professional status one must register his/her professional degree with the Bureau of Professions, Secretariat of Public Education which also has the responsibility of determining whether to grant approval of the application.

Confidential Personnel are persons who are positioned in upper level management positions or in positions of trust and confidence within the Mexico-based establishment. The *Secretaría de Gobernación* must determine that it is necessary for this individual to be granted immigration status due to the important services rendered by this person and the responsibilities entrusted to this person within the enterprise.

Scientist status is given to persons who lead or conduct scientific research, teach, or train research staff. Such activities should be conducted with the purpose of advancing Mexico development. Finally, Technician status is given to persons who possess special research capabilities not currently known to be possessed by present Mexico residents. These individuals are generally expected to conduct research in the areas of production and development in which the Technician's employer is presently involved.

In order for an application for immigrant status as a Technician to be renewed, one must have at least three Mexicans training under him/her in his/her area of expertise.

Further, if a company has been in existence for less than two years, it is likely that only a person applying as a Technician will receive immigrant status. A person applying as a Confidential Person or a Scientist will likely have to obtain *visitante* status for the first two years of a company's operation.

If one is anticipating acting in one of these types of positions for a semi-permanent period of time applying for immigrant status should be considered. It should be noted that the process of sponsoring a person in petitioning for immigrant status (*immigrante*) is generally more burdensome than sponsoring one in obtaining a visitor's permit (*visitante*). Immigrant status permits the foreign worker to obtain a power of attorney and legally act in Mexico on behalf of the Mexican company, including signing contracts and obtaining loans. Under the Civil Code, visitors who are not permanent residents may not be granted powers of attorney to act for an Mexican company; such powers are reserved for residents of the country.

Sponsorship

Foreign entities or corporations sponsoring a *visitante's* application for purposes of having that person conduct the company's business activities in Mexico should have at least \$150,000 pesos invested in the enterprise. This is not mandated by statute but is a threshold frequently used in practice. If the amount invested is less than \$150,000 pesos the Bureau of Immigration, when reviewing the application, is more likely to question the good faith quality of the sponsorship.



Payments To Foreign Persons

Dividends

Dividends of a Mexican subsidiary to its foreign parent are subject to the withholding obligation discussed below, and are included in the income subject to the mandatory 10% employee profit sharing.

Management Fees and Administrative Support Reimbursements

In order to be deductible, expenses for management fees and administrative support must meet the test of being "strictly indispensable" for the conduct of the business. Charges from a foreign affiliate for a pro rata share of general and administrative expenses or research and development costs are not deductible, except in the case of branches or other permanent establishment of foreign corporations.

Executive Compensation

Fees paid by a company domiciled in Mexico to a non-resident for services performed in Mexico, including director's fees, are subject to a flat 30% income tax withholding rate. There are no specific limits on amounts paid, as long as all normal payroll taxes and income tax withholdings are paid. After the withholding is made, the amount withheld can be credited toward the payment of taxes in the country of tax residence pursuant to the tax treaty.

Interest Payments

Interest on loans from related parties is deductible if the loan proceeds have been invested in the business of the company and proper withholding taxes, if applicable, have been paid. The rules on intercompany transactions apply, including the requirement that the terms be arm's length.

Royalties, Leases and Fees for Technical Services

Royalties paid to foreign licensors are deductible if the appropriate taxes are withheld, and the rules on intercompany transactions are met. They are only deductible if the corresponding fees are paid for services or know-how actually received, nor merely for the right to receive them, and the payments are made to the companies that directly provided the services involved.

Royalties are considered to include payments of any kind for the temporary use of patents, inventions, trademarks, copyrights, and commercial, industrial or scientific equipment and software.

Customs

Overview

Mexico is a free-trade country. In addition to NAFTA, it currently has trade treaties with over 40 countries. As a result of the full implementation of NAFTA, there are now virtually no tariff barriers for U.S. exports to Mexico. However, this free-trade mentality does not mean that the importation process is less complex or bureaucratic as a result. The importing process is subject to numerous regulations administered by many ministries and agencies, and failure to complete forms correctly or inadvertent oversight of customs requirements can have serious consequences, including fines and confiscation of products.

The best advice for companies importing and exporting into Mexico is to hire experienced freight forwarders and customs brokers. The agency with primary responsibility for the administration of foreign trade in Mexico is SE. In addition, the Ministry of Finance and Public Credit (*Hacienda*) imposes requirements, as does the Health Ministry, the Agricultural

Ministry and the Transportation Ministry. Mexico is party to numerous trade treaties so it is important to review the customs regime for the country exporting to Mexico. The customs regime changes with some regularity, and the information below is general in nature. It is imperative to consult a customs broker prior to beginning imports into Mexico to ensure that both the application process and the on-going paperwork are completed and filed properly.



