

# Baker McKenzie.



■ 2018

---

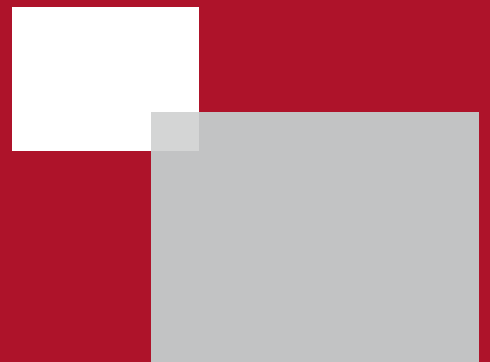
# DOING BUSINESS IN MEXICO



# Doing Business in Mexico

Latin America 2018

*English Version*



This document has been prepared by Baker & McKenzie Abogados, S.C. or our clients and professional associates. This document only refers to Mexican law. While every effort has been made to ensure accuracy, no responsibility can be accepted for errors or omissions, however caused.

The information contained in this document should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases. No responsibility for any loss occasioned to any person acting or refraining from action as a result of material in this document is accepted by the authors or Baker & McKenzie Abogados, S.C. If advice concerning individual problems or other expert assistance is required, we would be pleased to oblige.

Baker McKenzie authorizes you to forward, reproduce, copy, archive and distribute this document without any changes and as long as you include the copyright notice below. The distortion, mutilation, modification or edition of this document is prohibited without the author's prior consent.



# Contents

Overview.....	5
Political structure and legal system.....	6
<b>A. Foreign Investment Law.....</b>	<b>7</b>
1. No restrictions on most investments.....	7
2. Restricted activities under the FIL.....	7
3. Acquisition of existing Mexican-owned companies.....	9
4. Branches and representative offices.....	9
5. Registration requirements.....	9
6. Repatriation and remittance rights.....	9
7. Real estate.....	9
<b>B. Competition Law.....</b>	<b>10</b>
1. Monopolistic practices.....	11
2. Concentrations.....	12
3. Federal Economic Competition Commission.....	12
4. Dawn raids.....	13
5. Administrative penalties.....	13
6. Criminal penalties.....	13
7. Action for damages and lost profits.....	14
<b>C. IMMEX or <i>Maquiladora</i> Program.....</b>	<b>14</b>
1. Corporate presence in Mexico.....	14
2. Import permits and operation.....	14
3. Temporary importation.....	15
4. Import duties.....	16
5. Certified Companies Framework.....	17
6. Tax implications.....	19
7. Sales into the Mexican market.....	22
<b>D. Company Law.....</b>	<b>22</b>
1. Forms of business organizations.....	22
2. Corporations.....	23
3. Limited liability companies.....	24
4. SAPIs.....	25
5. SAPIBs.....	26
6. SABs.....	27
<b>E. Taxes.....</b>	<b>29</b>
1. Treaties.....	29
2. Corporate income tax.....	29
3. Value added tax.....	33
4. Tax incentives.....	34
5. Employee profit sharing.....	35

6.	Payroll tax .....	35
7.	Special tax on production and services .....	35
8.	Mining fees .....	36
<b>F.</b>	<b>International trade .....</b>	<b>36</b>
1.	Imports in general .....	36
2.	Mexico's Free Trade Agreements .....	36
3.	Foreign Trade Law .....	38
4.	Customs Law .....	38
<b>G.</b>	<b>Labor Law .....</b>	<b>38</b>
1.	Mandatory employee benefits .....	38
2.	Severance payments .....	41
3.	Outsourcing regime .....	42
4.	New ways of hiring .....	42
5.	Social security .....	43
<b>H.</b>	<b>Environmental .....</b>	<b>44</b>
1.	Environmental authorities .....	44
2.	Environmental impact authorization .....	45
3.	Prevention and control of air pollution .....	45
4.	Water .....	45
5.	Hazardous waste management .....	46
6.	Soil pollution .....	46
7.	Community right to know .....	46
8.	Protection of collective rights: legal standing and class actions .....	46
9.	The Environmental Liability Law .....	49
<b>I.</b>	<b>Intellectual property .....</b>	<b>51</b>
1.	Industrial Property .....	51
2.	Copyright .....	55
<b>J.</b>	<b>Real estate .....</b>	<b>56</b>
1.	Introduction .....	56
2.	Laws applicable to real estate transactions .....	56
3.	Categories of real property .....	56
4.	Foreign investment in real estate .....	57
5.	Limitations on acquisition of property within the restricted zone .....	57
6.	Limitations on acquisition of property outside the Restricted Zone .....	58
7.	Sub-soil rights .....	58
8.	Property conveyance under Mexican law .....	59
9.	Ensuring good title .....	62
10.	Planning issues .....	64
11.	Environmental issues .....	64
12.	Taxes and fees on real estate transactions .....	65
13.	Leasing .....	66
14.	Landlord/Tenant Law .....	67



15. Mortgagor/mortgagee law ..... 68

16. FIBRAS, FIBRA E, CKDs and CERPIs..... 69

**Locations:..... 71**







## Overview

This memorandum provides a general summary of certain aspects of Mexican law, which may be of interest to foreign companies considering doing business in Mexico. The areas of law summarized in this memorandum include:

- A. Foreign Investment Law
- B. Competition Law
- C. *Maquiladora* operations
- D. Company Law
- E. International trade
- F. Labor Law
- G. Environmental
- H. Intellectual property
- I. Real estate

Treaties to which Mexico is a party, particularly the North American Free Trade Agreement (the "NAFTA") among Canada, Mexico and the United States, may affect investors from certain countries and may modify the preceding areas of Mexican law. Although this memorandum makes numerous references to NAFTA and other treaties, it does not comprehensively address all instances in which Mexican law is modified or complemented thereby.

## Political structure and legal system

Mexico, whose official name is *United Mexican States*, is a federal republic that comprises 32 federal entities (31 states and the federal capital, Mexico City). As in the United States of America, the federal government is composed of the executive, legislative and judicial branches. The head of the executive branch is the president, who is elected by popular vote for a six-year term. Legislative power is vested in the Chamber of Deputies and the Senate, whose members are elected for three-year and six-year terms, respectively. The judicial branch consists of a Supreme Court of Justice, Circuit Courts and District Courts.

Each of the 32 federal entities has its own constitution, civil code and other local laws and regulations, as well as its own executive, legislative and judicial authorities. The head of the state executive branch is the governor. The legislative branch consists of the Chamber of Deputies and the local courts exercise judicial authority. Mexico has a civil law system that is based on the Continental European legal tradition stemming from Roman law and Napoleonic principles. Under this system, basic legal principles are largely codified in civil, commercial, criminal, judicial and procedural codes. Judicial precedents are not binding except for federal courts' decisions under certain circumstances.



## A. Foreign Investment Law

Mexico enacted a new Foreign Investment Law in 1993. The new FIL dramatically changed the regulatory framework for foreign investments in Mexico that has been in place since 1973. Additional reforms have been made to the FIL in 1995, 1996, 1998, 1999, 2001, 2006, 2008, 2011, 2012, 2014 and 2015. The reforms embodied in the FIL largely follow those imposed by NAFTA, although NAFTA affords greater benefits in certain areas to US and Canadian investors.

### 1. No restrictions on most investments

As a general rule, the FIL allows foreign investors and Mexican companies controlled by foreign investors, without prior approval, to (i) own up to 100% of the equity of Mexican companies; (ii) purchase fixed assets from Mexican individuals or entities; (iii) engage in new activities or produce new products; (iv) open and operate establishments; and (v) expand or relocate existing establishments. The only exceptions to that general rule are those expressly established in the FIL itself (discussed in Section 1.2 below) or, in the case of the financial sector, in the legislation covering that sector. This new regulatory framework replaces the restrictions of the old foreign investment law, which generally limited foreign investment in Mexican companies to 49% or less.

### 2. Restricted activities under the FIL

The FIL lists certain economic activities that are (i) reserved to the Mexican State; (ii) reserved to Mexican nationals or Mexican companies without foreign equity participation; (iii) subject to quantitative foreign investment limitations; and (iv) subject to prior approval if the foreign investor wishes to own more than 49% of a company engaged in those activities.

#### a) Activities reserved to the Mexican State

In compliance with the Mexican Constitution and as a reflection of historical concerns regarding private investment, the FIL reserves certain strategic areas to the Mexican State. Neither Mexican nor foreign investors may engage in these areas of economic activity. These areas include: (i) exploration and extraction of petroleum and other hydrocarbons; (ii) planning and control of the national electricity system as well as the public service of transmission and distribution of electricity; (iii) nuclear energy generation; (iv) radioactive minerals; (v) telegraphs; (vi) radio telegraphy; (vii) mail service; (viii) issuance of money; (ix) control, supervision and security of ports, airports and heliports; and (x) certain others expressly indicated under the corresponding legislation. It is important to note that Sections (i) and (ii) will be carried out in accordance with the Mexican Constitution and the regulations on electricity recently amended.

#### b) Activities reserved to Mexican investors

The activities reserved by the FIL to Mexican nationals and to Mexican companies without foreign equity participation include: (i) domestic and international<sup>1</sup> land transportation of passengers, tourism and cargo, excluding messenger and courier services; (ii) development banks; and (iii) professional and technical services reserved to Mexicans under the corresponding legislation.

---

<sup>1</sup> Under Transitory Article Sixth of the FIL, as of 18 December 1995, foreigners may own up to 49% of the capital of Mexican entities engaged in the international land transportation of passengers, tourism and cargo within Mexico and in administrative services for bus stations and related services; they may own up to 51% of such enterprises as of 1 January 2001 and 100% as of 1 January 2004. This liberalization schedule follows NAFTA's phase-out schedule for land transportation. Foreign investment in domestic land transportation will continue to be prohibited.

Under the FIL, foreign investors may not engage in any of the foregoing activities, directly or indirectly, through any agreement or corporate structure or scheme, except through special approved “neutral” shares without voting rights or with limited corporate rights, or as otherwise approved by the National Commission of Foreign Investments (“NCFI”).

### **c) Activities with foreign investment equity limitations**

The FIL establishes foreign ownership limits in certain companies, activities and types of shares, as set forth below:

- Up to 10%: production cooperatives
- Up to 49%: production and sale of explosives, firearms, cartridges, munitions, fireworks, excluding the purchase and use of explosives for industrial and extractive purposes, and the preparation of explosive mixtures for use in such activities; printing and publication of newspapers for exclusive distribution within Mexico; Series “T” shares of companies owning agricultural, cattle-raising and forest lands; freshwater and coastal fishing, and fishing in the exclusive economic zone, excluding aquaculture; comprehensive port management; piloting services for vessels engaged in interior navigation; shipping companies that operate commercial vessels for navigation in interior waterways and between domestic ports, excluding tourist ferries and the exploitation of dredges and naval devices for port construction, maintenance and operation; supply of fuel and lubricants for ships, airplanes and railroad equipment; certain telecommunication services depending on the reciprocity that exists in the country of the ultimate parent of the potential investor; and domestic (regular and non regular) and specialized air transport and air-taxi transport

Unless a treaty (such as NAFTA, in the case of financial services) provides otherwise, a foreign investor may not own more than the permitted percentage of equity in a Mexican company engaged in any of the above activities. These limits may not be surpassed either directly or through any type of agreement or corporate structure or scheme, except through the “neutral” shares mentioned in the FIL.

### **d) Activities where foreign investors require prior approval of the NCFI to own more than 49%**

Under the FIL, prior approval is required for foreign investors to own more than 49% of a company engaged in any of the following activities:

- Port services to vessels engaged in interior navigation, such as towing and mooring
- Naval companies using vessels exclusively for high-seas traffic
- Companies authorized to operate public airdromes
- Private schools, at the preschool, primary, secondary, preparatory and higher education levels
- Legal services
- Construction, operation and exploitation of railways as well as public railroad transportation services

Foreign investors are required to obtain prior approval of the NCFI to own more than 49% of a new or existing Mexican company and must therefore file an application with the NCFI. The NCFI has 45 business days from the day the application is filed to issue its ruling. If the NCFI does not rule within this 45-day period, the application will be deemed approved.



### **3. Acquisition of existing Mexican-owned companies**

Under the FIL, a foreign investor may acquire more than 49% of the equity of an existing company owned by Mexican investors, without the prior approval of the NCFI, provided that the target company is not engaged in a restricted activity and the total value of the assets of such company does not exceed certain monetary thresholds established annually by the NCFI. Currently, this threshold is MXN 4,005,167,839.31 (approximately USD 196,814,144.44).

### **4. Branches and representative offices**

Under the FIL, a foreign company must obtain approval from the Ministry of Economy ("SECON") to establish and register a branch or a representative office in Mexico. SECON must rule on the branch application within 15 business days from the date the complete application is filed. However, on 8 August 2012, SECON published in the Federal Official Gazette a general resolution issued by the NCFI eliminating the requirement to obtain such registration for foreign companies from the USA, Canada, Chile, Costa Rica, Colombia, Nicaragua, El Salvador, Guatemala, Honduras, Uruguay, Japan and Peru, and stating that such entities only have to file a notice declaring certain information of the company, such as the corporate purpose, main activity and domicile. After the company files the notice, it can be registered with the Public Registry of Property and Commerce.

### **5. Registration requirements**

Under the FIL, all foreign investments, whether subject to prior approval or not, must be registered with the Foreign Investment Registry within 40 business days from the date of the respective incorporation, branch registration, acquisition or execution of the relevant trust agreement. Foreign investors that do not register their investment with the Foreign Investment Registry are subject to administrative fines.

### **6. Repatriation and remittance rights**

Mexican law does not impose any general restrictions or limitations on the remittance of dividends or repatriation of capital.

### **7. Real estate**

Mexican law establishes certain restrictions on land ownership by foreign investors in Mexico. These restrictions are discussed below.

#### **a) Restricted Zone**

Under the Mexican Constitution, foreign individuals and entities may not hold direct title to real estate in Mexico located within 100 kilometers from the border or 50 kilometers from the coastline (the "Restricted Zone"). However, such individuals and entities may hold the beneficial interest in such real estate under a Mexican trust. Real estate trusts in Mexico have a maximum duration of 50 years and the trustee thereof must be a Mexican bank.

Under the FIL, Mexican companies with foreign equity participation may hold direct title to real estate located in the Restricted Zone if they engage in nonresidential activities. If they engage in residential activities, they may hold the real estate in trust, that is, they may not hold direct title thereto.

## **b) Nonrural land outside Restricted Zone**

Under Mexican law, foreign individuals and Mexican companies with foreign equity participation may hold direct title to nonrural land located outside the Restricted Zone.

## **c) Rural land outside the Restricted Zone**

Foreign individuals may hold direct title to rural land located outside the Restricted Zone. Mexican companies with foreign equity participation may hold direct title to rural land, provided that the ownership of such land is represented by special Series "T" shares. Foreign investors may not own more than 49% of the Series "T" shares issued by the respective company.

## **d) Quantitative restriction of land ownership**

The Mexican Constitution and regulatory agrarian legislation establish limitations on the amount of rural land a person may own and protect against expropriation for communal use. For example, generally, the maximum area of irrigated land that may be protected from expropriation is 100 hectares per person. For lands subject to seasonal use and un-irrigated pastures subject to agricultural harvest, the maximum protection area is 200 hectares. Under the Constitution, a Mexican corporation may own and protect up to 25 times the land area one individual is permitted to protect.

