

OVERVIEW ON DOING BUSINESS IN MEXICO

I.- Investment Vehicles.

For foreign corporations or individuals who seek to do business in Mexico, there are several ways for them to invest their capital in this country. As in many other jurisdictions, a very common vehicle for doing business in Mexico is through the incorporation of a Mexican company, where foreigners may own and participate in their capital stock.

Unlike several other countries including the United States, in Mexico, the legal provisions governing the incorporation of companies are of Federal nature, which means that regardless of the place of incorporation within the Mexican Republic, all companies are uniformly regulated by the Mexican Law Governing Commercial Companies (*Ley General de Sociedades Mercantiles*) (“LGSM”). The LGSM regulates five different kind of commercial companies. Considering the fact that the Mexican Income Tax Law grants the same tax treatment to such five types of companies, corporate practice has only left two of them as the most common choice used by foreign investors for doing business in Mexico:

(i) the variable capital limited liability stock corporation (*sociedad anonima de capital variable*) (“SA”); and

(ii) the non stock variable capital limited liability corporation (*sociedad de responsabilidad limitada de capital variable*) (“SRL”).

II.- The SA and the SRL.

The SA has been widely used in Mexico as an investment vehicle. This corporation has a capital stock divided into shares, where the shareholders’ liability is limited only and exclusively to the full payment of their capital contributions and the stock capital must be incorporated with a minimum of two shareholders (either corporations or individuals) and with a minimum aggregate capital contribution of \$50,000.00 pesos (approximately US\$4,500 Dollars), repre-

sented always by shares. Each share will represent one vote and may be of restricted or free transferability, as stated in the relevant by-laws.

Due to U.S. tax legislation (known as “Check-the-box” Regulations), the SRL, has been lately and often used in Mexico for tax benefits of U.S. parent companies, since it can be consolidated for accounting and tax purposes with U.S. holding companies. This way the organization has limited responsibility and pays taxes as a Mexican corporation, but it is considered, for tax purposes as a partnership in the U.S. We would strongly suggest that the above be confirmed by a US tax expert.

With regards to the limits on shareholders’ liability, there is no difference between the SA and the SRL, because in both shareholders and partners are only liable to pay their contributions and in no event would the shareholders or partners be liable for the operations of the company.

Management of an SRL is no different if compared to the SA because both allow the management to be handled by one or more directors which may not necessarily need to be shareholders or partners of the company.

III.- Differences between the SA and the SRL.

We can mention three main differences between the SA and the SRL:

1. - Equity Structure.

The SA issues stock, which is considered to be a negotiable credit instrument which can be used in exchange operations, such as endorsements; on the other hand, in the SRL the capital is divided in participation units instead of stock, therefore evidence of participation as a partner does not reside in a stock certificate, but rather in an equity participation recorded in the company’s ledger book (no physical title exists) and may only be transferred with the approval of the other partners. In the SRL, each partner has the right to own only one equity participation and each equity participation can have different values. Notwithstanding the foregoing and pursuant to the LGSM, the participation of a shareholder in a SA as well as the participation of a partner in a SRL are evidenced by the corporate books of the company, either through the stock ledger book in the case of a SA or the equity participation ledger book in the case of a SRL. Additionally, regarding SRLs, equity participations without par value are

not allowed nor provided for in the LGSM, whereas SA may issue shares without par value.

2.- Transmission of the partner/shareholder status.

In the SRL capital increase requires the approval of the other partners and the acceptance of a new partner requires a special quorum. As a general rule, such special quorum requires the vote of the majority holders of the equity participations, unless a higher quorum is established in the by-laws of the SRL. The general rule for the SA is the free transferability of the stock, provided that, it is very common for an SA to determine restrictions or special quorums in their by-laws to limit the transferability of the stock.

3.- Number of shareholders/partners.

With respect to the number of shareholders, the SA may have an unlimited number of shareholders (but should always have at least two shareholders), while the SRL may have a maximum of fifty partners and a minimum of two. Therefore, the SRL structure may not be used nor allowed for an initial public offering through the Mexican stock exchange. Only an SA may list their shares in the Mexican stock exchange. As you can see, the concept of corporations with only one partner or single stock holder is not allowed, nor contemplated under Mexican Law.

IV.- Minimum capitalization requirements.

As mentioned above, the minimum capitalization requirement for the SA is \$50,000.00 Mexican Pesos (approximately US\$4,500.00). On the other hand, the SRL requires a smaller capital investment. The minimum capitalization requirement for the SRL is \$3,000.00 Mexican Pesos (approximately US\$270.00), and each equity participation of the SRL must have a value of \$1.00 Mexican Peso or a multiple thereof.