Imports

For tax purposes, all Mexican importers must apply to and be listed on *Hacienda's* list of importers (*Padron de Importadores*). In addition, *Hacienda* has supplemental sector registries for such items as textiles, chemicals, electronics and auto parts. Mexican importers of items in these sectors must make separate application to be included in these registries. Mexico's import tariffs are assessed against goods classified according to the Harmonized Commodity Description and Coding System.

Duties

Under NAFTA, duties are calculated based on the U.S. plant value of products, as evidenced by the invoice, plus the inland freight charges and any other charges listed separately, such as packing. NAFTA compliant products imported into Mexico

are not subject to the customs processing fee (CPF) unless they are only temporarily imported, in which case it may be levied. NAFTA products must be accompanied by a certificate of origin. Goods imported under an IMMEX program are exempt from duty. U.S. companies do face certain non-tariff barriers, including the requirement to post a bond or guarantee the importation of certain goods which are subject to under-valuation. Mexico has established a list of such products, and set a minimum estimated price for the goods on which duty is calculated. The guarantee is often in the form of a cash deposit or a line of credit which must be held by a Mexican bank; the fees for opening and administering such accounts are relatively high. Mexico has implemented what are called “Sector Promotion Programs” (PROSEC) which reduce MFN tariffs to between 0-5% on a range of products considered necessary for the Mexican economy.

Value Added Tax

In addition to any duty, VAT is levied on goods imported into Mexico, unless they are imported on a temporary basis under an IMMEX program. VAT is 10% on goods that remain within the designated border areas and 15% on those imported into the interior of Mexico. Certain goods, such as food and drugs, are exempt from VAT. Alcohol and tobacco products are subject to extra tax at the border of between 20% and 110%, depending on the product.

Import Licenses

Certain sensitive items are subject to qualified import licenses issued by various governmental agencies, and the difficulty of obtaining such licenses varies with the product involved. Examples include weapons, some leather and fur products, medical products and equipment and

diagnostic equipment, and toxic and hazardous products. Penalties for importing without a required license are fines plus penalties calculated as a multiple of the value of the imported goods.

Import Documents

The basic Mexican import document is the *pedimento*, which must be accompanied by a commercial invoice in Spanish, a bill of lading, certificate of origin, documents demonstrating guarantee of additional duties for undervalued goods (see above), and documents demonstrating compliance with Mexican product safety and performance regulations. The *pedimento* must be retained and accompany any goods that are re-exported, for instance via the IMMEX program. If *pedimentos* are not properly filled out, or the importing company cannot demonstrate that the goods were properly imported, the tax authorities may impose hefty fines or impound the goods or equipment involved.

All products intended for retail sale in Mexico must bear a label in Spanish prior to importation into Mexico. Products must also comply with all commercial and sanitary Mexican mandatory technical standards (NOM) which are government-imposed standards of quality and safety. A company importing products subject to such standards must obtain a NOM compliance certificate prior to import, which must be presented with the products at the time of entry into Mexico. The NOM standards are frequently updated and revised, and the importing company should regularly check with SE regarding import of categories of items which are usually subject to NOM standards. NOM standards frequently require certain labels be affixed to imported goods, e.g. electronic products, toys and apparel.

Exports

VAT is not levied on exports. Certain goods are subject to export licenses before they can be exported from Mexico; it is advisable to consult with an experienced customs broker prior to shipment.

Federal Income Tax

Overview

Consistent with its overall system of government with most control centered in the federal government, the Mexican tax system is comprised of separate federal, state and local taxes, with federal taxes by far the most important. Federal taxes support the national government, and in many cases are shared with the state governments pro rata. This booklet only discusses the Mexican federal tax system. In addition to income taxes, the Mexican federal tax system contains specific excise taxes and a value added tax. The Mexican Congress enacts federal income tax legislation, and annually approves the federal revenue law (*Ley de Ingresos*) which principally lists the amendments to the federal tax laws and specific federal taxes to be imposed during the year. *Hacienda* is empowered to issue regulations for implementation of the tax laws, which interpret the legislation.

Mexican Corporate Income Tax

Mexican corporations and all other Mexican entities other than non-profit organizations are taxed on their worldwide income. Nonresident corporations, including branches of foreign corporations registered to operate in Mexico, whose principal administration or management is established in Mexico, may be considered to have a permanent establishment in Mexico and be taxed on their worldwide income as well.

Nonresident corporations which are not considered to have a permanent establishment in Mexico are taxed only on their Mexican-source income at a flat rate applied on a withholding basis. All Mexican entities other than non-profits are taxed in accordance with the rules applying to corporations.



Mexican corporations pay a 28% federal income tax on their corporate profits. Corporations may reduce their corporate income tax burden by re-investing profits. The corporation must pay the deferred tax upon distribution of the profits. Any income tax paid to foreign countries on income received from foreign sources will usually qualify for tax credits against a Mexican corporation's Mexican income tax liability. Mexico has tax treaties with a number of countries, including the U.S. and Canada, to address double taxation.