Under certain circumstances and if certain requirements are met, a landowner may protect an area that exceeds the above limitations, such as if the landowner improves the quality of the land by installing irrigation or drainage systems.

## **B. Competition Law**

On 22 December 1992, Mexico published in the Federal Official Gazette the Federal Law of Economic Competition (*Ley Federal de Competencia Económica*), which became effective on 22 June 1993. The Federal Law of Economic Competition was substantially amended on 28 June 2006 and again on 11 May 2011.

On 30 August 2011, an amendment to Article 38 was published in order to introduce class actions (collective actions) provisions.

On 11 June 2013, Mexico passed a bill for the amendment of several provisions of the Mexican Federal Constitution introducing important and substantial changes to competition regulation. Finally, on 23 May 2014, a New Mexican Competition Law was published in the Federal Official Gazette. The new law became effective on 7 July 2014.

Changes introduced by both the Constitutional amendment and the New Law aim to strengthen the Mexican Competition Policy as well as the authorities in charge of enforcing the competition law by creating two autonomous agencies: (i) The Federal Economic Competition Commission – FECC (which replaced the former Federal Competition Commission – FCC); and (ii) The Federal Institute of Telecommunications – FIT (which replaced the former Federal Telecommunications Commission – FTC).

Both the FECC and the FIT enforce the Mexican Competition Law, including handling merger control processes, monopolistic practices investigations and proceedings to resolve the existence of dominant undertakings. The FIT enforces the Mexican Competition Law in matters involving telecommunications and broadcasting, while the FCC deals with all other industries.



The Competition Law: (i) restricts monopolistic practices and regulates concentrations; (ii) creates the Federal Economic Competition Commission (*Comisión Federal de Competencia Económica*, the “Commission”) with broad investigative and enforcement powers; (iii) sets forth the basic procedure for actions to be carried out by and/or before the Commission; and (iv) establishes the sanctions that may apply for breaching the Competition Law, without prejudice to the private right of action for damages and lost profits that might be applicable.

## 1. Monopolistic practices

The Competition Law prohibits in broad terms those monopolies and practices that “diminish, damage or impede free competition in the production, processing, distribution and marketing of goods and services.” Monopolistic practices are classified as “absolute” or “relative.”

Absolute monopolistic practices can be defined as any agreement between competitors with the purpose of eliminating competition between them. According to the Competition Law, typical absolute monopolistic practices include agreements or arrangements among competitors, whose purpose or effect is to: (i) fix prices; (ii) limit production, purchase or distribution; (iii) divide markets; (iv) “rig” bids; or (v) exchange information, resulting in any of the above mentioned conducts (i) to (iv). The Competition Law provides that, in addition to the civil and criminal sanctions that may be applicable to the parties involved, such agreements and arrangements are null and void and therefore will not have any legal effect.

Relative monopolistic practices are actions performed by economic agents with “substantial market power” to unduly displace other agents from a “relevant market”. Relative monopolistic practices consist of acts, contracts, agreements or procedures whose purpose or effect is to eliminate third parties in a specific market, unduly prevent market access to third parties or give exclusive advantages to certain persons. The Competition Law establishes as relative monopolistic practices the following conducts:

- Between noncompetitors, (a) establishing exclusive distribution agreements, whether based on subject matter, geographic territories or time periods, including the allocation of customers or suppliers; and (b) imposing noncompete obligations for certain periods
- Imposing price or other conditions on distributors or suppliers on the re-sale of goods or the provision of services
- Bundling/tying sales
- Conditioning sales or other transactions on not dealing with certain third parties
- Refusing to deal with certain parties
- Pressuring or retaliating against third parties through concerted action (e.g., boycott)
- Selling goods or services below average (total or variable) cost
- Selling or granting of discounts conditioned on exclusivity
- Providing crossed subsidies
- Practicing price discrimination among different buyers or sellers that are under the same conditions or circumstances

- Engaging in any other action to increase the costs, block the production processes or reduce the sales of third parties
- Discriminatory access to essential inputs
- Margin squeeze

Relative monopolistic practices, unlike absolute monopolistic practices, are not illegal per se. Thus, in order for such practices to be illegal, they must be performed by an economic agent with substantial market power and have a negative impact on the affected markets.

## 2. Concentrations

In general terms, a concentration is defined as any merger, acquisition or other action by which companies, associations, shares, equity quotas, trusts, or assets in general are accumulated. A prohibited concentration is defined as a merger, acquisition or other action between any persons or entities, whether competitors or not, having the purpose or effect of diminishing, damaging or preventing competition in identical, similar or substantially related goods or services. The Competition Law identifies certain items that the Commission must consider in determining whether a concentration is prohibited, such as the possible market power or price-fixing capabilities resulting from the concentration. The Commission has the power to condition its approval of a proposed concentration on the restructuring of the transaction to avoid anti-competitive consequences. In addition, the Commission is also empowered to order the partial or full unwinding of a prohibited concentration.

The Commission must be given prior notice of a proposed concentration if the underlying transactions: (i) have a value in the Mexican Republic exceeding 18 million times the value of the Measure Unit ("MU")<sup>2</sup>, (approximately USD 72.54 million); (ii) involve the accumulation of more than 35% of the assets or shares of a person or entity whose assets or sales in Mexico exceed more than 18 million times the MU (approximately USD 72.54 million); (iii) (a) imply an accumulation of assets or capital stock in the Mexican Republic that exceeds 8.4 million times the MU (approximately USD 33.8 million), and (b) involve undertakings whose combined assets or annual sales in Mexico exceed 48 million times the MU (approximately USD 193.44 million).<sup>3</sup>

After notification, the Commission has 60 business days to issue a decision on a concentration (an extension of 40 business days is available in complex cases). The term restarts if the Commission requests any additional information after receiving the notification. If the Commission does not respond within 60 days, the transaction will be deemed as approved.

On 8 December 2017, the Federal Economic Competition Commission (*Comisión Federal de Competencia Económica*) or COFECE introduced and set the rules under which it will operate its electronic merger control filing system. In light of the above, as of 2018, the parties to a reportable transaction can now notify such operation either in person at COFECE's filing office (as customary) or electronically through the merger control filing system.

## 3. Federal Economic Competition Commission

As the agency responsible for enforcing the Competition Law, the Commission has broad investigation and enforcement powers. It may initiate administrative procedures on its own or, at the request of third parties, investigate and resolve such cases and enforce its orders through administrative penalties. It may also refer

<sup>2</sup> The current MU is MXN 80.60 as of 1 February 2018.

<sup>3</sup> The exchange rate is volatile. For reference purposes, we used an exchange rate of MXN 20.00 per USD 1.00 to calculate these amounts.





criminal cases to the District Attorney. Moreover, the Commission may issue opinions, both binding and nonbinding, in antitrust matters.

#### **4. Dawn raids**

During the investigation of a monopolistic practice or a prohibited concentration, the Commission may conduct verification visits without prior notice (i.e., dawn raids) at the premises of the entities under investigation to request documents and information related to the investigation. In addition, the Commission is empowered to interview any employee of the target during the raid.

#### **5. Administrative penalties**

In addition to the obligation to cease prohibited practices or divest prohibited concentrations, violators may be subject to administrative penalties in the following amounts:

- Up to 10% of the annual income of the offender for carrying out an absolute monopolistic practice
- Up to 8% of the annual income of the offender for carrying out a prohibited relative monopolistic practice or a prohibited concentration
- Up to 5% of the annual income of the offender for failing to notify the Commission of a concentration
- Up to 200,000 times the MU (approximately USD 806,000.00) for individuals directly participating in a prohibited monopolistic practice or concentration in their capacity as representatives of the offenders. The Competition Law does not expressly define what kind of representation is required to be responsible and subject to sanction; therefore, this penalty may be applicable to all individuals involved directly or indirectly in the violation.
- Up to 180,000 times the MU (approximately USD 725,400.00) for entities or individuals who induced, provoked or participated in a monopolistic practice or prohibited concentration
- Up to 8% of the annual income of the offender for breaching a settlement agreement with the Commission that closes an investigation early
- Up to 8% of the annual income of the offender for failing to observe a “stop order” imposed by the Commission during a concentration review process
- Up to 10% of the annual income of the offender for breaching an order issued by the Commission to discontinue those acts deemed as a monopolistic practice or a prohibited concentration

For a repeat offender, the Commission may double the amounts of the fines listed above.

#### **6. Criminal penalties**

In addition to the administrative fines listed in the preceding section, individuals engaged in an absolute monopolistic practice may also be subject to civil and criminal penalties. Criminal penalties include five to 10 years imprisonment and monetary fines.

The Commission appears before the General Attorney to bring the criminal action against an offender based on the administrative process and identifies the individuals allegedly responsible for the relevant absolute monopolistic practice.

## **7. Action for damages and lost profits**

The Competition Law also grants private parties an express right of action to bring ordinary civil suits for damages and lost profits. In order to bring such an action, the plaintiff must have previously alleged and provided evidence of damages and lost profits during the administrative proceedings before the Commission. The judge is allowed to consider the Commission's opinion on the plaintiff's alleged damages and lost profits.

On 29 February 2012, class actions (collective actions) were introduced into Mexican law by amendments to the Federal Civil Proceedings Code (enacted in August 2011). This amended code allows the Commission or any representative of a group comprising at least 30 members to file a collective action for damages in circumstances where a group of end consumers have been harmed by an anti-competitive practice. As with individual actions, a prior finding of infringement by the Commission is a condition to bringing a collective action for damages.

## **C. IMMEX or *Maquiladora* Program**

The Mexican *maquiladora* or IMMEX program was introduced over 30 years ago by the Mexican government to promote employment in Mexico. The *maquiladora* industry in Mexico is governed by the Decree for the Promotion of the Manufacturing, *Maquiladora* and Export Services Industry (the "*Maquiladora* Decree" or the "IMMEX Decree") in accordance with its last amendment on 28 July 2016 and the Mexican Income Tax Law published on 11 December 2013.

### **1. Corporate presence in Mexico**

Under the IMMEX Decree, a foreign investor may qualify to operate under *maquiladora* status only if it has a corporate presence in Mexico. A Mexican corporation that qualifies for *maquiladora* status may have up to 100% foreign ownership. The great majority of *maquiladoras* (also known as IMMEX companies) are wholly owned by foreign corporations.

### **2. Import permits and operation**

The Ministry of Economy (or "SECON" as abbreviated in Spanish) is the authority in charge of authorizing the *maquila* or IMMEX program. In order for the company to qualify and obtain such authorization, the company must submit certain documentation and provide detailed information about the manufacturing process or service operation to be carried out, including descriptions of the following:

- The product(s) to be assembled and/or manufactured in Mexico.
- The manufacturing or service process.
- The time and domicile where temporarily imported goods will remain in national territory.
- The investment program in Mexico.
- The materials, machinery, equipment, tools and auxiliary items to be temporarily imported into Mexico for the manufacturing or service process.

Additionally, for purposes of the IMMEX Decree, the company must either have sales abroad exceeding USD 500,000 annually or derive at least 10% of its total invoicing from exports of products or services.



SECON has 15 business days from the date of filing of the *maquiladora* application to issue its resolution. If SECON does not issue a resolution within this period, the application will be deemed to be approved. The approved *maquiladora* program has an indefinite validity, provided that the company permanently complies with all the provisions of the IMMEX Decree and the specific conditions for the *maquiladora* program approval.

### a) **Maquila services**

The IMMEX Decree provides for different types of *maquiladoras*: industrial, services, holding, outsourcing and shelter. The most common are the industrial *maquiladoras* (engaged in manufacturing activities) and services *maquiladoras* (engaged in providing services for goods to be exported or providing export services). Currently, companies that qualify for a services *maquiladora* program include those providing services for importation, warehousing, distribution, classification, inspection, testing, verification, repair, reworking and recycling of goods for export. Services such as product design, engineering, software-related, administration and information technology services may also qualify under a services *maquiladora* program.

The tax reform, in force since January 2014, includes a definition of what constitutes a “maquila operation” for purposes of exempting the foreign Principal of the *maquiladora* from a permanent establishment exposure. This definition is established in the Income Tax Law.

## 3. **Temporary importation**

In general terms, the *maquiladora*/IMMEX program allows the temporary importation of goods (including any material, parts and components, machinery and equipment) used in the manufacture of export products or in the rendering of export services. Currently, the temporary importation of goods is duty free under certain circumstances (as discussed further below in Section 4, subsections b) and c)). An additional benefit for companies operating under the IMMEX program is that they are exempted from non-tariff-related regulations and restrictions (such as product labelling) on temporarily imported goods.

Pursuant to the recent tax reform effective since January 2014, the temporary importation of goods under an IMMEX program are subject to the payment of Value Added Tax (“VAT”) and Special Tax on Products and Services (“IEPS”). Nonetheless, VAT paid upon temporary importation of goods may be recovered, provided the importers evidence the subsequent exportation of such goods. Alternatively, importers may avoid payment of VAT upon temporary importation of goods by: (i) securing a certification from the tax authorities to access advanced credit for the VAT to be levied upon temporary importation (“VAT/IEPS Certification”); and/or (ii) using a bond to guarantee the subsequent exportation of the goods that were temporarily imported.

One of the most important obligations for *maquiladoras* is that every good imported on a temporary basis must be: (i) exported within the legally prescribed time frame; or

(ii) changed from a temporary to permanent importation within the legally prescribed time frame, paying the corresponding duties and taxes. The period of time under which temporarily imported goods may remain in Mexico under the temporary importation customs regime varies as follows:

- Up to 18 months for raw materials, parts, components, auxiliary materials, packaging material, fuel and lubricants, as well as labels and bulletins, if those goods are imported by an IMMEX company
- Up to 36 months if those goods are imported by an IMMEX company that is also authorized under the Certification Framework, VAT/IEPS modality, or up to 48 months if the importer is also authorized under SECIIT modality

- Up to 24 months for trailer containers and other containers
- During the validity period of the IMMEX program for machinery and equipment

As a general rule, an IMMEX Company is not allowed to transfer temporarily imported goods to other companies in Mexico except when such transfers are made to (a) other *maquiladoras*; (b) Mexican automobile manufacturers; or (c) companies that are authorized to import goods to the strategic bonded warehouse regime.

When temporarily imported goods are transferred between *maquiladoras*, the goods are considered as virtually exported by the transferor *maquiladora* and virtually imported by the transferee *maquiladora* on a temporary importation basis. In such cases, the transferred goods must be exported or subjected to a change of custom regime from temporary importation to definitive importation within the prescribed terms for temporary importation.

In connection with the above, the Foreign Trade General Rules for 2018 ("FTGR") set forth that companies certified under the VAT/IEPS Certification, "AAA" category, are allowed to transfer goods temporarily imported to non-IMMEX companies, as long as these companies comply with the requirements for such transaction.

#### **4. Import duties**

The payment of import duties upon temporary importation of goods into Mexico under an IMMEX program will be subject to different treatments as described below:

##### **a) Duties on the importation of machinery and equipment**

Currently, the importation of machinery and equipment is not subject to duty-free treatment. According to the Customs Law, an IMMEX company must pay the applicable duties upon the temporary importation of machinery and equipment. Nevertheless, reduced duties may be available through Mexico's network of free trade agreements and under special programs available for manufacturers, such as Sectorial Promotion Programs ("PROSEC"). Machinery and equipment temporarily imported are still exempt from compliance obligations related to certain nontariff regulations and restrictions.