V.- Incorporation Process.

The incorporation of a Mexican company is quite unique and may not be compared with the incorporation process followed in common law countries. We can say that the incorporation process is complex and may take from a couple of weeks to more than a month to have the business entity ready to start doing business in Mexico.

Due to our civil legal system, the participation of state appointed officers is required (with the same name but different functions as notary publics in common law countries), either *Notarios Públicos* or *Corredores Públicos* to carry out public certification of legal acts. The participation of such state appointed officers in the incorporation process plays a very important role. Such officers are professionals (who, in the case of notaries, must be lawyers) that are granted with “public faith” (*fe pública*) by the government with the function to certify legal acts and should not be considered as equal to the notaries in the United States or in other common law countries. Generally, the participation of such certifying officers is to formalize the consent of the shareholders or partners of the company and therefore, such shareholders or partners (or their representatives) must appear before them to execute the relevant incorporation documents.

The process for the incorporation of a company would need to follow the following steps:

- 1.- To obtain from the Ministry of Foreign Affairs (“MFA”) a permit to use the corporate name of the company;
- 2.- To draft the by-laws of the company (based on the provisions of the LGSM and/or any shareholders agreement or other kind of agreement when different groups of shareholders or partners that shall be equity holders of the company);
- 3.- To execute the incorporation deed containing the company’s by-laws before a public faith officer (including powers-of attorney granted to officers of the relevant company);
- 4.- To file before the Public Registry of Commerce of the company’s domicile the public deed containing the articles of incorporation (and powers-of-attorney) of the company.
- 5.- To file and obtain before the Mexican Tax authorities the tax identification number (*Registro Federal de Contribuyentes* or *RFC*);
- 6.- Filing and registration before other Mexican authorities (such as the Foreign Investment Registry, the Business Information System (*Sistema de Información Empresarial Mexicana*)). Thereafter and during the life of the company, it will have to provide to such authorities’ periodical information and/or renewal filings.

The information required to incorporate either an SA or an SRL are practically the same. Please note as follows the information that would be required in order to incorporate either a SA or a SRL:

(a) As mentioned above, it is required to obtain a permit from the MFA for the incorporation of the company to use its corporate name. Such permit is usually obtained within two to three days after filing. The MFA requires that the applicant provides at least three possible different corporate names for the new company in case some of them are already used.

(b) The name of the persons who will be shareholders or partners of the company (at least two (2), which may be either individuals or entities). The shareholders or partners may grant a special power-of-attorney to the persons that will appear before the Mexican certifying officer to incorporate the company on their behalf. Such power-of-attorney would also need to be valid and enforceable pursuant to Mexican Law and therefore if granted abroad it shall be granted before a notary and comply with International Treaties signed by Mexico, such as the Inter-American Convention on the Legal Regime of Powers of Attorney to be used Abroad, the Washington Protocol on the Uniformity of Powers of Attorney and the Convention de La Haye. In order for such power-of-attorney to be effective in Mexico, it must also be translated into the Spanish language by an expert translator appointed by the relevant court.

(c) The amount of the capital stock of the Mexican Company and the participation of each shareholder or partner in such capital stock (we would recommend to start with the minimum capital required under Mexican corporate law).

(d) The name of each member of the Board of Directors or in the event that it is so decided, the name of the Sole Administrator (as the case may be) of the company, and the names of the examiner and main officers thereof.

(e) The names of the persons that will receive powers-of-attorneys from the company, and limitations to such powers-of-attorney (generally such persons would be carrying out the day to day management of such company).

VI.- Taxation.

Both companies, the SA and the SRL, once incorporated shall obtain from the Mexican Ministry of Finance a Tax Payer's identification number and will be considered as full Mexican entities for tax purposes, since such entity will be a Mexican resident with permanent establishment in Mexico. When the tax payers' identification number is obtained, the company may start issuing invoices for their business.

Residents of Mexico (individuals and corporations) are subject to taxation on their worldwide income, irrespective of the source of income or their nationality. Business entities having the principal administration of their business in Mexico are considered Mexican residents for tax purposes.

We would recommend consulting a Mexican accountant or tax expert if specific and further information is required regarding tax matters.

VII.- Foreign ownership of Mexican real estate.

Under Mexican Foreign Investment Law there are a set of rules to be enforced in connection with foreign ownership of real estate properties located in Mexico.