Corporate profits are calculated by deducting certain allowed expenses from accruable gross income. Income is considered accrued when the first of the following occurs: an invoice (*factura*) is issued, goods are delivered to the buyer or services are rendered, or partial amounts of the transaction are collected or payable, including advance payments.

Dividends received from a Mexico corporation are not includable in gross income nor are they deductible by the

distributing company, while dividends received from foreign corporations are fully taxable. Dividends paid to a Mexican company's foreign shareholders are subject to 5% withholding tax. Five per cent of profits must be set aside annually until the amount so retained reaches 20% of the value of the outstanding capital stock.

Filing Dates for Returns and Payments

Taxpayers must use the calendar year as the fiscal year. Annual income tax returns must be filed by March of the following year. Most corporate taxpayers are required to file income taxes through monthly provisional payments, calculated on the basis of 1/12th of the previous year's annual taxable income, which will be credited against the annual income tax return. Most company financial statements must be audited by an independent public accountant. The annual accounts and the disposition of any profit must be approved by the shareholders or partners each year at an annual meeting called for that purpose. Companies that are listed on the Mexican stock exchange are required to publish their accounts in the newspaper; privately held companies are not.

Accounting Standards and Practices

Mexican accounting standards and practices are similar in many respects to the U.S., with a few key differences. As a result of historical periods of high inflation, the value of non-monetary assets must be adjusted annually. A company that has operations in both the U.S. and Mexico should select accountants that have experience on both sides of the border.

Withholding Taxes

In many cases a company making payments to third parties is required to withhold and pay to the tax authorities the income tax owed by the third party. This is the case in general for all payments to individuals (e.g. payroll, dividends). In all cases the company is jointly liable for the tax that should be withheld. Failure to make the appropriate withholding is subject to interest and fines.

Enforcement

In recent years, general rules to avoid abuse through transfer pricing have been broadened. Payments to related parties should be on an arm's length basis and properly documented in order to be deductible. There are strict rules regarding documentation, withholding taxes, and prior authorization for certain deductions, which if not complied with, may result in denial of deductibility of costs and expenses. All items to be deducted must be set forth in a proper *factura* or the deduction can be denied. Tax authorities generally base their analysis on the documentation and not the purpose of a transaction, giving rise to the statement that form may rule over substance. They can be aggressive about pursuing delinquent taxes, taxes not properly withheld and improper returns.

Clearance Procedures

Under the rules of the Tax Code, taxpayers may request advance rulings from *Hacienda* on specific transactions before carrying them out. Advance rulings provide legal certainty as to the effects prior to completion; however, these have been curtailed by recent changes in the tax law. Such rulings are difficult to obtain and the process can be lengthy and time consuming.

If the ruling adversely affects the taxpayer's interests, this can be overcome by obtaining annulment in the tax court or federal appeals courts, but this causes further delay and is uncertain.

Tax Audits and Appeals

Income tax returns are considered accepted by the tax authorities as filed, although they are empowered to review or audit in detail any return they may choose. There is no specific rule that guides who may be selected for audit. The audit may include a detailed review of accounting records to determine compliance with tax duties. Any type of federal tax is subject to audit, including foreign trade taxes, import duties (and the corresponding *pedimentos*), payroll taxes and income tax. Keeping meticulous records is important with regard to all tax matters, as the form of the documents filed is very important. Generally speaking, audit rights and the ability of the authorities to collect additional taxes expire after 5 years. However, in cases where the taxpayer failed to conform to certain form requirements, such as maintaining tax records for 10 years, the statute of limitations is 10 years.

Sales, Use and Other Taxes

IETU

The IETU tax (*Impuesto Empresarial a Tasa Unica*, tax on EBIT plus investments) serves as a minimum tax. A Mexican taxpayer corporation must pay an IETU tax of 17.5% on net income only to the extent such amount exceeds the company's regular income tax for the year.

Value Added Tax

A company doing business in Mexico will also be obligated to pay VAT at a general

rate of 15% on sales, rents, and imports of goods and services. A discounted 10% VAT rate applies to transactions in certain border areas, and certain items (food, medicines, books) are exempt from VAT altogether. Normally VAT is paid in addition to any import duties that may apply to the goods imported, but companies operating under an IMMEX program do not pay VAT on the equipment, materials or inventory that they import. VAT is not levied on exports. It is paid at each stage of a commercial transaction to the "upstream" operation, and is reimbursed from the "downstream" operation. The ultimate consumer pays the VAT in the end. Companies must file their VAT reports and make payments to the tax authorities monthly. States and municipalities are prohibited from taxing transactions subject to VAT; they receive a portion of the federal VAT receipts.

Employment Taxes

Mexican corporations are subject to a local state payroll tax and federal social security and labor contributions which may equal up to 35% of the payroll (for details see above). Payroll fees and taxes are deductible for income tax purposes. All salary payments for workers residing in Mexico will be subject to a withholding tax of up to 28%, while salary payments for workers residing abroad are subject to various tax rates.