##### **b) Duties on the importation of raw materials, parts and components pursuant to NAFTA provisions**

As a result of the implementation of the NAFTA provisions, if products manufactured with non-NAFTA-originating raw materials, parts and components imported under temporary basis are exported to the United States or Canada, the non-NAFTA-originating materials incorporated into products manufactured in Mexico may be subject to the payment of Mexican import duties. NAFTA-originating materials are exempted from the payment of duties if imported on a temporary basis. The payment of duties in Mexico can be made pursuant to the so-called "lesser of rule" under Article 303 of NAFTA. This rule calculates the amount of Mexican import duties applicable to non-NAFTA-originating materials and subtracts the amount of import duties paid in the United States or Canada for the finished product imported into such countries. The result of this subtraction will be the amount of duties payable in Mexico. If the result is zero, no duties are payable in Mexico.

These rules are currently in force; however, they may change as a result of the NAFTA negotiations currently being carried out.



### c) **Duties on the importation of raw materials, parts and components pursuant to the provisions of the Free Trade Agreement with the European Union**

The free trade agreement entered by Mexico with the European Union (“EUFTA”) has similar provisions to NAFTA’s Article 303. EUFTA provides that as of 1 January 2003, Mexico may not grant exemptions or drawback on import duties for non-EUFTA-originating inputs incorporated into products exported to the European Union. Still, EUFTA and NAFTA provisions differ in the sense that duty relief restriction would only apply under EUFTA when the finished products (which contain non-EUFTA-originating inputs) are imported into the European Union with preferential duty treatment. Therefore, if the finished products are imported into the European Union without claiming preferential duty treatment, the *maquiladora* would not be subject to the payment of import duties for the non-EUFTA inputs incorporated in the finished products.

## 5. **Certified Companies Framework**

*Maquiladora* companies and certain non-*maquiladora* companies (in some cases) may secure a special registration from Mexican customs authorities to operate as a Certified Company, which grants access to certain benefits that allow companies to save costs and time by being able to enjoy easier and more expedited customs clearance processes, reduction in documentation requirements, as well as certain tax and customs advantages related to the virtual exportation and importation of goods. The specific benefits granted to each company depend on the Certified Company category under which each company is authorized.

As a result of the amendments to the FTGR 2016, which entered into force on 20 June 2016, the Certified Companies Framework was created. The framework includes different certification modalities in accordance with the operations and level of compliance with the requirements of the companies. It also integrates the Certified Companies Registry, the VAT/IEPS Certification, Authorized Economic Operator (“AEO”), Guarantee of Interest Payment and the Reliable Importer program (*Revisión en Origen*) as well as establishes the following modalities (with their corresponding submodalities and categories):

- VAT and IEPS (A, AA and AAA categories)
- Trader and importer
- Authorized Economic Operator, with the following modalities:
  - Importer and/or exporter
  - Controller
  - Aircrafts
  - SECIIT
  - Textile
  - Strategic Bonded Warehouse
- Certified Commercial Partner, which includes the following modalities:
  - Terrestrial carrier

- Customs broker
- Railway transport
- Industrial park
- Bonded warehouse
- Courier companies

**a) Requirements to secure the registry under the Certified Company Framework**

Companies shall follow certain requirements and steps in order to obtain Certified Company authorization. There are general requirements for all categories, as well as specific requirements for each category and/or modality, such as the value of importations, compliance with tax and customs obligations, number of employees and value of fixed assets, among others.

By virtue of the above referred framework, it is possible to apply for the registry as a Certified Company under the VAT/IEPS and AEO categories simultaneously. Additionally, it establishes the possibility of obtaining the automatic renewal of such registry as of the business day following the date of filing of the automatic notice and the standardization of the validity of the VAT/IEPS – OEA certifications.

For further reference, please find below a detailed description of two of the certification categories that grant the most important benefits (VAT/IEPS – AEO):

**VAT and IEPS**

(Its main objective is to avoid the payment of VAT and IEPS on temporary importations, applying a tax credit in an amount equal to 100% of the applicable VAT and IEPS for the temporary importation of goods.)

- Tax credit on temporary importations in *maquila* programs; in fiscal deposit operations for the assembly and manufacturing of vehicles; of manufacturing or repair in the bonded warehouse or strategic bonded warehouse.
- Refund of the VAT paid in temporary importations.
- Automatic registration in the Specific Sectors Importer's Registry, Sectors 10 "Footwear", 11 "Textile and Clothing", 14 "Steel", and 15 "Steel products".
- Automatic registration in the Specific Sectors Exporter's Registry: Sectors 10 "Plastics", 11 "Rubber", 12 "Wood and Paper", 13 "Glass", 14 "Iron and Steel", and 15 "Aluminium".
- No automatic suspension in Importer's Registry and Specific Sectors Importer's Registry, derived from inconsistencies identified by the customs authority.
- Possibility to self-correct the inconsistencies detected regarding omitted duties within 60 days, without the payment of fines.
- No obligation to provide the customs broker with the value manifest and the calculation sheet for the determination of the customs value of the goods to be imported.
- Virtual transfer of temporarily imported goods to non-



	<p>IMMEX companies (applicable only for AAA category)</p> <ul style="list-style-type: none"> <li>• 60 days to comply with nontariff. regulations after the notification of a seizure of goods ("PAMA").</li> </ul>
<p>AEO (Its main objective is to guarantee supply chain security.)</p>	<ul style="list-style-type: none"> <li>• Exclusive "EXPRESS"/"FAST" lanes</li> <li>• Transfer of temporarily imported goods to non-IMMEX companies through a virtual transaction</li> <li>• Fewer causes for suspension in the Importers Registry</li> <li>• Rectification of origin information after customs clearance and before audit by Hacienda, and for increasing declared quantity or amount of goods (maximum three months after customs clearance)</li> <li>• Return of labels and manuals that were previously imported on a temporary basis, and without paying importation duties, to the United States or Canada</li> <li>• Regularization of surplus or undeclared goods detected by the authority (within a term of 10 days following the date of the corresponding notice)</li> <li>• PROSEC rates for changes of customs regime from temporary importation to definitive importation</li> <li>• Process pedimentos for temporary importation or return of surplus or undeclared goods detected by the authority (as long as such goods correspond to the productive process registered for IMMEX program purposes)</li> <li>• Return, without penalties, undeclared goods that do not belong to IMMEX productive processes (as long as such goods are returned before audit)</li> <li>• Benefit of processing one complementary <i>pedimento</i> for all returns in one month (TLCAN-303)</li> </ul>

## 6. Tax implications

As explained in more detail below, the tax implications for a *maquiladora* operation in Mexico are dependent on the operational structure and the type of activities carried out by the *maquiladora*.

### a) Structuring of operations

Export *maquiladora* operations can be implemented either under what is commonly known as the "buy-sell" model or under a "consignment manufacturing" model.

Under a buy-sell model, the *maquiladora* company owns the machinery and equipment, raw materials used for operations and the finished products. IMMEX companies sell the finished products to foreign-related or

unrelated parties or to customers in Mexico. An IMMEX company operating under this model is subject to taxation in Mexico under general rules.

A more common structure for *maquiladora* operations is the so-called consignment manufacturing model (or toll-manufacturing) whereby a foreign company provides (on a free bailment basis) the inventory and the machinery and equipment to the *maquiladora* company, which processes such inventory in exchange for a manufacturing services fee. The finished products are owned by the foreign resident.

This model allows for the foreign resident to maximize the benefits arising from the sale of the finished products while attributing a modest return to the *maquiladora* company calculated in accordance with transfer pricing regulations, as described in more detail below.

## **b) Tax benefits of operating as a *maquiladora***

*Maquiladoras* are subject to Mexican taxes, including Income Tax ("ISR") and VAT. The tax benefits of operating through a *maquiladora* company structured under the consignment manufacturing model are summarized as follows:

- The ability to engage in consignment manufacturing (i.e., toll manufacturing) with a foreign principal without exposing the foreign principal to the risk of having a tax presence (i.e., a permanent establishment) in Mexico that subjects the foreign principal to the payment of Mexican ISR
- The ISR liability as determined pursuant to the *maquiladora's* income tax base at the general rate of 30%
- The application of special transfer pricing rules that give the *maquiladora* a choice of two methods for computing the amount of the *maquiladora* service fee charged to the foreign Principal (included in Article 182 of the Income Tax Law)
- Zero VAT on the invoices issued by the *maquiladora* to its foreign-related party for the manufacturing processing or service fee

## **Requirements to have a maquila operation to exempt the permanent establishment exposure of the foreign principal in Mexico**

According to the Income Tax Law ("ISR"), a permanent establishment exposure may be created for non-Mexican tax residents that have an economic or legal relationship with a Mexican entity who habitually processes for them consigned inventories, with assets furnished by the non-Mexican tax resident. However, such permanent establishment exposure may be exempt if the Mexican manufacturer operates in Mexico with an IMMEX authorization, if Mexico has in place a treaty for the avoidance of double taxation with the country of residency of the foreign principal, and provided that the IMMEX company complies with the requirements to have a *maquila* operation under the terms of the ISRL, which may be summarized as follows:

- All the productive income of the IMMEX company must originate exclusively from its *maquiladora* operation.
- The materials subject to the manufacturing operations may be consigned by the non-Mexican resident. The materials consigned to the *maquiladora* may be property of a third party, provided that the third party has a manufacturing arrangement with the principal of the *maquiladora*.





- The IMMEX company shall undertake transformation or repair activities. A transformation activity includes, by fiction of the law, the following specific processes carried out with temporarily imported merchandise:
  - Dilution in water or in other substances
  - Washing or cleaning, including removal of rust, grease, paint or other covering surface treatments
  - The application of conservatives, including lubricants, protective encapsulation or protective painting
  - Adjustment, polishing or cutting
  - Adjusting in doses
  - Packaging or repackaging
  - Testing, marking, labelling or classification
  - Product development
- Domestic goods or definitively imported goods may be incorporated in the manufacturing process, provided that they are exported abroad along with the finished products manufactured with the other temporarily imported materials.
- All of the temporarily imported goods must be physically or virtually exported. Therefore, it is possible to transfer finished products from one IMMEX company to another.
- The maquila operation must be carried out with machinery and equipment owned by the foreign resident in at least 30% out of the total machinery and equipment used in the maquila operation.

In order to carry out the transformation and repair process, the use of machinery and equipment owned by the foreign resident may be supplemented with machinery and equipment owned by:

- i. A foreign resident that has a manufacturing relationship with the principal of the *maquiladora*, provided that they have a manufacturing relationship
- ii. The *maquiladora*
- iii. A third party and leased from a nonrelated party

However, in none of the abovementioned cases should the machinery or equipment have been owned by another resident in Mexico that is a related party of the *maquiladora*.

### **IMMEX shelter companies**

As published in the Federal Official Gazette on 23 December 2015, foreign residents who undertake operations in Mexico through an IMMEX company authorized under a Shelter modality were granted an additional four years to the previously determined term of four years in the ISRL, to operate in Mexico without being considered to have a permanent establishment in the country, provided they meet certain requirements and conditions.

## 7. Sales into the Mexican market

According to the IMMEX Decree, companies authorized under the program may sell a portion of their output in the domestic Mexican market. A company under the IMMEX program may sell in the domestic market up to 90% of the total value of its annual sales. Import duties and VAT should be paid on all temporarily imported materials or components contained in the finished product to be sold in the Mexican market unless the sale is made to a foreign resident with a physical delivery to another company under the IMMEX program in accordance with customs procedures mentioned above.

Nonetheless, it is important to emphasize that under the terms of the LISR, companies that have a "maquila operation" for tax purposes will not be able to obtain income from the sale of products, so it is important to carry out a proper planning of operations. export and sales in Mexico in order to mitigate the risk of the resident abroad having a permanent establishment in the country (see Section 6).

## D. Company Law

### 1. Forms of business organizations

The Mexican General Law of Commercial Companies ("GLCC") regulates various forms of business organizations. The GLCC regulates not only the requirements for their incorporation, but also sets forth their corporate governance directives. Relevant and commonly used forms of business organizations regulated in the GLCC include the following:

- Corporations (*Sociedad Anónima* or "S.A." or *Sociedad Anónima de Capital Variable* or "S.A. de C.V."; hereinafter collectively referred to as "corporation(s)").
- Limited liability companies (*Sociedad de Responsabilidad Limitada* or "S. de R. L." or *Sociedad de Responsabilidad Limitada de Capital Variable* or "S. de R.L. de C.V.").

Foreign investors and mainly US investors frequently incorporate limited liability companies because this form of business organization does provide limited liability to its partners and certain benefits for US tax purposes (as they are considered pass-through entities). Corporations, however, are by far the most common form of business organization used in Mexico. Therefore, Section 4 is limited to corporations and limited liability companies.

In addition, the Securities Market Law contemplates the following forms of business organizations:

- Investment development corporations (*Sociedades Anónimas Promotoras de Inversión* or "SAPIs")
- Securities investment development corporations (*Sociedades Anónimas Promotoras de Inversión Bursátil* or "SAPIBs")
- Publicly held corporations (*Sociedades Anónimas Bursátiles* or "SABs")

SAPIs' main purpose is to promote access by the technology sector and investment companies and thereby support seed capital, venture capital and private equity investment due to SAPIs' shares flexibility and rights restrictions. Through several funding rounds, SAPIs attract different investors, as this figure allows to define,



while defining the rights of each kind of share that will be issued, thus ensuring a more precise and flexible control of minority rights.

## **2. Corporations**

Corporations are created only by shareholders, which are obligated for the payment of their shares. As in any capitalist company, shareholders with a major capital stake in a corporation will have more corporate and economic rights.

### **a) Capital stock**

Upon incorporation, a corporation must have fully subscribed capital stock in an amount freely set by the shareholders in the corporation's charter and bylaws (minimum fixed capital) and at least 20% of their capital contribution paid in cash. In case of contributions in kind, the same must be subscribed and paid in full on the incorporation date. In case of contributions, some special rules apply, requiring the corporation to withhold shares paid with in-kind contributions for 24 months as of the contribution's date as a guarantee that the value of the in-kind contributions are not reduced by more than 25%.

Shares of stock, certificates of which are considered negotiable instruments under Mexican law, represent the capital stock of corporations. The S.A. and S.A. de C.V. differ in at least one significant aspect in this regard. A maximum amount of capital stock for an S.A. is fixed and specified in its charter and bylaws, and any subsequent increase or decrease to such fixed capital requires amending the referred incorporation documents. On the other hand, the charter and bylaws of an S.A. de C.V. sets the minimum fixed portion of its capital stock and the variable portion of such capital may remain open. In this scenario, the variable portion of its capital stock may be unlimited and may be increased or decreased without amending the incorporation documents as in the case of the S.A. For this reason, foreign investors, particularly those with wholly owned subsidiaries that want flexibility to increase or decrease the corporation's capital stock without any other formalities, prefer to organize their business activities in Mexico under the form of an S.A. de C.V. rather than through an S.A.

### **b) Minimum number of shareholders**

There must be at least two shareholders to incorporate a corporation. Unless otherwise limited by the Foreign Investment Law and its Regulations, the GLCC allows the shareholders of any given corporation to be Mexican and/or foreign.