A Mexican entity with foreign investment (foreign shareholders or partners) may acquire a real estate property in Mexico; however, it should be noted that, if such property is located within what is determined as the "restricted zone" (an area of 100 km across the Mexican border and 50 km across the Mexican beaches) and is acquired for residential purposes, then, such Mexican entity (as well as foreign individuals or foreign corporations) may not directly acquire such property (residential purposes shall be considered as those destined exclusively for living purposes of the owner or third parties). In such cases, a Mexican trust must be created where to the property is settled in trust and whereby such Mexican entity, foreign individual or foreign entity is appointed as beneficiary thereto (no real estate rights can be owned by such Mexican entity, foreign individual or foreign entity, only trust rights and the maximum duration of such trust is 50 years, subject to renewal); provided further that, in such cases it is required to obtain a permit from the MFA in order for such trust to own the relevant real state property in the "restricted zone".

On the other hand, a Mexican entity with foreign investment but which agrees to a statement called the “Calvo Clause” (which basically states that any foreign shareholder or partner shall be considered to be Mexican with respect to such participation or interest and shall agree not to invoke the protection of their Government, under the penalty, in case of failure to honor such commitment, to forfeit such interest or equity participation to the benefit of the Mexican Nation), may acquire property located in the restricted zone for non residential purposes, in which case, they would require to give a notice to the MFA of such acquisition within the next sixty (60) days following the date of the acquisition.

Non residential purposes pursuant to the regulations of the Foreign Investment Law are considered as those destined to time sharing, industrial, commercial, or tourism related activities and generally those used by entities pursuant to their corporate purpose, such as sales or transfers, urbanization, construction, or development of real estate developments.

Foreigners may acquire real estate properties outside of the “restricted zone” provided that they obtain a permit from the MFA.

VIII.- Labor Consideration.

Mexican Labor Law is quite unique and different from other Labor legislations in the world. Labor relationships in Mexico are governed by the Mexican Federal Employment Law. The provisions of the Mexican Federal Employment Law are non-waivable, and in resolving disputes, the burden of proof often lies with the employer rather than the employee when contesting an issue. When interpreting labor law provisions, in case of doubt, the most favorable interpretation for the employee shall prevail.

The lack of labor agreement does not deprive an employee of the rights arising from the labor laws and the services performed. This lack of agreement shall be imputable to the employer. It is a common practice to enter into labor agreements with high level employees or key employees.

Mexican Labor Law grants profit-sharing rights to employees. It is common practice within the corporate policies of some groups of companies, to establish a service company to provide labor force for other companies within the same group. This practice is done in order to reduce the impact of profit sharing rights. While permitted under law, labor joint liability issues must be considered in following this practice. In this case, the company or companies obtaining the

benefit of the labor force of the service company are jointly liable for the obligations contracted with the employees of the former.

Mexican labor law does not recognize the existence of work performed by the hour. Pursuant to the Mexican labor law, relationships may be for a determined task or for limited time, or for an undetermined period. In case of silence, the relationship will be of undetermined duration.

In Mexico, bankruptcy of the company is not accepted as a reason for termination of a labor relationship nor for nonpayment to employees for services.

Under Mexican Federal Employment Law, employees are entitled to the following minimum benefits, provided that, employers may elect to grant additional benefits such as saving plans, food assistance, insurance and others:

(i) Christmas bonus. Employees are entitled to an annual bonus at least equivalent to 15 days' salary, including a partial bonus if an employee has worked for the company for a period of less than one year.

(ii) Vacation. Employees are entitled to pre-specified paid vacation days per year according to the number of years of employment. While on vacation, employees are entitled to receive their normal salary, plus a vacation premium of an additional 25% over their current salary.

(iii) Days off and holidays. Employees are entitled to take one day off for every six consecutive working days. In addition to weekly days off, employees are entitled to receive a minimum of seven prescribed holidays per year, plus every six (6) years, on the date of Mexico's president change of office.

(iv) Working shifts. A maximum six-day, forty eight-hour work week.

(v) Termination and severance payment. Employers are obligated to pay their employees an amount equivalent to three months' salary plus twenty days' salary for each year the employee has been employed by the employer, unless termination occurs as a result of mutual consent, resignation on the part of the employee, or for a justified cause, as provided under the Mexican Federal Employment Law. Additionally, employers must pay a seniority premium equivalent to twelve days' salary for each year the employee has been employed by the employer to any employee terminated without the employee's consent;

provided, however, that if the employee's salary exceeds twice the relevant mandatory minimum salary, the seniority premium would then be based on a salary equivalent to twice the mandatory minimum salary.

Employers must also contribute in the benefit of its employees to the (i) Low Income Housing Fund (*Infonavit*), (ii) Mexican Social Security System (*IMSS*), and (iii) Retirement Savings Fund.

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