State and Local Taxes

Although the federal income tax is the main tax levied on Mexican companies, states and municipalities may also impose certain taxes. These normally take the form of property taxes, taxes on the transfer of real property, and payroll taxes.

Other Indirect Taxes

In addition to the taxes discussed above, there are federal excise taxes on alcohol, cigarettes and gasoline. There are also federal taxes levied on the ownership of automobiles and on the purchase of new vehicles.

Financing The Mexico Operation

Owner Loans and Capitalization

As in the U.S., most Mexican companies are financed by initial capital or capital increases. Each form of Mexican entity has a minimum capital which must be paid (see above). If a form of entity with variable capital is selected (see above) increasing capital when needed is a relatively simple matter. Companies in Mexico are not taxed on their capital or the number or value of shares outstanding. Generally speaking, intercompany loans are treated the same as third-party loans with respect to deductibility of interest. However, if certain criteria are met, the interest paid may be characterized as a non-deductible dividend. These criteria include a payment on demand clause and if the interest is based on obtaining certain profit levels.

Bank Loans

The type of financing chosen to fund operations in Mexico depends upon multiple factors. If a company plans to produce and sell goods in the local Mexican marketplace, a local commercial bank may be the best source of financing. A local bank has the ability to make loans either in Mexican pesos or in foreign currencies. If the entity is a Mexican subsidiary of a foreign company, the bank may be willing to negotiate a line of credit with the parent company for the subsidiary so long as the

parent company guarantees the loan. Financing tends to be expensive in Mexico and the application process can be cumbersome.

Other Financing Sources

Bancomext (the Mexican export import bank) and Nafinsa (a public financing agency) also have financing available, but their rates are usually higher than foreign financing options. Details can be obtained from the Mexican federal government or incentive agencies.

Venture Capital

Venture capital in Mexico is still in its infancy and largely foreign-based. However, there is growing interest from the private sector, universities and governmental bodies. Venture capital as a means of financing is expected to grow in the next few years.



Economic Development Incentives

Historically, Mexico provided few investment incentives. Of those provided, many were repealed in an effort to reduce national debt and those that remained were mainly industry-specific. Tax incentives were marginal. In more recent years, as part of the general liberalization of the Mexican economy, the Federal and State governments of Mexico, through the utilization of Executive Decrees, have modified laws and

tax rules to make Mexico an appealing location for development. ProMexico is the agency responsible for attracting investment to Mexico. It has offices in a number of U.S. cities.

Federal Tax Incentives

Seeking to encourage industrial movement outside of Mexico City, Guadalajara and Monterrey, areas already highly saturated with industrial development, Mexico provides some federal tax incentives to develop factories outside of these industrial zones. Further, if a company upgrades to more modern equipment it may be able to take advantage of accelerated depreciation of the new equipment. Specifically, companies that purchase pollution control equipment may be eligible for accelerated depreciation of this equipment at a rate of up to 35% per year. Finally, the Federal Government, through the National Commission of Science and Technology (CONACYT) provides support for funding research and development projects, which may be granted to taxpayers who invested in research and development projects during the fiscal year.

State Tax Incentives

In order to further encourage industry in various locales, many Mexico state governments have active economic development programs that include various incentives to locate new business, or grow or retain current businesses, in that state. These include offering incentive packages which may include reduced property taxes. Additionally, states are encouraging development through the use of exemptions in areas such as payroll taxes, construction licensing fees, real estate tax and utility connection fees. Exemptions are also being utilized to encourage environmentally friendly investment projects. Depending on

the state in which the foreign company is located or the specific industry involved, the incentives can be very generous. As in the U.S., application for such incentives is fact intensive and requires the assistance of counsel or consultants with experience and good contacts to local and state government.

Tourism

The main non-tax incentives that Mexico offers are in the area of tourism. The Mexico government has traditionally sought to encourage the development of hotels, condominiums, shopping centers and other such types of establishments. The rights to established tourist locations can be purchased at subsidized rates from FONATUR, Mexico's tourism agency. The agency develops these locations and provides consultation regarding development plans and projects. Foreigners are authorized to purchase these properties and are permitted to own all of the rights, except legal title to land in the coastal areas or along Mexico's borders. There are no restrictions on ownership of nonresidential property in these locations. FONATUR made a substantial investment to develop the necessary infrastructure to support numerous resort developments.

Industrial Parks

Industrial parks have been developed in many areas in order to provide the necessary infrastructure required by the development of industry. Land is generally available in these locations and can often be obtained on investor friendly terms. The terms of the investment package may be included in other incentive arrangements offered by the state or municipality.

Free Trade Zones

There are a number of duty-free zones in border areas that were traditionally the site of *Maquila* operations. These tend to be industrial parks close to the U.S. border and details vary from state to state. They can be important for non-NAFTA countries, but with the full implementation of NAFTA are less relevant for the U.S. and Canada now than in the past.