### **c) Management structure**

The corporation's management may be vested in one (Sole Administrator) or more directors (Board of Directors). Whenever two or more directors are entrusted with the management of a corporation, they must act as a Board of Directors. If the Board of Directors has three or more members, the individual shareholder or group of shareholders owning 25% or more of the corporation's capital stock has the right to appoint at least one member of the Board. The corporation will be legally represented by its Sole Administrator or Board of Directors, as the case may be, and its authority will be contained in the corporation's bylaws or conferred by the shareholders.

The corporation's Sole Administrator or Board of Directors will be vested with the authority to appoint one or more general or special managers. By its nature, such appointment may be revoked at any time by the corporation's Sole Administrator, Board of Directors or by the shareholders. Appointment as Sole Administrator, Board member and/or general or special manager is subject to certain statutory limitations contemplated by the GLCC.

#### **d) Management surveillance**

In order to obtain better protection of the shareholders of Mexican corporations, the GLCC provides for the existence of a Statutory Examiner (*Comisario*) to be appointed directly by shareholders, whose main task and duty will be to survey the corporation's management for the benefit of the shareholders. Similar to the appointment of managers attempting to secure their independence with respect to the corporation's management, certain statutory limitations contemplated by the GLCC must be followed prior to appointment as Statutory Examiner of any given corporation.

#### **e) Annual shareholders meetings**

The shareholders of Mexican corporations must hold an annual shareholders meeting to discuss and approve, as the case may be, the management report and the financial statements of the corporation. Such annual shareholders meeting must be held no later than 30 April of every year.

### **3. Limited liability companies**

Limited liability companies are formed by partners who are obligated to pay only their contributions. In contrast to a corporation, the partners' contributions are only represented by quotas, which do not constitute a negotiable certificate. The transfer of quotas and admission of new partners are limited in this company.

#### **a) Capital**

Upon incorporation, a limited liability company must have a fully subscribed capital with at least two equity quotas valued no lower than MXN 1.00 each (minimum fixed capital), as established by the members in the company's charter and bylaws, and at least 50% of such capital contribution must be fully paid. The capital of limited liability companies is divided into equity quotas, which by law are not considered negotiable instruments. The assignment of equity quotas, as well as the admission of new members to participate in the limited liability company's social capital, require a prior favorable resolution of the majority of its members, unless the company's bylaws establish a higher percentage. As in the case of corporations, the treatment of minimum fixed and variable portions of the capital on the S. de R. L. and the S. de R.L. de C.V. differ in a similar manner as set forth in Section 4.2.1 above. Based on the above considerations, most foreign investors prefer to organize their business activities in Mexico under the form of a S. de R. L. de C.V. rather than through a S. de R. L.

#### **b) Number of members**

At least two members must organize a limited liability company; a limit of 50 members has been set forth by the GLCC. Unless otherwise limited by the Foreign Investment Law and its Regulations, the GLCC allows the members of any given limited liability company to be Mexican and/or foreign.

#### **c) Management structure**

The limited liability company's management may be vested in one (Sole Manager) or more managers (Board of Managers), which can be freely removed by the company's members at any time. Whenever two or more managers are entrusted with the management of the company, they must act as a Board of Managers. The company will be legally represented by its Sole Manager or by its Board of Managers, as the case may be, and its authority will be established in the company's by-laws or conferred by the members.

As in the case of corporations, some statutory limitations established by the GLCC will be applicable for the appointment of the company's Sole Manager or the managers who form the Board of Managers.



#### **d) Annual partners meeting**

The members of a limited liability company must have at least one meeting at any time of every year.

### **4. SAPIs**

SAPIs are corporations incorporated pursuant to the GLCC that adopt the SAPI regime as provided by the SML (a corporation subtype that may precede the SAPIBs, which may trade its stock in the stock market). SAPIs are not required to register their securities with the National Securities Registry (*Registro Nacional de Valores* or "NSR").

SAPIs must transform to SAPIBs in order to be capable of being publicly traded. SAPIs are not subject to the surveillance of the National Banking and Securities Commission, unless their securities are registered with the NSR.

The management of SAPIs shall be vested in a Board of Directors. SAPIs may also adopt the surveillance regime applicable to SABs for the establishment of their Board of Directors, the creation of auxiliary committees of the Board of Directors, and the appointment of an independent external auditor.

Likewise, the appointment of a member of the Board of Administration shall only be revoked by other shareholders when the revocation of all the members of the board is made, in which case the replaced members shall not be appointed with such character for a 12-month period following the revocation date.

SAPIs may, with prior approval from its Board of Directors, acquire their own shares by: (a) charging them to their net worth, in which case, the SAPIs may retain the shares and no capital reduction will be needed; or (b) charging them to their paid-in capital, provided that such shares are cancelled or converted into issued unsubscribed shares held by the treasury of the SAPI.

SAPIs are subject to a regulatory framework different than that applicable to corporations (*sociedades anónimas*) in accordance with the GLCC with respect to minority rights. Some of the differences are as follows:

- (a) The right to appoint or revoke the appointment of a member of the Board of Directors and a Statutory Examiner (in its case), for shareholders holding at least 10% of the total voting shares, inclusive of limited or restricted vote (at least 25% in the case of ordinary commercial corporations)
- (b) The right to request the call to a general meeting of shareholders (or extend the voting of its resolutions for up to three calendar days) resolving matters on which they are entitled to vote, for shareholders holding at least 10% of the paid-in capital of the corporation (at least 25% in the case of ordinary commercial corporations)
- (c) The right to commence civil liability claims against the administrators and/or the Statutory Examiner (in its case) in the interest of the corporation, for shareholders holding at least 15% of the total voting shares, inclusive of limited or restricted vote (at least 25% in the case of ordinary commercial corporations)
- (d) The right to judicially oppose certain resolutions of the general shareholders' meeting, as long as they are entitled to vote on said matter, for shareholders holding at least 20% of the paid-in capital of the corporation (at least 25% in the case of ordinary commercial corporations)

Shareholders of SAPIs may enter into agreements providing for (i) noncompetition; (ii) call and put options subject to diverse modalities; (iii) exercise of preferential share purchase or sale rights or restrictions; (iv) voting exercise covenants; and (v) covenants for purchase and sales of shares in public offerings.

SAPIs cannot be publicly traded. Yet due to the preferential treatment of SAPIs as compared to ordinary commercial corporations, as well as the institutional perception that may be derived from adherence to more modern transparency and corporate governance standards, SAPIs may constitute an attractive corporate subtype entity for some companies.

## **5. SAPIBs.**

In the event a SAPI wishes to register its shares (or the negotiable instruments representing them) in the NSR and list them on the stock exchange, the SAPI must comply with the requirements applicable to SAPIBs. SAPIBs may operate for a maximum of 10 years before transforming to SABs. The purpose of this term is to provide SAPIBs a transitional period during which they can adopt the corporate governance and administration measures required to comply with the entirety of the regulations and meet the entirety of the obligations applicable to SABs.

To become SAPIBs and hence subject to registration with the NSR, SAPIs shall:

- (a) Request registration with the NSR and to that effect adopt the information disclosure requirements set forth by the NBSC.
- (b) Resolve the following statements through a shareholders' assembly: (i) adding the expression "*Bursátil*" or its abbreviation, the letter "B", to the denomination of the corporation; (ii) adopting the SAB form within a term not exceeding 10 years as of the date of recording with the NSR or before, if the net worth at close of the corresponding year exceeds the equivalent in Mexican currency of 250 million of investment units ("UDIS") pursuant to its audited financial statements; (iii) progressively adopting the regulatory regime applicable to SABs in accordance with the rules set out by the stock exchange and modifying the by-laws of the SAPIB to adequate the integration of the capital stock to the regime applicable to SABs.
- (c) Have at least one independent member of the Board of Directors.
- (d) Appoint a corporate practice compliance committee (which shall also have the duties of the auditing committee if so decided by the corporation) to be presided over by an independent member of the Board of Directors.
- (e) Validate that the secretary of the board has authenticated the number of shares held by each shareholder.

Once registered with the NSR, in order to be traded in the stock exchange with or without public offering, an SAPIB shall:

1. Prepare a placement prospectus or informative document establishing its differences as compared to SABs and the terms and conditions for the implementation through time of the program for the compliance of the requisites applicable to SABs.



2. Obtain the approval of the Mexican Stock Exchange for its program, contemplating the progressive adoption of the regime applicable to SABs. This program must comply with the requirements established in the internal regulations of the Mexican Stock Exchange.

## **6. SABs**

The SML establishes that corporations that are not SAPIBs, and whose shares are registered before the NSR, shall add to their corporate name the word "*Bursátil*" or its abbreviation "B". In other words, any company having such word or abbreviation in its corporate name will indicate its being a publicly held company (be it an SAPIB or an SAB). In the past, publicly held corporations were known only as issuer or securities corporations.

The modifications most relevant to the organizational and functional regime of the SAB include the following:

### **a) Creation of consortiums**

Group of companies that are part of the same economic unit are characterized, for purposes of the SML, as a consortium, that is, a single economic management and decision unit. Consequently, the SML shall be applied to them on a consolidated basis, mainly in aspects such as (i) the disclosure of information (given that any event that affects the value of any of the subsidiaries will affect the value of the consortium); (ii) the auditing and corporate practices roles of the Board of Directors (so that the operation policies with respect to related parties are observed among all members of the whole consortium); and (iii) consolidated accounting.

### **b) Duties of the Board of Directors**

The role of the Board of Directors is modified by vesting upon it the following duties (related to the strategy and surveillance of the corporation, as opposed to the regime set out by the GLCC for ordinary commercial corporations and in accordance with the operational reality of publicly held companies):

1. Establish general strategies and policies relevant to the operation of the business.
2. Approve relevant transactions or those which SABs enter into with related parties, taking into consideration the prior opinion of the corresponding committee.
3. Oversee the management and governance of the SAB.

### **c) Duties of the general manager**

The general manager (as the main officer of the SAB) shall be responsible, among other things, for:

1. Management, conduct and execution of the day-to-day business
2. The existence and maintenance of the accounting, control and registry systems
3. The compliance of the resolutions adopted by the Board of Directors and the shareholders' meetings, and the disclosure of relevant information

### **d) Surveillance**

One of the main changes is the removal of the Statutory Examiner and the distribution of the surveillance duties of the SAB among the Board of Directors, the auditing and corporate practices committee or committees, and the independent external auditor. Hence, surveillance duties for the management, conduct and operation of the business of the SABs and other legal entities controlled by the SABs is vested in the Board of Directors through

the committee or committees created to carry out the activities related to corporate practices and auditing, as well as through the legal entity that performs the external audit of the company, based on the competencies that correspond to each of them.

### **e) Integration of Board of Directors**

The Board of Directors shall be formed by a maximum of 21 members out of whom at least 25% shall be independent directors not having conflicts of interest with the SAB.

### **f) Integration of committees**

Committees shall be formed by a minimum of three independent counselors not having conflicts of interest with the SAB, to guarantee the impartiality of their recommendations (although such recommendations are not binding on the Board of Directors). However, if the Board of Directors does not comply with the recommendation of a committee, this fact must be disclosed to the stock market.

### **g) Duty of loyalty and duty of care**

The functions and responsibilities of the directors and officers of the SAB are regulated. The governing principles of their positions are to: (a) create value for the SAB; and (b) act in accordance with duty of loyalty and duty of care principles, subject to the business judgment rule.

#### **(i) Duty of care**

In general terms, the duty of diligence that should govern the actions of members of the Board Directors of SABs consists in their obligation to conduct themselves in good faith and place the interests of the SAB above their own. To this end, directors are entitled to secure the information they deem necessary to make decisions, request the appearance of relevant officers, postpone meetings of the board when justified causes exist, and deliberate and vote. In certain cases, abstaining from attending the meetings of the Board of Directors or the committees, failure to disclose relevant information to the board or the committees and failure to comply with their statutory obligations translate to breaches of the duty of care.

#### **(ii) Duty of loyalty**

In general terms, the duty of loyalty, which extends to members and the secretary of the Board of Directors of SABs, consists of the obligation to (i) maintain confidentiality of corporate matters in respect of which they gain knowledge in the exercise of their corporate duties; (ii) abstain from acting in a manner inconsistent with conflict of interest rules; and (iii) inform the audit committee and the external auditor about any irregularities with the company or the consortium of which they become knowledgeable during the exercise of their appointment.

### **h) Minority rights**

1. At least 5% of shares is needed to exercise a civil action against directors and officers.
2. Relevant information and relevant events are disclosed to provide fair treatment of stock market participants and allow them to attain a better knowledge of the financial standing of the SAB.
3. Hostile takeover protection clauses are allowed when: (i) they are adopted in an extraordinary shareholders' meeting; (ii) no more than 5% of the shareholders present at the meeting have voted against it; (iii) they do not exclude from the benefits of such clause a shareholders' group





different from those who pretend to achieve the control; and (c) they do not obstruct in an absolute manner the corporate control of the SAB.

## **E. Taxes**

### **1. Treaties**

Mexico has executed treaties for the avoidance of double taxation with various countries, including the United States, Canada and most OECD countries. Those treaties establish different rules for taxation of permanent establishments and of Mexican-sourced income (e.g., withholding rates on dividends, royalties and interest) derived by residents of the signatory countries. The relevant tax treaty must be reviewed to determine the applicable rates. Absent such a treaty, the rules of the Mexican Income Tax Law ("ITL") will govern, as discussed below.

It should be noted that in the past years, in line with the Internationally Agreed Tax Standard adopted by the Global Forum of Transparency, Mexico has executed several Tax Information Exchange Agreements with different countries for purposes of promoting international cooperation in tax matters through exchange of information. Some of these TIEAs have been executed with countries like Netherlands Antilles, the Bahamas, Bermuda, Isle of Man, Cayman Islands, Cook Islands and Guernsey, despite the fact that they remain on Mexico's blacklist.

### **2. Corporate income tax**

#### **a) Corporations**

Individuals and legal entities are subject to the payment of Corporate Income Tax when: i) they are Tax Residents of Mexico with respect to their worldwide net income (that is, gross income minus allowable deductions); ii) they are foreign tax residents with a permanent establishment (tax presence) in Mexico, with respect to the income attributable to such permanent establishment; and iii) they are foreign tax residents with Mexican-sourced income but do not have a permanent establishment in Mexico, or if such income is not attributable to a permanent establishment.

The general Corporate Income Tax rate is 30% for legal and corporate entities, whereas the rate applicable for individuals may range from 1.92% to 35% depending on the net income/revenue of the individual. Recognizable income includes income in cash, in kind, service, credit (i.e., when accrued) or any other form.

The basis of the tax is equal to the recognizable income minus allowable deductions and the previous year's net operating losses.

The allowable deductions include, among others, returns, discounts, and rebates; cost of goods sold; expenses, net of discounts, bonuses, or returns; depreciation and amortization; bad debts; certain losses; accrued ordinary interest and penalty interest with certain requirements; annual inflationary adjustment; and net operating losses.

Mexico is a formalistic country and, consequently, several requirements apply for the deductions to be allowed. All deductions must be strictly indispensable for the activities carried out by the taxpayer, supported by invoices that meet specific requirements, recorded in the accounting books of the taxpayer, and paid with check or credit/debit/service card or by wire transfer. In addition, the taxpayer must comply with withholding and reporting obligations, if applicable, among other obligations. Other deductions must meet the specific requirements established by the ITL.

Some expenses are not allowed as deductions. Such is the case, for example, with taxes, conventional penalties, goodwill, fringe benefits (deductible in up to 53% of the expense), among others.