The *Maquila* or IMMEX Program

In an effort to increase employment opportunities in Mexico, the government implemented policies to facilitate the development of *Maquiladoras* (now IMMEX). As previously noted, *Maquiladoras* may be entirely owned by foreign investors. The *Maquila* program allows a company to register with the National *Maquiladoras* Industry Registry and obtain special customs treatment. This program allows for duty-free importation of all necessary components of production, assembling or processing in Mexico and exportation. The U.S., the main location to which such exports are sent, has generally only levied import duties on the added value of the export. Although they were earlier restricted to only border areas, *Maquilas* can presently be operated all over Mexico.

Export Incentives

Some of the most important incentives offered by Mexico are found within the context of the Mexican economic development plan. These incentives are designed to increase the export of manufactured goods. Size of an establishment or percent of foreign ownership of the entity does not affect these incentives' applicability. Given the changing landscape in Mexican economic development, the programs sponsored by the

Mexican government vary over time. Current SE export programs include: temporary imports program (IMMEX); high volume exporting companies program (*Programa de Empresas Altamente Exportadoras*—ALTEX); and import duty drawbacks (*devolución de impuestos a los exportadores*). It is advisable to seek the advice of experience local counsel to work with local and federal authorities to complete incentive applications.

Product Liability

All Mexican entities and individuals that produce, distribute or sell goods are subject to the Federal Consumer Protection Law, which is administered by the Federal Consumer Protection Agency (PROFECO), which has power to levy fines and shut down businesses violating the law. The Federal Consumer Protection Law was passed to protect consumers against merchants and manufacturers who do not comply with minimum standards or specifications for products and services. In addition, SE is empowered to impose fines and use other enforcement measures to protect consumers. There are minimum standards for sanitation and safety and availability of spare parts. Food products and medicine are subject to special regulations and control.

The Mexican Civil Codes do not have specific provisions governing the liability of manufacturers for damages caused in Mexico by defective products. Lawsuits for defective products are extremely rare in Mexico, due to the reluctance of the courts to recognize liability of manufacturers for such products. Any such action would be based on Art. 1910 of Federal Civil Code, which governs liability generally for “wrongful acts.” A plaintiff would need to prove negligence or misconduct on the part of the manufacturer; while not impossible, it

is not part of the Mexican legal or commercial culture to sue for product liability.

Damages awards are also extremely limited, covering only compensatory and not punitive damages. Compensation for medical and other expenses and lost wages are standard in the event a claim of damages resulting from defective products is proved. Any further damages, such as disability, is limited by statute to an amount set in the FLL, a maximum of four times the amount of the highest minimum daily wage in effect in the region. U.S. companies should note, however, that they are subject to U.S. law for products manufactured in Mexico and imported back into the U.S. While the risks of being sued in Mexico for defective products are low, if defective products are imported into the U.S. the legal risks are the same as those of any U.S. manufacturer.

Litigation

Overview

Although at first glance the judicial system in Mexico appears quite similar to the U.S., a closer analysis reveals fundamental differences. As a federal state, like the U.S., Mexico has federal and state courts which dispense justice based on jurisdiction over certain subject matters. However, due to certain unique features of Mexican law, in particular the process of *amparo*, which permits citizens to appeal many state court decisions to federal courts, lawsuits that begin in state courts may continue in federal court. Other key differences to the U.S. are the following: the absence of juries, the central role of judges, and the lack of public trials. Except for certain limited offenses, all cases are tried to either one or a panel of three judges. In certain appeals cases, an *en banc* panel of judges will hear a case. As is customary in civil law countries, judges

serve as both the finder of fact and the interpreter of the law. Most trials are conducted primarily on the basis of written submissions of complaints and evidence filed by the lawyers for either side; oral examination of witnesses, if any, is usually conducted by the judge, and the judge and his or her clerks are responsible for collecting and organizing the evidence on which to decide the case. All evidence in support of a claim must be attached to the complaint. The “trial” is not as one would see in the U.S. – there is no public hearing and the judgment is handed down based on the documents and evidence provided to the judge.

Commercial Disputes

Overall, Mexico is less litigious than the U.S. and most business people attempt to resolve their differences outside of court. As in the U.S., litigation is costly and time-consuming. There is no injunctive relief in Mexico so companies that need quickly to obtain results are more likely to negotiate than litigate.

Commercial matters in Mexico are governed by the Commercial Code, which also includes procedural rules. Commercial disputes are normally brought before the state civil courts, with the statute determining where the lawsuit must be filed. The loser in a lawsuit may have to pay both lawyers if it was agreed to do so, or if the plaintiff filed a lawsuit without merit or in some way abused the litigation process. Lower court decisions can be appealed to appeals courts, which may or may not stay the enforcement of the lower court’s decision pending appeal. There are procedures for summary enforcement of judgments, including attachment and sale of a debtor’s property.

Overview of Commercial Litigation

Commercial lawsuits are initiated in the local courts with a first instance litigation which is heard by a single judge. The ruling of the local state court may be appealed before the State Court of Appeals (*Tribunal Superior de Justicia*). The ruling of the State Court of Appeals may be appealed by the *amparo* proceeding to the Federal Courts of Appeals. Secondary court rulings that do not end a trial may be appealed to the federal District Courts. There are no jury trials in Mexico except for treason cases. Trials can be lengthy as there are opportunities for delay on the part of the defendant and the proceedings are largely written.



Stages of a Civil Lawsuit in Civil Court

Prior to filing a complaint, there are three possible types of preliminary discovery or pre-filing motions.

1. Pre-filing stage (*Etapa Preliminar*)
 - a. *Preparatorios del proceso* – a party tries to clarify a doubt, remove an obstacle or cure a defect before a complaint is filed, for example to obtain an admission or denial

regarding facts, production of property or evidence or prior examination of witnesses

- b. Filing motions for interim equitable relief (*medidas cautelares*)

2. Opening or introductory phase (*Etapa Expositiva*): Statement of claim or response

- a. This stage is also called *etapa postulatoria* or *etapa introductoria*. The parties state their claims to the court, including the facts and the law on which they rely. These are made by written submissions of a complaint by the plaintiff and a written response by the defendant.

- b. The judge rules on admissibility of the complaint. If the complaint is admissible, then the Court serves the defendant who has 9 days to respond for normal civil suits. Failure by the defendant to respond can lead to a default judgment

- c. The defendant's response may be:

- i. Acquiescence to demand (*allanamiento a la demanda*),
- ii. An affirmative defense (*oposición de excepciones*), or
- iii. A counterclaim (*contrademanda*)

- d. A pre-trial conference is held within 10 days of the defendant's response (*audiencia previa y de conciliación*)

3. Evidentiary Stage (*Etapa probatoria*)

The parties prepare and present evidence to the court. The judge conducts this stage without any intermediaries. Only facts may be introduced into evidence and these may include evidence of usage or custom. The rules of evidence are less stringent than in the U.S., since a judge is collecting and

weighing the evidence, rather than a jury of laypersons. There are relatively few hearings; witness testimony is similar to a deposition in the U.S. and conducted by the judge and the lawyers.

4. Closing stage (*etapa conclusiva*)

The parties make their closing arguments, reciting the facts and law that they find relevant. The judge issues a judgment (*sentencia*) which must include a discussion of the issues and the evidence and the basis in law for the decision. The judge's decision binds only the parties, and is not precedent for later cases between other parties. This is a key difference to the U.S. legal system.

Appeals Court

Appeals courts in Mexico may review not only the legal conclusions reached by the lower court but also its factual findings. The appeals court may reject the lower court's factual findings if it is clear that the lower court misinterpreted the facts. Appeals are classified as ordinary, special or exceptional.

Ordinary appeals (*medios de impugnacion ordinarios*) include a motion to appeal and a motion for reconsideration of an interlocutory order of a trial judge.

Special appeals are only for challenges to certain types of decisions set forth in the Civil Procedure Code (CPCDF) Art. 723, and a civil action filed against a judge for violating the law either negligently or through inexcusable ignorance.

Exceptional appeals can be filed even after a case has been finally decided.

Ordinary appeals

These must be filed with the judge who issued the judgment, within 6 days of an interlocutory decision and 9 days of a final decision. The lower court judge forwards the appeal to the appeals court, which agrees to hear if it meets the statutory requirements. A stay of execution of the lower court's judgment may or may not be granted. No new evidence may be introduced other than evidence of an event that took place after the trial began and was cause for a dismissal.

There are five phases to an appeal:

1. Receipt of the appeal, consideration of admissibility of the appeal and determination of the effects of the motion
2. Statement of causes for the appeal
3. Review of the evidence
4. Arguments
5. Final decision by the appellate court

The appeals process is largely written, with closing oral arguments made by the parties. The final ruling may uphold the lower court's decision, partially modify the lower court decision, or completely overturn the lower court decision. In the latter two instances, the case will be returned to the lower court for action in keeping with the appellate decision.

Enforcing Foreign Judgments

Judgments and other judicial decisions from foreign courts have the force in Mexico that its treaties may provide. In the absence of a treaty, they have the same force as is given to Mexican judgments and decrees in the country of origin. Foreign judgments and decrees will be enforced only if:

- they comply with regulations relating to letters rogatory;
- they were rendered in a personal action;
- the obligation on which they are based is legal in Mexico;
- the defendant was personally served in the action;
- they are final judgments according to the law of the country of origin; and
- they are properly authenticated.

Foreign judgments are enforced by the Mexican court that would have had jurisdiction if the judgment had been rendered in Mexico. The Mexican court does not inquire into the merits of the judgment, but merely determines its authenticity and whether it is enforceable under Mexican law.