## **b) Dividends**

Dividends distributed by Mexican companies to foreign residents or Mexican individuals are subject to a 10% withholding tax. This withholding tax is applicable to the shareholder or equity quota holder, as the case may be, and it is not an additional tax to the entity distributing the dividends. Dividends paid to another Mexican legal entity will not be subject to the 10% withholding tax. This tax also applies to profits distributed by permanent establishments to their headquarters or other permanent establishments of foreign residents. If the dividends originated from profits generated until December 2013, such dividends will not be subject to this tax. The dividend tax may be reduced or even eliminated if the shareholders or partners are residents of a country with which Mexico has signed a treaty for the avoidance of double taxation.

If the dividends are distributed from a net after-tax profit account, the dividends being distributed will not be subject to any additional corporate income tax applied to the company. However, if the dividends being distributed do not derive from the net after-tax profit account, the dividend being paid will be subject to the corresponding corporate income tax in addition to the 10% withheld to the recipient of the dividends.

## **c) Withholding taxes**

Royalties, license fees or other compensation paid by a Mexican licensee to a nonresident for unpatented technology, software or technical assistance are subject to withholding tax at the rate of 25%. Royalties paid to a nonresident for patents, trademarks, trade names or for advertising are subject to withholding tax at the rate of 35%. Under most tax treaties that Mexico has entered into, the rate on royalty payments (as defined in those treaties) drops to 10% of the gross amount of the royalty.

Interest payments to nonresidents are subject to withholding tax at percentages of 4.9, 10, 15, 21 or 35, depending on the type of payee or payer. Under Mexican law in general, if the payee is a foreign bank or any other financial institution that is the beneficial owner of the interests and provides the Ministry of Finance certain information regarding loans granted to Mexican residents, the interest payments will be subject to withholding tax at the rate of 10%. According to the ITL, this percentage could be reduced to 4.9% in case the beneficial owner is a resident for tax purposes of a country that has executed a Double Taxation Treaty with Mexico, and the special requirements set forth in such treaty to apply the rates regarding interests are fulfilled. If (i) the payer is a credit institution (and the payee is other than a bank or financial institution that provides the required information to the Ministry of Finance to which the 10% tax rate applies); (ii) the payee is either a foreign supplier of machinery and equipment that form part of the fixed assets of the payer; or (iii) the payee is a foreign entity that finances the purchase of such machinery and equipment or provides certain working capital financing pursuant to an agreement that sets forth these circumstances and the entity provides certain information to the Ministry of Finance, the interest payments will be subject to withholding at the rate of 21%. In all other cases, interest is subject to withholding tax at the rate of 35%. These rates may be lower in the case of countries with which Mexico has tax treaties. For example, under the US - Mexico Tax Treaty, the rates may be 4.9%, 10% or 15%.

Payments to residents of tax havens are generally subject to a 40% withholding tax, except for certain interest and for dividends.



#### **d) Sale of shares**

Generally, the sale of shares of a Mexican company is subject to Mexican income tax, regardless of the country where the sale takes place. Foreign residents who sell shares of Mexican companies are subject to a 25% tax on the gross proceeds from the sale, or at the option of the foreign resident if it has a local representative in Mexico, to a 35% tax on the net gain derived from the sale. This option is not available to foreign sellers domiciled in a tax haven jurisdiction or a jurisdiction with a territorial taxation system. Under certain conditions, tax rulings may be available to defer payment of taxes in transfers of shares in reorganizations between members of the same group of companies.

The net gain is determined by subtracting from the gross sale proceeds the seller's tax basis in the shares sold, adjusted for inflation and other factors as determined in the ITL. Under this alternative, the party transferring the shares or quotas is required to appoint a legal representative in Mexico. It is also required to file a tax return with respect to the sale or exchange shortly after the transaction, and obtain a fiscal certification (dictamen fiscal) from a Mexican certified public accountant to the effect that the gain as reported on the tax return is correctly calculated. If transactions are made between related parties, the certified public accountant will need to certify in the dictamen fiscal that the adjusted tax cost of the shares has been calculated correctly and that the shares have been properly valued in accordance with the arm's-length principles set forth in Mexican law for purposes of determining the shareholder's gain or loss on the exchange.

#### **e) Thin capitalization rules**

Thin capitalization rules have been in effect in Mexico since 2005. In essence, the rules disallow the deduction of interest corresponding to debts with nonresident related parties when the total amount of all debts generating interest exceeds three times the taxpayer's book net worth. These rules, however, do not apply to entities that form the financial system and provided that such debts are contracted to carry out their business activities, as well as in those cases in which debt is contracted for productive infrastructure related to strategic areas of Mexico and for the generation of electric power. Interest must be established at arm's length. Interests might be re-characterized as dividends if they derive from back-to-back loans, of which Mexican law has a very broad concept.

#### **f) Transactions and investments related to tax havens**

Beginning in 1996, Mexico's tax reforms incorporated several provisions aimed at eliminating or controlling investments in and transactions with companies that are located in low-tax jurisdictions. Mexico considers a low-tax jurisdiction or preferential tax jurisdiction to be a country where the income tax actually paid is less than 75% of the tax payable in Mexico for the same income. These tax provisions may affect shareholders, trust beneficiaries or other entities or individuals who are tax residents in Mexico or have a permanent establishment in other countries and receive income from legal entities or from entities that the ITL considers as transparent entities.

#### **g) Transfer pricing**

Mexican taxpayers who entered into transactions with related parties must, for tax purposes, charge or pay the prices that would be agreed to between independent parties in comparable transactions. These taxpayers are required to prepare and keep current documentation supporting the prices charged or paid.

## **h) Transfer pricing rules applicable to *maquiladoras***

*Maquiladora* operations generally create a permanent establishment in Mexico for the foreign principal that provides the raw materials and machinery and equipment to the *maquiladora* company, which would expose such foreign resident to income tax in Mexico. An exemption from constituting a permanent establishment in Mexico for the foreign resident is available provided that the *maquiladora* complies, among other requirements, with special transfer pricing requirements.

To this end, *maquiladoras* shall determine their income fee by following the so-called safe harbor method, which states that the *maquiladora* must generate a tax profit equal to the greatest amount equivalent to either 6.9% of the value of the assets used in their activity or 6.5% of the amount of ordinary costs and expenses of their operation. Alternatively, *maquiladoras* may opt to file for and secure from the tax administration an advance pricing agreement with respect to their transfer pricing methodology.

The special safe-harbor rule is only applicable with respect to *maquiladora* operations, as defined in the ITL, carried out by the *maquiladora*.

The ITL provides specific conditions in order to have a maquila operation concept for income tax purposes and to exempt its foreign related party from a permanent establishment in Mexico. These conditions include the following:

- Undertaking of transformation activities
- Utilization of raw materials furnished by the foreign principal, with the obligation to export physically or virtually (to another *maquiladora*) 100% of the productive output
- Use of at least 30% of the foreign principal's total machinery and equipment, which must not have been previously owned by the *maquiladora* or a Mexican related party
- Production of income from productive activities exclusively from the maquila operation
- The foreign principal's tax residence in a country with which Mexico has in place a tax treaty

If the *maquiladora* performs other activities that are not deemed as *maquiladora* operations, the *maquiladora* must comply with general transfer pricing rules.

## **i) Deductibility of outsourcing payments**

Outsourcing is defined as the relationship whereby an employer, defined as a contractor or service provider, carries out works or provides services with the contractor's employees under the contractor's subordination, in favor of a contracting party or service recipient (an individual or a legal entity) which sets and supervises the contractor's tasks during the development of the services and the performance of the assignments entrusted. Additionally, the following criteria should be met:

- (a) Outsourcing cannot perform all the company's activities.
- (b) Outsourcing should be reserved for tasks that require specialized labor.
- (c) Outsourced tasks should not be similar or equal to those performed by the direct employees of the company.



As of January 2018, in order to claim the tax deduction of the expense and to claim a VAT credit for the services contracted, the service recipient must gather the following documentation from the service provider:

- Issuance of payroll tax stubs or vouchers (“CFDIs”) utilizing version 1.2. corresponding to the employees of the service provider for the performance of their services.
- Evidence of compliance with the payment of social security contributions.
- Evidence of compliance to withholding and payment of income tax for wages and salaries.
- Evidence of compliance with the VAT monthly obligations of the service provider.

### **3. Value added tax**

Mexico imposes a value added tax on the following activities:

- Sale of goods
- Lease of goods
- Rendering of services
- Importation of goods or services

The general rate is 16% of the value of the subject matter transaction. A 0% rate applies in certain limited cases, mainly related to exportation of goods and services, as well as food and medicines. VAT is levied on a cash-flow basis.

VAT exemption applies to certain other transactions including the sale of temporarily imported goods between nonresidents of Mexico, and the sale of land, company shares and equity quotas, among others.

VAT normally operates by having each party in the chain of production charge the tax to its customer and pay to the tax authority the difference between the tax charged by its suppliers and the tax charged to its customers, on a monthly basis. VAT on all purchases, rentals, services and imports may be creditable to the extent that the specific expense is tax deductible.

With respect to the *maquiladora* industry, VAT is assessed at the regular 16% rate on temporary imports; the exportation of service (the manufacturing fee) is subject to a 0% VAT rate. However, as explained below, *maquiladora* companies that secure a special VAT certification will not have to make a cash disbursement for the temporary importation of goods.

VAT paid on imports is assessed on the customs value of the import plus the import duty. Because the importer is entitled to credit all VAT paid against VAT collected from its customers, the ultimate burden of the VAT is effectively passed along to the importer’s customers and from there to the end consumer.

#### **a) VAT credit during preoperative periods**

The VAT Law establishes requirements and conditions for the crediting of VAT regarding expenses and investments made during preoperative periods.

Taxpayers may credit the VAT triggered prior to the start of their business activities until the date they make their first transactions subject to VAT (commercial transactions exempt from VAT are not considered for the purpose of claiming VAT credit).

Also, taxpayers can choose to request the VAT crediting that was transferred to them during the preoperative period, provided that the conditions established by the VAT Law are met. For such purposes, taxpayers must submit the information indicated in the VAT Law together with their initial request for VAT refund.

In the event that taxpayers fail to carry out VATable transactions within a term of 12 months following the initial VAT refund, they shall reimburse the recovered preoperative input VAT. However, the taxpayer would remain entitled to obtain a new refund of such amounts once they start business operations subject to VAT. Taxpayers dedicated to hydrocarbon exploration and extraction would be exempted from certain conditions for the VAT credit during preoperative periods when the extraction is not feasible or when, due to economic circumstances not attributable to the company, the extraction of hydrocarbons becomes unaffordable. Other taxpayers that foresee that their preoperative period would last more than 12 months may apply to the tax authority for an authorization in order to avoid a reimbursement of the refunded VAT.

#### **4. Tax incentives**

Tax incentives have been granted by the Mexican government to promote investments and development of certain types of industries and projects. There are incentives for *maquiladoras*, Technology Research & Development ("TRD") projects in the film and entertainment industries; those who hire handicapped employees and adults who are 65 years old; as well as real estate investment trusts, among others.

The *maquiladora* industry enjoys a tax incentive that grants an additional deduction equivalent to 47% of the fringe benefits paid to employees when, in turn, they represent exempt income for such employees, which represents a potential deduction of 100% of said payments. Otherwise, the deduction of fringe benefits would be limited up to 53% of the expense.

Taxpayers that employ handicapped individuals whose limited capacity has been certified by the Mexican Institute of Social Security are allowed to take a deduction towards their own income tax an amount equivalent to 100% of the withheld and remitted income tax of said handicapped employees.

Taxpayers that build or acquire real property intended for lease or its subsequent sale through a trust are granted a tax incentive that includes an exemption from estimated income tax payments. The application of these benefits is contingent on various requirements, such as: (i) the trust must be created pursuant to Mexican law; (ii) 70% of trust capital must be allocated to acquire real property for lease and subsequent sale, and the remainder of capital must be invested in federal government securities; the buildings/constructions or acquired real property are intended for leasing purposes and are sold after a four-year period has elapsed; (iv) the trust issues participation certificates for the assets in the trust's patrimony, and such certificates are publicly traded or acquired by a group of (at least 10) investors that are not related parties and none of whom controls more than 20% of such certificates; (v) the trust distributes at least once per year 95% of the taxable income of the previous fiscal year generated by the assets in the trust's patrimony; (vi) when variable amounts or amounts referred to as percentages are included in the leasing agreements to determine the consideration or rent payments, these concepts may not exceed 5% of the total amount of the trusts' annual rent income; and (vii) the trust is registered in the "Trust Registry" for the construction and acquisition of real estate.

In general terms, the tax incentive to TRD consists of a tax credit equivalent to 30% of the incremental expenses made in the fiscal year in TRD, applicable against the income tax triggered in the fiscal year in which such tax



credit is determined. This tax incentive can only be applied on the incremental basis of the expenses and investments made in the corresponding year, with respect to those made in the previous three fiscal years, and should not be accumulated for purposes of income tax. The TRD projects and expenses that can benefit from this tax incentive are those that comply with the guidelines established for this purpose by the National Science and Technology Council (or "CONACYT" as abbreviated in Spanish) and an Institutional Committee.

Note that the above are the main tax incentives that may taxpayers doing business in Mexico may apply; additional sector-oriented tax incentives are also available under federal and local laws.

## 5. Employee profit sharing

Under the Mexican Federal Constitution, employees are entitled to participate in the profits of the employer. This is commonly known as "PTU" (the Spanish acronym for "*Participación de los Trabajadores en las Utilidades*"). Employers have the obligation to pay an amount equal to 10% of their taxable base to their employees within 60 days after the employer is required to file its year-end income tax return. Fifty percent of the amount to be paid is required to be distributed in proportion to the number of days worked by each employee during the year, and the remainder according to the wages of each employee.

Newly created companies are exempted from PTU during their first year of operation.

Corporate taxpayers are allowed to deduct the employee profit sharing paid during the tax year from income tax taxable profits. The PTU paid, however, is not deductible for purposes of determining the basis to calculate the PTU of neither the tax year in question nor the tax losses pending to be applied from previous tax years.

On 30 November 2012, a labor reform was published in the Federal Official Gazette including a special regime for outsourcing companies. These amendments may represent PTU risks for current structures using services companies. We recommend analyzing these structures in light of the reform.

## 6. Payroll tax

Although taxed at a state level, most, if not all, states in Mexico have a payroll tax. The basis for this tax is usually all wages and other benefits that are paid to an employee. Rates vary from state to state but generally can range between 2% and 3%.

## 7. Special tax on production and services

As of fiscal year 2014, the sale and importation of flavored beverages with sugar added, including among others, soft drinks, powders and syrups is deemed a taxable activity for purposes of this tax. The tax will be MXN 1 per liter.

The sale and importation of certain "nonbasic food" with high caloric values (275 kilocalories per 100 grams) has also been included as a taxable activity beginning fiscal year 2014. According to the law, the following items, among others, are deemed "nonbasic food": snacks, chocolates, ice creams, custards, puddings, fried food, pastry, milk sweets and cereal-based food. The tax rate is 8% on the sales price.

The sale and importation of fossil fuels (propane, butane, gasoline, avgas, turbosine, and other kerosene, diesel, fuel oil, oil coke, coal coke, mineral coal and other fossil fuels that include any other derived from oil and mineral coal destined for a combustion process) will be subject to this tax as of fiscal year 2014. This tax can be paid by the delivery of carbon credits when these derive from projects developed in Mexico and endorsed by the United Nations.