From a procedural standpoint, the foreign judgment must be duly translated and both parties and a government attorney must be heard in the matter. The Mexican judge's decision to enforce the foreign judgment may be appealed.

Mexico is a signatory to the UN Convention on Recognition and Enforcement of Foreign Arbitral Awards. For this reason including an arbitration clause in a contract between a foreign and a Mexican company should be considered, as an arbitration award may be more easily enforced.

Antitrust

Overview

Mexico has both constitutional (Art. 28) and statutory prohibitions on monopolies and

other practices that restrict competition. The Federal Law of Economic Competition, amended in 2006, regulates competition and anti-trust matters in Mexico. The law resembles U.S. anti-trust legislation. In addition, Regulations to the Law of Economic Competition were issued in 2007. Monopolies, monopolistic activities, and unlawful business concentrations are prohibited, as is price-fixing.

A Federal Competition Commission (FCC), an office of the SE, is responsible for review and regulation of anti-trust activity. The FCC has operational and technical autonomy, and may issue decisions related to anti-trust matters without seeking approval from the SE.

The FCC has authority to investigate the existence of monopolies or other conglomerations of economic power, may resolve disputes related to anti-competitive practices, impose administrative penalties including fines or require divestiture if it determines that too great a concentration is in place, and report any criminal conduct pertaining to competition to the Ministry of the Public Prosecutor.

While the law contemplates that individual citizens may initiate an anti-trust action and the FCC can respond to complaints, only the FCC may prosecute the case, judge the violation and carry out any penalties. Thus the role of private citizens in anti-trust matters is smaller in Mexico than in the U.S.

Fines vary by the severity of the violation, with higher amounts imposed for “absolute” monopolistic practices, similar to *per se* violations in the U.S. These include price-fixing, limiting distribution of goods, dividing market share and colluding in public bidding, auctions or other competitive proceedings. Lower fines are levied for “relative” monopolistic practices, which

include actions that have the effect of improperly displacing others in or preventing them access to the market, anti-competitive distribution agreements, tying agreements and the like. Fines are expressed as a multiple of the Federal district minimum wage (GMW), with the highest being 375,000 times the daily minimum wage for an absolute monopolistic practice.

Mergers and Acquisitions

A foreign company planning to purchase an existing Mexican company should first confirm that no competition filing is required. The FCC is the agency responsible for approving such applications. In addition to mandatory filings (discussed below), a company contemplating a merger or acquisition in Mexico may make a voluntary filing for approval. If cleared, the transaction may not be later challenged or investigated in Mexico.

A filing with the FCC for clearance must be made if the underlying transaction:

- involves in Mexico, through one or more steps, directly or indirectly, regardless of its place of execution, an amount greater than 18 million times the GMW (approximately \$75 million U.S.);
- through one or more originating actions, implies the accumulation of 35% or more of the assets or shares of an economic agent, whose annual assets or sales in Mexico are greater than 18 million times the GMW (approximately \$75 million U.S.); or
- through a single or subsequent originating actions, implies an accumulation of assets or stock in Mexico greater than 8.4 million times the GMW (approximately \$32 million U.S.), and the transaction

involves at least two or more economic agents with worldwide annual sales or assets greater than 48 million times the GMW (approximately \$200 million U.S.) whether individually or combined.

As amounts are determined by reference to the GMW and the applicable exchange rates, the exact thresholds for notification must be determined on a case-by-case basis.

Transactions between foreign entities must be notified if they are in any way legally or de facto effective in Mexico. Thus, a transaction must be notified if any of the parties has a presence in Mexico as a branch, through one or more subsidiaries, property of assets, or through any distribution, sale or any other commercial agreements.

The amount of time permitted the FCC to issue a clearance depends on the likelihood that the notified transaction has anti-competitive effects. Notified transactions not raising any obvious competition concerns must be resolved within 15 business days following the notification in accordance with article 21-bis of the Competition Law. In cases involving competition concerns, the FCC has a 35 business-day period to issue its clearance. Within the first 15 business days following the filing, the FCC is entitled to request additional information, which must be delivered by the parties within the following 15 business days. As a consequence, the 35 business-day period for issuing the clearance is not deemed to have commenced until the FCC has received all information it requires. In justified cases, the original 15 business-day period (for requesting additional information) and/or the 35 business-day period (to issue a resolution) may be extended by the FCC for an additional 40 business-day term.

Environmental Laws

Overview

Over the past couple decades, in part due to NAFTA, Mexico has increased its regulation of environmental hazards and its administration of the environmental programs. It can no longer be viewed as a country tolerant of pollution or environmental hazards.

A comprehensive package of laws, the General Law of Ecological Equilibrium and the Protection of the Environment, or “Ecology Law,” serves as the umbrella federal legislation. It contains numerous laws, regulations and standards modeled principally on U.S. environmental laws and regulations.

In addition to passage of the Ecology Law, Mexico also updated and re-issued its environmental standards and issued dozens of new ones. The administration of the federal environmental legislation has changed over the years and currently resides with the *Secretaria del Medio Ambiente y Recursos Naturales* (SEMARNAT).