This tax is also imposed, as of fiscal year 2014, on pesticides that have a toxicity level of 1-4. The rates vary depending on the toxicity level of each pesticide. For example, for pesticides that are levels 1 and 2, the rate is 9%; for level 3 pesticides, the rate is 7%; and for level 4 pesticides, the rate is 6%.

## **8. Mining fees**

Holders of mining concessions will be subject to an annual “special mining fee” at a rate of 7.5% on the positive difference from reducing income originated by the sale of the extraction activity, as well as certain deductions pursuant to the ITL, except for: (i) investments, excluding exploration and prospecting expenses; (ii) interest accrued during the fiscal year, without any adjustment and default interest; and (iii) the deductible annual inflation adjustment.

An “additional mining fee” will have to be paid by holders of mining concessions who do not carry out work and exploration or development activities pursuant to the Mining Law during two consecutive years within the first 11 years of the mining concession. In this case, the additional mining fee is equal to 50% of the amount set forth in Article 263-VI of the Federal Law on Fees per hectare granted under concession, and will be payable on a six-month basis. For holders of concessions of 12 years or more, the fee is equal to 100% of said amount.

Holders of mining concessions will be subject to an annual “extraordinary mining fee” at a 0.5% rate on the total income derived from the sale of gold, silver and platinum, without any deduction.

## **F. International trade**

Free trade agreements are part of Mexico’s overall strategy to increase the competitiveness of its economy and become an important player in global trade. The open economy strategy began in the mid-1980s with Mexico’s adherence to the General Agreement on Tariffs and Trade. Specifically, Mexico’s network of Free Trade Agreements (“FTAs”) has allowed it to become one of the largest manufacturers of export goods in the world.

### **1. Imports in general**

Mexican import controls have been significantly eased, but in recent years, some control measures have been implemented for certain sensitive sectors such as steel, textile and footwear. In Mexico, however, most products do not require prior import permits, and import duties have been reduced. Duties are assessed based on the customs value of the products imported into Mexico and may be reduced and/or deferred pursuant to the applicable foreign trade programs enacted by the government.

### **2. Mexico’s Free Trade Agreements**

FTAs offer more than preferential duty access; they also provide legal certainty by giving companies the ability to predict treatment of their products and services, as well as their investments in the country of destination. FTA provisions include National Treatment for goods and investments from the other party, as well as Most Favored Nation Treatment for its goods and services. FTAs also eliminate performance requirements by removing the need to comply with national content or export requirements.

Regarding investment, Mexico’s FTAs provide for the free transfer of capital without restrictions and for reimbursements in case of expropriations, as well as the creation of dispute settlement mechanisms that are a strong guarantee of justice. Some of Mexico’s FTAs cover the protection of intellectual property rights, antitrust provisions and better thresholds for government procurement. Additionally, FTAs commonly require the standardization of customs documents, making import-export transactions faster and more efficient.





Currently, Mexico has 12 FTAs in force<sup>4</sup> giving it preferential access to 46 countries<sup>5</sup> including: the United States and Canada in 1994; Colombia and Venezuela in 1995 (only Colombia since 2006); Chile in 1999; Israel in 2000; the European Union in 2000; Norway, Switzerland, Iceland and Liechtenstein in 2001; Uruguay in 2004; Japan in 2005; Peru in 2012; Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua<sup>6</sup> in 2012 and 2013<sup>7</sup>; Panama in 2015 as well as Pacific Alliance: Chile, Colombia and Peru in 2016<sup>8</sup>.

It is important to mention that with the United Kingdom's withdrawal from the European Union ("Brexit"), goods of British origin will only continue to enjoy tariff preferences under the trade agreement between Mexico and the European Union, until the exit of the United Kingdom becomes effective<sup>9</sup>. If they do not reach an agreement, the effective date of the exit will be 29 March 2019. It is still uncertain whether there will be a bilateral commercial agreement between the United Kingdom and Mexico.

On other matters, regarding the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("CPTPP"), previously the Trans Pacific Partnership ("TPP"), the participating countries negotiated their terms without the participation of the United States of America. The 11 countries — Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam — have finalized the text of this trade agreement, which is expected to be signed in March 2018. The treaty will come into force when at least six countries ratify it.<sup>10 11</sup>

Following US President Donald Trump's statements, the NAFTA continues under a renegotiation process, although it is uncertain whether the parties will reach an agreement. The topics that stand out in the renegotiation discussions are: energy, investment, financial services, textiles, rules of origin, anti-corruption, environment, good regulatory practices, agricultural products and trade technical barriers<sup>12</sup>. Additionally, it is expected that Mexico will continue seeking to strengthen its commercial relationships with other countries.

In addition to FTAs, Mexico is a signatory to multiple Agreements on the Mutual Protection and Promotion of Investments (bilateral investment treaties, or "BITs" in English). These agreements protect investments made by investors from signatory countries. To date, Mexico has signed international investment agreements with 44 countries: 32 BITs and nine FTAs that include investment chapters.<sup>13</sup>

Mexico has signed BITs in Latin America and the Caribbean with Argentina, Cuba, Panama, Trinidad and Tobago, Haiti and Uruguay; in Asia and Oceania with Australia, China, South Korea, India and Singapore; in the Middle East with Bahrain and Kuwait; in Europe with Germany, Austria, Belarus, Denmark, Slovak Republic, Spain, Finland, France, Greece, Iceland, Italy, Netherlands, Portugal, United Kingdom, Czech Republic, Sweden, Switzerland, Turkey, and the Belgium-Luxembourg Union<sup>14</sup>. The FTAs that include an investment chapter are with the United States and Canada, Chile, Colombia, Costa Rica, Nicaragua, El Salvador, Guatemala, Honduras, Uruguay, Peru, Panama and Japan.

<sup>4</sup> [http://www.economia.gob.mx/files/gobmx/mapa\\_tratadosacuerdosMexico.jpg](http://www.economia.gob.mx/files/gobmx/mapa_tratadosacuerdosMexico.jpg)

<sup>5</sup> <http://www.gob.mx/se/acciones-y-programas/comercio-exterior-paises-con-tratados-y-acuerdos-firmados-con-mexico>

<sup>6</sup> [http://www.dof.gob.mx/nota\\_detalle.php?codigo=5266126&fecha=31/08/2012](http://www.dof.gob.mx/nota_detalle.php?codigo=5266126&fecha=31/08/2012)

<sup>7</sup> [http://www.sice.oas.org/TPD/CACM\\_MEX/CACM\\_MEX\\_s.asp](http://www.sice.oas.org/TPD/CACM_MEX/CACM_MEX_s.asp)

<sup>8</sup> [http://www.sice.oas.org/agreements\\_s.asp](http://www.sice.oas.org/agreements_s.asp)

<sup>9</sup> <http://cnnspanol.cnn.com/2017/03/29/reino-unido-invoca-el-articulo-50-para-iniciar-el-brexit/>

<sup>10</sup> <http://www.elfinanciero.com.mx/economia/este-es-el-nuevo-nombre-del-tpp-y-lo-que-propone.html>

<sup>11</sup> <https://www.eleconomista.com.mx/empresas/TPP-11-supera-divergencias-y-sera-una-realidad-este-ano-20180124-0020.html>

<sup>12</sup> <http://www.reforma.com/aplicacioneslibre/preacceso/articulo/default.aspx?id=1302681&urlredirect=>

<sup>13</sup> <http://www.gob.mx/se/acciones-y-programas/comercio-exterior-paises-con-tratados-y-acuerdos-firmados-con-mexico>

<sup>14</sup> <http://www.gob.mx/se/documentos/comercio-exterior-paises-con-tratados-y-acuerdos-firmados-con-mexico-acuerdos-internales-appris>

### **3. Foreign Trade Law**

Mexico enacted its Foreign Trade Law on 28 July 1993. The FTL regulates international trade and prohibits unfair trade practices such as dumping and trade subsidies. Additionally, it contains provisions on nontariff regulations and restrictions. The FTL follows GATT principles and conforms to the requirements of NAFTA and other FTAs.

### **4. Customs Law**

As a result of the last amendments to the Customs Law, Mexican import controls have been eased, thereby facilitating the review of goods during customs clearance operations using non-intrusive technologies; allowing the processing of import and export operations without requiring the services of customs brokers; allowing the establishment of strategic bonded warehouses all over the Mexican territory; and eliminating unnecessary procedures, among other amendments. These have been approved in line with the principles of the Organization for Economic Cooperation and Development for the international trade of goods.

Additionally, the Customs Law contains provisions on customs clearance (import, export and control of goods), duties and taxes payable upon importation, and nontariff regulations and restrictions on foreign trade. It also sets forth the customs regimes for imports and exports; the requirements, rights and obligations of customs brokers; and sanctions related to foreign trade transactions. The provisions contained in the Customs Law are supplemented by the Customs Law's Regulations, the Foreign Trade General Rules issued by the Ministry of Treasury and Public Credit (Hacienda), and the Foreign Trade General Rules and Criteria issued by the Ministry of Economy.

## **G. Labor Law**

The Mexican Federal Labor Law regulates employment relationships in Mexico. The FLL is applicable to all employees in Mexico regardless of nationality or the place in which their employment agreement was executed. It was last relevantly amended on 30 November 2012, 42 years after the last substantive changes were made, and 32 years after the last procedural changes.

### **1. Mandatory employee benefits**

#### **a) Profit sharing**

As of the second year of operation, an employer must distribute among its employees an amount equal to 10% of the employer's pretax profits within 60 days after the employer is required to file its year-end income tax return. Of the profit-sharing amount, 50% must be distributed in proportion to the number of days worked by each employee during the year, and the remaining 50% distributed in proportion to the employees' wages. Certain managerial employees are not entitled to profit sharing.

#### **b) Year-end bonus**

All employers must pay their employees a year-end bonus equal to at least 15 days' wages, payable before 20 December of each year.

#### **c) Paid holidays**

Employees are entitled to mandatory paid holidays, which must be observed by employers. An employee required to work on a mandatory paid holiday must be paid three times the employee's regular wage (this



already includes the regular wage of the worked mandatory holiday). The following mandatory paid holidays are observed in Mexico:

- 1 January
- First Monday of February
- Third Monday of March
- 1 May
- 16 September
- Third Monday of November
- 1 December every six years for Inauguration Day
- 25 December
- Other dates established by election law for ordinary elections

#### **d) Vacation and vacation premium**

Employees are entitled to paid vacation at a rate of at least 25% of their wage as follows:

Years of service	Paid vacation days	Vacation premium
1	6	25%
2	8	25%
3	10	25%
4	12	25%
5-9	14	25%
10-14	16	25%
15-19	18	25%

#### **e) Training**

All employers are required by law to provide training to their employees. The employer must have a training program approved by the Ministry of Labor. A Joint Commission must implement the program or schedule composed of an equal number of representatives of the employees and of the employer. Companies with more than 50 employees are required to establish a Joint Commission for Training, Instruction and Productivity that comprises an equal number of representatives of the employees and of the employer.

#### **f) Housing contributions**

The FLL requires employers to pay an amount equal to 5% of each employee's wages to the Federal Workers' Housing Fund ("Infonavit"). Employers must deposit these contributions in a special account at a local bank so that Infonavit can distribute the contributions to each employee's housing account.

#### **g) Minimum wage**

The FLL establishes a minimum daily wage that must be paid to all employees in cash, without deductions or withholdings, on a weekly basis. The National Minimum Wage Commission determines the minimum wage from time to time. The general minimum wage applies to all employees throughout the country, except those working in certain job categories. Note that companies normally pay more than the minimum wage. Wages in Mexico are most often set by market conditions and competitors' benefits packages, which exceed minimum wage. Therefore, awareness of local labor conditions is extremely important.

#### **h) Overtime**

An employer may require an employee to work, without having to pay overtime, a maximum of 48 hours per week on the day shift. The employer must pay the first nine hours of overtime at 200% of standard pay, and overtime exceeding nine hours at 300%. An employer may not require an employee to work more than three hours of overtime per day and not more than three times per week.

Regular work hours may be distributed throughout the week as necessary provided it is agreed in writing; most employers now distribute them across five days (9.6 hours per day). At least one paid full day of rest per week must be observed. Sunday work is subject to a 25% premium, notwithstanding any overtime premium that may apply. If an employee works in excess of 57 hours a week, the labor authorities may penalize the employer.

#### **i) Health and safety**

The employer is required to provide a safe and sanitary environment for workers to render services. Each employer must create a Health and Safety Commission to investigate the causes of illness and accidents, and to propose resources to avoid them. In addition, employers are required to comply with Federal Health & Safety Regulations, and with a number of Official Mexican Standards dealing with all types of health and safety issues such as fire and accident prevention, exposure to toxic substances, employee protective gear, etc.

#### **j) Paid maternity leave**

All employers must provide their female employees with a fully paid maternity leave of six weeks prior to the approximate delivery date and six weeks thereafter. After this 12 week period, employers must offer such employees their former positions back, including any rights accrued while on maternity such as seniority and vacation pay. Employees have the right to move up to four weeks from the pre-birth period to the post-birth period.

#### **k) Paid paternity leave**

All employers must provide their male employees with fully paid paternity leave of five days after the birth of a child or after an adoption is granted.

#### **l) Employer Social Security contributions**

See Section 5. "Social Security" below.



### **m) Additional non-mandatory benefits**

Employers may voluntarily enhance the minimum benefits established by law. Benefits such as savings funds, punctuality and attendance bonuses, cafeteria and transportation subsidies, productivity bonuses, etc. are provided by many Mexican employers, depending on the market conditions and on the economic situation of each employer.

## **2. Severance payments**

### **a) Occasion and basis of the payment; reinstatement**

Employers may not freely dismiss employees without cause. To dismiss an employee without being liable for the severance pay, an employer must (i) be able to prove, in labor court if necessary, that the dismissal was for a statutorily defined “just cause” and (ii) give the employee, directly or through the Labor Board, prompt written notice of the dismissal and the “just cause”. If the employer fails to prove “just cause” as explained below, the employer must make the following severance payments: (i) three months of salary; (ii) a seniority premium, equal to 12 days of salary per year of service (subject to salary limitation of twice the minimum wage); (iii) back wages from the date of dismissal through the date of payment (back wages are limited to a maximum of 12 months of wages; once this period concludes, an interest shall be paid at a 2% monthly rate, applied to 15 months of wages, capitalized upon payment); and (iv) accrued benefits.

If the employee ends the individual employment relationship with cause under the FLL, the employer is required to pay, in addition to the foregoing, 20 days of salary per year of services rendered. The payment of three months of salary and 20 days per year must be calculated based on the employee’s integrated salary, which is the standard pay plus benefits.

An employee dismissed without “just cause” has the option to be reinstated instead of receiving the severance payment. In some cases, e.g., dismissal of an employee from a position of “trust” as described below, the employer may avoid having to reinstate the employee by making the payments mentioned in the two preceding paragraphs.

### **b) “Just Cause” for dismissal**

The FLL lists the specific causes for which an employer may dismiss an employee without being liable for severance pay. These causes include, for example, immoral conduct, sexual harassment, repeated absenteeism, unauthorized disclosure of trade secrets, unreasonable refusal to follow directions and conduct lacking integrity and detrimental to the employer, its clients or providers.

### **c) Employee’s “just cause” for termination**

An employee may resign and be entitled to severance pay if the employer commits specified acts listed in the FLL. These acts include reduction of salary, conduct detrimental to the employee’s dignity, sexual harassment, failure to pay salary when due and causing or allowing unsafe working conditions.

### **d) Termination of the individual labor relationship**

The FLL provides that a labor relationship may be terminated without either party being liable under certain circumstances, including: (i) mutual agreement of the parties; (ii) death of the employee; (iii) the conclusion of a specific job; and (iv) the physical or mental incapacity or disability of the employee.

### **e) Employees in positions of "trust"**

The FLL creates a special category of employees for managers in general and other employees in positions of trust (*trabajadores de confianza*). Employers are not required to reinstate employees to a position of trust, as mentioned in Section 2. Employees in a position of trust may form unions that must be separate from those of other employees.

The determination of whether an employee holds a position of trust depends not on title but on actual work functions. The FLL defines functions of "trust" as those of direction, inspection, surveillance and supervision generally and those that involve personal matters of the owner(s) of the company.

### **f) Seniority premium**

The seniority premium discussed in Section 2, equal to 12 days of salary (limited to twice the minimum wage) per each year of services rendered, must be paid to all employees who: (i) voluntarily leave their jobs after completing 15 years of employment; (ii) leave their jobs for "just cause"; (iii) are dismissed by the employer with or without "just cause"; or (iv) die while still employed, in which case their beneficiaries receive the seniority premium.

Despite the current FLL provisions, employers have to consider the culture, needs and way of thinking, among other factors, that characterize the workforce in a particular place before establishing a business. Likewise, it is advisable to keep in mind that interpretation of the FLL provisions depends on the labor authorities' and Federal Courts' criteria.

## **3. Outsourcing regime**

The FLL establishes a legal framework for outsourcing, which is defined as the relationship whereby an employer, defined as a contractor, carries out works or provides services with the contractor's employees, under the contractor's subordination, in favor of a contracting party, an individual, or a legal entity, which sets and supervises the contractor's tasks during the development of the services and the performance of the assignments entrusted.

The types of work that can be outsourced:

- (a) May not comprise all the activities taking place in the workplace
- (b) Must have a specialized nature that justifies their being outsourced
- (c) May not include tasks equal or similar to those being carried out by the contracting party's employees

If these conditions are not met, the subcontractor could be considered the employer for all legal effects, including social security obligations.

## **4. New ways of hiring**

The amendment to the FLL that took place in November 2012 introduced new ways of hiring employees. The amendment maintained Individual Employment Agreements ("IEA") for hiring for a specific period of time, a specific task and an undetermined period of time. The amendment, however, introduced three new ways of hiring employees: (i) a trial period, (ii) a training contract; and (iii) seasonal work.



### **a) Trial period**

A trial period allows an employer to evaluate whether an employee meets the requirements and has the necessary knowledge to carry out specific job duties.

This trial period must be negotiated in the employment contract and must not last more than 30 days (with an extension to 180 days in specific cases). If the employee does not meet the job requirements at the completion of the trial period, the employer, at its sole discretion, and considering the opinion of the Joint Commission of Productivity, Training and Education, is entitled to terminate the employment relationship without liability (i.e., severance).

### **b) Training contract**

The purpose of the training contract is to allow the employee to acquire the necessary knowledge and skills for the job.

A training contract may last three months at most (with an extension to six months in specific cases). If the employee does not acquire the knowledge and skills necessary for the job at the completion of the training period, the employer, at its sole discretion, and considering the opinion of the Joint Commission of Productivity, Training and Education, is entitled to terminate the employment relationship without liability (i.e., severance).

### **c) Seasonal work**

This is a new hiring modality within the contracts for an undetermined period of time. The effects of the employment relationship are suspended during the nonseasonal period, meaning that the employee's obligations of providing services and the employer's obligation of paying wages are suspended. These and other obligations re-establish at the next seasonal period.

The seasonal period may comprise certain days of the week, certain weeks of the month, or certain months of the year.

## **5. Social security**

The Social Security Law enacted on 31 January 1942 has undergone a series of amendments throughout the years, the last of which occurred on 9 July 2009. Under the SSL, the creation of an employment relationship automatically entitles the employee to various social security benefits, which are funded by contributions paid by both the employer and the employee, depending on the risk factor of the company. An employer must register its employees with the Mexican Social Security Institute ("IMSS"); by doing so, the employer can relieve itself of responsibility for the following: (i) work-related risks; (ii) health and maternity insurance; (iii) disability pension and life insurance; (iv) retirement, old age pension and old age unemployment insurance; and (v) child care and social benefits.

The IMSS assumes all responsibility for providing the benefits, and the employer is released from any liability for work-related accidents or illnesses unless it has not complied with its registration and payment obligations. Even if the employer has not complied with its registration and payment obligations, the IMSS will nevertheless provide the benefits to the employee, but the IMSS will seek reimbursement of the cost from the employer and will impose penalties. Social Security benefits are provided at IMSS facilities located throughout Mexico.

The basis for the Social Security contributions is the integrated wage, which includes all monetary and in-kind compensation and benefits received by the employee, excluding only the following:

- Work tools and clothing
- Savings funds, provided they include matching contributions by the employer and the employee
- Contributions paid by the employers for social or union purposes
- Contributions made by the employer to the Retirement Savings System for worker housing
- Profit sharing paid to the employees
- Food and shelter, provided the employee pays a portion thereof
- Food baskets
- Attendance and punctuality bonuses
- Overtime pay, unless such service is agreed upon on a permanent basis, or exceeds the overtime allowed by the FLL

Any employer who fails to properly withhold and pay the corresponding social security contributions, who submits false information to the IMSS or who otherwise fails to fulfill its obligations under the SSL may be subject to a range of penalties.

## **H. Environmental**

Mexico has enacted a considerable number of laws, regulations and standards in the area of environmental protection particularly dealing with diverse issues such as environmental impact and risk; flora and fauna protection; prevention and control of air, water and soil pollution; and hazardous substance handling and disposal.

The General Law of Ecological Balance and Environmental Protection (the “Environmental Protection Law”), enacted in 1988 and amended in 2011, is the primary Mexican environmental statute. It contains specific chapters concerning: environmental impact permitting; prevention and control of air, water and soil pollution; and protection of natural resources. It also sets out enforcement procedures and other provisions concerning the respective responsibilities of the federal, state and municipal governments. The General Law for the Prevention and Integral Management of Waste (the “Waste Law”), enacted in 2004 and amended in 2007, establishes guidelines for the regulation of soil pollution and waste handling, disposal and management plans. The Regulations on the Waste Law were published in 2006. In addition, all 31 Mexican states have promulgated environmental laws and all activities conducted in Mexico must comply with federal, state and municipal laws.

### **1. Environmental authorities**

The Ministry of Environment and National Resources (“SEMARNAT”) is the federal authority entrusted with setting and overseeing national policy for environmental protection. In addition, it is responsible for enacting Official Mexican Standards (“NOMs”) that establish: (i) pollutant limits for air emissions and wastewater discharges and (ii) criteria for designating waste as hazardous. A technically autonomous agency within





SEMARNAT, the Federal Bureau of Environmental Protection (“PROFEPA”) is in charge of carrying out enforcement activities.

With the energy reform approved in 2014, a new environmental authority was created. This authority is the National Agency of Industrial Safety and Environmental Protection of the Hydrocarbons Sector (“ASEA”). This agency has the authority to regulate all activities of the sector, including but not limited to the exploration and exploitation of oil and gas, as well as activities related to petrochemicals and the transportation and distribution of hydrocarbons.

ASEA has a dual function because it is a regulatory agency that issues environmental authorizations and licenses (such as for environmental impact, air emissions, hazardous waste handling) and is also an enforcement agency that may impose penalties including fines, shutdowns and remediation orders.

## **2. Environmental impact authorization**

Prior to initiating operations, industrial facilities must receive an environmental impact authorization (“EIA”). If the activity to be carried out is federally regulated<sup>15</sup> pursuant to the Environmental Protection Law, the EIA must be issued by SEMARNAT and ASEA, as in the case of hydrocarbons.

If the activity to be carried out is not federally regulated, the EIA must come from the corresponding State or Municipal Environmental Authority (the “Local Environmental Authority”) in accordance with the applicable municipal or state law.

## **3. Prevention and control of air pollution**

Industrial facilities that emit gases, fumes or solid particles into the atmosphere are required to secure an Operating License if the stationary source is under state jurisdiction or a Consolidated Environmental License if the source is subject to federal jurisdiction. In addition, stationary sources are required to comply with Mexican Official Standards in the area of air quality as well as with specific air emission reporting and monitoring requirements.

## **4. Water**

The National Water Law (the “Water Law”), enacted in 1992 and amended in 1998, requires that a concession be secured by the National Water Commission (“CONAGUA”) in order to draw groundwater for industrial, commercial or service activities. Concession holders are required to pay applicable fees based on the volume of water they consume.

Parties that discharge wastewater must secure a wastewater discharge permit from CONAGUA if the wastewater is discharged into a federal water body or into the soil. If wastewater is discharged into a municipal or urban sewage system, a discharge permit or registration must be secured from the corresponding State or Municipal water authority.

In addition, wastewater must comply with the water quality limits established by applicable Mexican Official Standards.

---

<sup>15</sup> Federally regulated activities include oil, petrochemical, steel, paper, sugar, mining, cement and electricity generation industries, as well as hazardous waste treatment, confinement and disposal activities.

## **5. Hazardous waste management**

According to the Waste Law, a hazardous waste is defined as “any waste in any physical form which is corrosive, reactive, explosive, toxic to the environment, flammable or biologically infectious, and which represents a hazard to the ecological balance of the environment.”

Hazardous waste generators must comply with a number of reporting, handling, transportation and disposal requirements. They must register themselves before SEMARNAT or ASEA and must ensure that all of their hazardous waste is collected, transported and disposed of by licensed hazardous waste disposal companies, in order to avoid liability resulting from improper handling.

If hazardous waste is generated as a result of processing raw materials and components imported temporarily into Mexico under a specific importation regime, such hazardous waste must be exported to its country of origin. Waste that is recyclable may remain in Mexico.

## **6. Soil pollution**

According to the Waste Law, owners or occupiers of land that is contaminated with hazardous waste are jointly liable for its remediation regardless of fault. In addition, parties that cause soil or groundwater contamination may face administrative, civil and, in some cases, criminal liability.

To remediate a contaminated site, monitoring, sampling and remediation protocols established by the Waste Law, its Regulations and applicable Mexican Official Standards must be followed.

## **7. Community right to know**

As a result of the amendments to the Environmental Protection Law, SEMARNAT created a public pollutants registry composed of data furnished by individuals and entities that (i) emit pollutants into the air, soil or water; and (ii) handle hazardous substances. This means that all information, subject to federal jurisdiction, regarding a facility's air emissions, wastewater discharges and waste stream is made public. SEMARNAT is currently negotiating collaboration agreements with many states and municipalities in order to increase the information to be included in such registry. This is consistent with a chapter of the Environmental Protection Law that allows any person the right to receive environmental information from SEMARNAT as well as from State or Municipal authorities.

The Regulations to the Environmental Protection Law in the Area of Emission and Pollutant Transference Registry were published on 3 June 2004. These regulations established a National Registry of all pollutants generated in Mexico.

## **8. Protection of collective rights: legal standing and class actions**

On 30 August 2011, the Mexican government published amendments to several federal laws, in order to allow collective actions.

These actions, which are similar to “class actions” in the United States, will allow a group of persons to go to Federal Civil Courts to protect diffuse or collective rights, such as those of an indivisible nature, or individual rights or interests having a collective incidence and that deal with any of the following areas:

- Consumption of goods and services, whether public or private



- Environmental protection

**a) Who will have a right to file a collective action**

According to the Federal Civil Procedure Code, the following individuals and entities will have legal standing to file a collective action:

1. SEMARNAT, PROFEPA or ASEA; (ii) Federal Bureau of Consumer Protection; (iii) National Commission for the Protection and Defense of Users of Financial Services; and (iv) the Federal Competition Commission
2. A common representative of a community composed of at least 30 members
3. Civil nonprofit associations (such as nongovernmental organizations) legally incorporated at least one year prior to filing the collective action, whose corporate purpose includes the promotion or defense of rights and interests in any of the areas detailed above, and that comply with the requirements established in the Federal Civil Procedure Code
4. The Attorney General of the Republic

**b) Statute of limitations**

The statute of limitations for filing collective actions will be three years and six months from the moment when harm or injury was caused. However, in the case of harm or injury having continuous or ongoing effects, the term will run as of the last day (or more recent day) in which the harm has been caused (as in the case of acts or omissions that cause environmental harm, many of which are of a continuous nature).

**c) Types of collective actions**

Diffuse action:	Action of an indivisible nature, exercised to uphold diffuse rights or interests, held by an unspecified group, for the purpose of seeking judicially that harm caused to such group be repaired, by restoring things to where they stood prior to the harm having been caused, or by a substitute reparation, taking into account the harm caused to the rights and interests of the group, without there needing to be a legal link among the members of the group and the defendant
Individual (homogeneous action):	Indivisible action exercised to uphold collective rights and interests, held by a specific or unspecified group, on the basis of common circumstances, in order to judicially seek that a defendant repair a harm or injury caused, by carrying out or abstaining from carrying out one or more actions, and also by paying damages individually to each member of a group and which derives from a common legal link that exists by a mandate of law between the group and the defendant.
Individual (homogeneous action):	Divisible action exercised to uphold individual rights or interests having a collective incidence, held by individuals grouped by common circumstances, for the purpose of claiming from a third party the mandatory compliance or termination of an agreement with its consequences and effects, in accordance with applicable law.

#### **d) Legitimate causes to bring a collective action**

The following are legitimate causes to bring a collective action before a Federal Civil Court:

- Against actions or omissions that harm (i) consumers or users of goods and services, whether public or private; (ii) the environment; or (iii) acts that have harmed a consumer due to the existence of improper concentrations or practices that constitute a monopoly, declared as such by a final resolution from the Federal Competition Commission
- When there are common factual or legal issues among members of the group in question
- When there are at least 30 members of a community in the case of collective actions in a strict sense
- When there is coincidence between the purpose of the action and the harm or injury suffered
- If the matter being litigated has not been tried and decided (*res-judicata*) in prior proceedings resulting from the exercise of collective actions
- If the statute of limitations has not lapsed

#### **e) Settlement arrangements**

A federal judge hearing a collective action will have the authority to call a hearing for the parties to settle the case. In that hearing, the judge may propose solutions to the conflict and may call on the parties to try and resolve their differences. The matter may be settled through a judicial agreement at any time during the trial.

#### **Precautionary measures (injunctive relief)**

At any time during the procedure and at the request of any of the parties, a federal judge may impose any of the following precautionary measures:

- An order to cease and suspend the acts or activities that are causing or will cause imminent irreparable harm to the group
- An order to carry out acts or actions to prevent imminent irreparable harm to the group
- The removal from the market or the seizure of instruments, goods, samples and products related to the irreparable harm having been caused, that is being caused or that will likely be caused to the group
- Any other pertinent measure to protect the group.

#### **f) Rulings**

If there is no settlement and the trial goes forward, a federal judge may issue any of the following rulings once the procedural and probatory phases have concluded:

- In diffuse actions, a judge may only condemn a defendant to repair the harm caused to the group, consisting of restoration to the state existing prior to the harm having been caused, if at all possible. If this is not possible, a judge may impose substitute compliance (monetary compensation), taking into account the rights and interests of the group.