A Federal Attorney General for the Environment was created to assist in enforcement. The criminal code was also amended to include environmental crimes. Enforcement of environmental norms, traditionally weak in Mexico, was boosted by Mexico’s conclusion of the NAFTA treaty, by funds from the World Bank and by rising economic conditions.

Environmental law is an area of concurrent jurisdiction, so state and municipal governments may also legislate in this area. As a result, in addition to federal laws many states and municipalities also have environmental standards and regulations with which companies must comply.

Coastal areas have additional requirements regarding ocean and estuary quality.

Although many laws and rules were on the books for years, enforcement is increasingly rigorous in Mexico and foreign companies operating there should be aware of this change. Companies beginning operations in Mexico should carefully examine the environmental laws applicable to their industry, and consult with counsel and industry experts early in the process.



New Facilities

Any company desiring to establish a new facility which may have a negative impact on the environment or exceed the limits set in the Ecology Law must seek prior approval of federal and state officials by filing an environmental impact statement. If the facility will also generate, store or dispose of hazardous waste, it must also comply with numerous other regulations and reporting requirements.

Existing Facilities

Companies purchasing an existing facility should be especially wary of old environmental problems dating from the days of lax enforcement and poor infrastructure. Many smaller facilities operated without proper permits, and many stored or buried hazardous waste on-site, resulting in later contamination of the

surrounding area. SEMARNAT has a voluntary audit program which can be helpful to potential purchasers of existing Mexican facilities. It permits the company to conduct its own environmental audit and notify SEMARNAT of the results. Once the audit is complete, the remediation plan is negotiated with SEMARNAT and becomes legally binding. Remediation is then done in cooperation with SEMARNAT to avoid future surprise inspections, shutdowns or fines. Careful diligence is required prior to purchasing any existing facility and the involvement of experienced Mexican counsel is advised.

Toxic or Hazardous Waste

The Mexican standards for regulating the generation, treatment, storage, disposal and transportation of hazardous waste are based on those in the U.S. and are nearly identical. Mexico's water laws were based on the U.S. Clean Water Act, although in many respects the Mexican law is broader. Mexico's air quality standards are likewise modeled on the U.S. Clean Air Act. In the border areas, there is close cooperation between the U.S. Environmental Protection Agency and Mexican authorities regarding environmental issues. However, air quality remains an issue in Mexico, both along the border and in Mexico City, due in large part to lax enforcement.

Enforcement

Lack of infrastructure and enforcement remains a problem in Mexico, as the central government has had difficulty finding resources to enforce the laws with respect in particular to existing business. Another factor affecting enforcement is the centralized nature of administration in Mexico. Environmental issues are rarely addressed by means of citizen lawsuits, as they are in the U.S. In Mexico only the

federal and state government agencies have the authority to enforce environmental laws and have struggled to field enough inspectors.

SEMARNAT's inspection program is divided into four programs:

- targeted inspection (mostly for highly-polluting industries such as petroleum, petrochemicals and the like);
- public complaints;
- aerial surveillance for air quality violations, and
- vehicle emissions.

Environmental enforcement in Mexico can be draconian, and generally involves one or more of the following: plant closure (permanent or temporary), negotiation of compliance agreements and posting of a compliance bond, and steep fines. It is not uncommon for the authorities to begin with a plant closure, which facilitates the negotiations.

Dissolving a Business

Overview

The term "dissolution" refers to the true ending of a company's legal existence for purposes of conducting business. Below is a general outline of procedures involved in dissolving corporations and limited liability partnerships. Dissolution of all entities is governed by the Commercial Code.

Corporations

A Mexican corporation may be dissolved in several ways. It can be dissolved by a vote of the shareholders or by judicial action filed

by a third party having an interest in the corporation. There are five possible causes for dissolution:

- expiration of the company's legal term;
- the impossibility of carrying on the principal object of the company, or when the object has been achieved;
- resolution of the shareholders or partners, in accordance with the articles and the law;
- when the number of shareholders or partners is reduced below the minimum required by law or when all the shares are owned by one person;
- upon the loss of two thirds of the capital stock (i.e. when the assets are worth less than one third of the stock issued).

Liquidation

Upon dissolution, the company must be liquidated by one or more liquidators who are appointed by the shareholders who approved the dissolution. The liquidation process is similar to that in the U.S. The liquidators must complete any pending transactions, collect any outstanding payments owed to the company, and sell the assets of the corporation to calculate the final liquidation balance. This is deposited with the Public Registry of Commerce where the request for cancellation of the registration of the corporation must also be filed. The final liquidation balance must be published three times prior to completing the liquidation process. If any assets remain, they are distributed among the shareholders. Once the Public Registry has registered the cancellation of the corporate registration, the company is officially dissolved. The dissolution process is the same for an S. de R.L and a corporation.

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