- In collective actions, in a strict sense as well as in homogeneous actions, a judge may order that the defendant repair the harm by carrying out one or more actions or by requiring that each individual be compensated.

#### **g) Date of entry into force**

This decree, which contains amendments to the different laws that govern collective actions, entered into force six months after being published in the Official Federal Gazette. This means that the decree became effective on 1 March 2012.

### **9. The Environmental Liability Law**

On 7 June 2013, the Environmental Liability Law was published in Mexico's Official Federal Gazette. The ELL entered into force on 6 July 2013.

#### **a) Implications of the ELL**

With this new law, any person from an affected community, an environmental nongovernmental organization, the Federal Bureau of Environmental Protection (PROFEPA) or a state environmental agency, may bring a civil action before federal courts against a party that causes environmental harm in order to seek repair or compensation.

The ELL regulates the environmental liability borne out of harm caused to the environment, as well as its repair and compensation. This law also contemplates alternative mechanisms for the solution of controversies, administrative procedures and procedures that may correspond in the case of environmental crimes.

#### **b) Subjective and objective liability**

The ELL states that, as a general rule, environmental liability will be subjective except in the following cases:

- Any action or omission involving the handling, use, transportation or disposal of hazardous waste
- The use or operation of ships in coral reefs
- Carrying out high-risk activities (defined as those that imply the generation or handling of substances having corrosive, reactive, radioactive, explosive, toxic, flammable or bio-infectious characteristics in accordance with the General Law of Ecological Balance and Environmental Protection)

In other cases specified by the Federal Civil Code, the ELL states that no environmental harm will be deemed caused if losses or damages are not adverse in the following cases:

1. They were expressly manifested by the responsible party and explicitly identified in their scope, as well as evaluated, mitigated and compensated through specific conditions, in addition to being previously authorized by the Ministry of Environment and Natural Resources (SEMARNAT) either as part of an environmental impact, land-use change procedure or any other permitting process.
2. They do not surpass the limits established by environmental laws and applicable Mexican standards.

If requirements or conditions established by SEMARNAT were not met or complied with, the existence of environmental harm may be established through the corresponding procedure.

### **c) Economic penalties**

The ELL states that a judge may impose any of the following economic penalties as a result of harm being caused to the environment:

1. 300 to 50,000 times the minimum wage in Mexico City if the party responsible is an individual
2. 1,000 to 600,000 times the minimum wage in Mexico City if the party responsible is an entity

According to the ELL, fines imposed on a legal entity (such as a corporation) may be reduced up to a third of the total amount if at least three of the following circumstances may be demonstrated:

- If the entity has not been previously sentenced in the terms of the ELL and/or is not a repeat offender
- If none of its employees, representatives or directors have been sentenced for crimes against the environment
- If during a term of at least three years prior to the conduct that caused environmental harm the entity has had an internal organism in charge of permanently verifying compliance with environmental laws and licensing requirements
- If there is a financial guarantee in place (such as a bond or insurance) to cover against environmental harm
- If it holds one of the audit certificates established by the General Law of Ecological Balance and Environmental Protection (such as a "clean industry certificate" issued once an environmental audit has been successfully carried out)

A judge may order whoever is found liable for causing environmental harm to repair such harm, and if this is not possible, to implement compensatory measures either partially or totally, as well as implement the necessary actions to prevent environmental harm from increasing.

### **d) Statute of limitations**

It is important to mention that the statute of limitations for bringing an action for environmental harm is 12 years as of the moment when the harm has been produced.

### **e) Legal standing**

The following individuals and entities have legal standing to file an action for environmental harm:

1. Individuals that inhabit a community adjacent to the location where the harm has been caused
2. Private nonprofit Mexican entities incorporated for the purpose of protecting the environment, when acting on behalf of an inhabitant of a community adjacent to the location where the harm has been caused
3. The federal government through PROFEPA



#### 4. State environmental protection bureaus and agencies

## I. Intellectual property

Mexico has been part of the world harmonized Intellectual Property system since the early 1990s, when it became part of the World Trade Organization's Trade Related Aspects of Intellectual Property, as well as NAFTA with the United States of America and Canada, two of its main commercial partners. As a result of joining these international agreements, the local legal framework was thoroughly amended to enact a revised and revisited Mexican Industrial Property Law ("MIPL"), which at the time was one of the most progressive intellectual property laws in the world, as well as create the Mexican Institute of Industrial Property ("IMPI"). While the general framework described in the following sections continues to be the standard for local intellectual property, a substantive transformation of the MIPL is in the works that is derived from Mexico's participation in talks to become part of multilateral free trade agreements. These discussions include the now-defunct Trans-Pacific Partnership; ongoing NAFTA revisions; as well as discussions of a trade agreement with the European Union and bilateral discussions with Argentina and Brazil.

These discussions and negotiations have shed light over what could be upcoming modifications and updates to the Mexican legal framework, which would recognize and create protection over several aspects of patent law, trademark law, design and data privacy in addition to other institutions. These revisions are intended to harmonize the local framework with international standards in specific aspects such as biotechnological patents, digital trade and digital environment enforcement, among others, in addition to bolstering Mexico's position as an appealing market for foreign investors and creating a more competitive environment for local manufacturers and producers.

Following this path, Mexico's legal framework has begun to undergo modifications such as the revisions to the appellation of origin framework in the IPL and to the industrial design framework, which was enacted in late 2017. Likewise, there is currently a bill in the Mexican congress that aims to shape and update the intellectual property landscape in the years to come. While the proposed bill is still in its early phase, it is likely that as 2018 is an election year, such a political juncture could bring about a modified Intellectual Property framework.

Following international standards, the Mexican Intellectual Property system is divided into two categories, i.e., industrial property and copyrights. Industrial property is regulated by the Mexican Industrial Property Law comprising patents, industrial designs, utility models, trade secrets, trademarks, trade names, slogans, appellations of origin, as well as enforcement and unfair competition. Copyrights are regulated by the Federal Copyright Law. The following paragraphs discuss the current relevant issues concerning these areas of law.

### 1. Industrial Property

#### a) Overview

The MIPL was enacted on 27 June 1991 and last amended on November, 2017, with the implementation of revised sections regarding appellation of origin. The MIPL's purpose is to promote the improvement of Mexican processes and products, promote creativity and the quality of goods, and protect industrial property by: regulating and granting patents; registering utility models, industrial designs, trademarks, and slogans; publishing trade names; protecting appellations of origin; and regulating trade secrets. It also provides protection against counterfeiters and unfair competition practices, so long as these unlawful activities are related to IPRs.

## **b) Trademark Law**

### **(i) Overview**

Trademark protection and the exclusive use of a distinctive sign in Mexico arise only upon registration with the IMPI, as no trademark use needs to be proven to obtain registration. In other words, Mexico has in place a first-to-file, first-to-register system. An application for trademark registration should be filed as early as possible to ensure proper protection before entering the marketplace, especially for foreign companies looking to start business operations in the country.

While the MIPL foresees the possibility of challenging the registration of a bad-faith registration through a prior overseas use nullity action, there are key issues to consider. First, the timeframe for filing this action is very limited, that is, three years after the registration is granted, which is nonextendable. Second, a nullity action is a litigation procedure that has three instances, which normally translates to three or four years that a company will need to wait until it can engage in commercial activities in this jurisdiction. Third, it is important to prospect early, given the increase in the existence of “creative” entrepreneurs who have made a business out of this type of trademark filing.

Trademarks are registered according to the international classification of goods and services. There are no multi-class applications in Mexico, and as of today, there is no opposition system. As a consequence of the Madrid Protocol’s ratification, Mexico implemented the Opposition System, which integrates the domestic system with the worldwide harmonized system.

Enacted in 2016, the Opposition System is a mechanism for alerting trademark owners to the filing of a trademark application that could affect or harm their interests. It should be highlighted that one of the Opposition System’s main objectives is to avoid the granting of trademark registrations that could invade previously conferred rights, thereby providing them with a potential solution to extensive litigation proceedings such as nullity actions filed against registrations granted by mistake by the Mexican Patent and Trademark Office. The right to start nullity and cancellation actions remains available and is not affected by the Opposition System.

Essentially, in an opposition, a party will present arguments and evidence for the Mexican Patent and Trademark Office to consider justified reasons why the application should be refused. In turn, the applicant will have the right to file a brief reply in defense of the opposition’s arguments and evidence. IMPI’s examiners are not obliged to take into consideration the arguments and evidence included in either brief; the resolution will depend on IMPI’s assessment and criteria.

The non-extendable term for filing an opposition brief is one month counted from the date in which the application was published in the Industrial Property Gazette. IMPI periodically publishes the Gazette, albeit the publications do not follow a specific timeline and instead depend on the volume and applications filed. Brand owners are advised to implement a watch service, with supplementary legal advisory, to define in which cases it is worthwhile to file an opposition, litigation or to refrain from taking action.

As such, when filing a motion under the system, right holders may present information, arguments and documents provided by the former that examiners might find informative, which otherwise they would not have access to.





The term of trademark protection is 10 years starting from the filing date and may be renewed for equal 10-year periods. Using the mark locally on at least one product or service for which it was registered will be sufficient to prove that its use has not been interrupted for three or more consecutive years.

Upon registration, the mark should be labelled with "*Marca Registrada*" or with the abbreviations "Marc. Reg." or "MR". IMPI also permits the use of the ® symbol to indicate registration.

A trademark license or assignment of trademark rights should be registered with IMPI, for several reasons. First, registration helps in the event actions are taken against counterfeiters or infringers. Second, it serves as a source of evidence in case the registration's validity is challenged by a third party through a cancellation action based on non-use. Third, it helps in the event of tax structuring derived from the payments of royalties. The registration procedure is also straightforward and user-friendly.

Besides trademarks, the MIPL also grants protection to commercial slogans, trade names and appellations of origin.

#### (ii) Madrid Protocol

On 19 February 2013, Mexico officially joined the Madrid system for the international registration of marks (Madrid system). With this addition, Mexico became the 89th member of the International Trademark system and the third country in Latin America to join the Madrid system. There has since been an increase in the filing of international trademark applications from Mexican companies, especially transnational companies, as well as filings made by foreign companies, which signals growing interest among these companies in investing in Mexico.

The Madrid system provides a mechanism whereby a trademark owner who has an existing trademark application or registration in a member jurisdiction may obtain an international registration by filing a single application directly before their local Trademark Office. The Madrid system does not replace the original registration method of each country.

A useful feature of the Madrid system is that this protection may generally be extended to additional jurisdictions at any time, such that international trademark protection can be extended to new jurisdictions which subsequently join the Madrid system, or to such other jurisdictions as the trademark owner may choose.

Individuals may file a trademark application through the Madrid system through IMPI, as long as they are Mexicans domiciled in Mexico. Legal entities, such as companies, may file a trademark application through the Madrid system as long as they have a real and effective industrial or commercial establishment in Mexico, organized under Mexican laws.

### c) Trade secrets

In Mexico, trade secrets are protected not only under the MIPL but also under other statutes, including the Federal Labor Law and the Criminal Code<sup>16</sup> both at federal and at state level. However, Mexico's trade secret regime is quite complex due to the high level of formalities set out in the MIPL for information to be considered as a trade secret, as well as the process that must be followed to inform the receiver that the information should be considered as trade secret. Only a limited number of owners of trade secrets take advantage of this system as a result of this formality level.

---

<sup>16</sup> The Banking Law also includes provisions dealing with a bank's confidential obligations.

The MIPL defines a trade (and industrial) secret as any information susceptible to industrial or commercial application, maintained in secrecy and useful to obtain or to maintain a competitive or economic advantage vis-à-vis third parties, over which its holder has adopted sufficient means or systems to preserve its confidentiality and restricted access thereto.

Information comprising a trade secret must relate to the nature, characteristic, or purpose of a product, production method, or process, or to a way or means of distributing or marketing a product or rendering a service. Unlike other countries, for information to be considered a trade secret, it must be fixed in a document, electronic or magnetic medium, optical disc, microfilm, film or other similar instrument, in order to satisfy the requirements.

The above requirements must be proven by the party claiming that it is a trade secret. In addition, the MIPL requires that the receiver of the information be informed that it is a trade secret and provided a certain degree of information of this nature as well as written confirmation of this prior notice. These conditions must be met to create reasonable grounds for a potential damages claim or a criminal action.

In view of the above, to create an adequate scenario for enforcing the protection given to trade secrets in Mexico, it is advisable to tailor foreign clauses of confidentiality and nondisclosure agreements to adapt the same to the MIPL requirements when dealing with disclosure or authorization to use trade secrets or confidential information to employees, officers, consultants, key personnel, etc.

Finally, the MIPL and the Federal Criminal Code<sup>17</sup> considers the disclosure or use without proper authorization of a third party's trade secret or confidential information learned through a person's job or position within an entity as a felony. The burden of proof relies on the plaintiff, who needs to file sufficient evidence for proving the existence of an unlawful activity. It is relevant to point out that special care should be observed when hiring key personnel previously employed in a competitor's company for the same or similar position, since the use of confidential information/documentation secured during the employee's former job may put the new employer at risk.

## **d) Patent Law**

### **(i) Patent practice overview**

Under the MIPL, patents are protected in Mexico for a nonrenewable period of 20 years starting from the filing of the application.

Since patents follow the principle of territoriality, the owner of a foreign patent may file an application for the corresponding patent in Mexico if the priority period under the Paris Convention or the National Phase Entry period under the PCT for the protection of industrial property is observed.

Under the MIPL, any patent license or assignment of patent rights must be registered with the IMPI. If not registered, such license or assignment will not be effective against third parties.

## **e) Patent Prosecution Highway programs**

Mexico has now entered into Patent Prosecution Highway programs with the United States, Spain, Japan, China and South Korea. With these PPH programs, it is possible to reduce the prosecution stage up to three months

---

<sup>17</sup> As well as the local criminal codes of most states.



after the filing of the application in Mexico, if the foreign application claimed as priority has already been granted and the Mexican application has already been published and the in-depth examination has not begun.

#### **f) Utility models and industrial designs**

Deemed as utility models are the articles, utensils, apparatuses, or tools that present a different function with respect to the parts that compose them or the advantages insofar as their utility is concerned. Simply put, a utility model is an article, utensil, apparatus or tool that due to a modification presents a different function or advantage, and which is protected for a nonrenewable term of 10 years starting from the filing of the application. The MIPL also protects industrial designs for a nonrenewable term of 15 years starting from the filing of the application.

It is relevant to mention that Mexico intends to adopt the Hague Agreement concerning the International Registration of Designs in a manner similar to the Madrid Protocol adoption in 2016. This could take place at any time within 2018, as major progress has been done on the implementation. Becoming part of this Treaty will create a simplified filing process for both foreign and local owners.

## **2. Copyright**

Mexico is a signatory to the Universal Copyright Convention ("UCC") and the Berne Convention. Consequently, by bearing the UCC copyright notice (i.e., © [name of owner]), an original work is automatically protected by copyright in Mexico. Even though FCL establishes a procedure to register works in Mexico, it does not require registration in Mexico in order to secure copyright protection. However, when dealing with enforcement issues, it is highly advisable to file applications for registration as the local certificate will be requested by the Mexican authorities, who tend to be formalistic.

The FCL defines copyright as the patrimonial and moral rights in a literary or artistic work held by the creator of the work and recognized by the state. The holder of the patrimonial rights may authorize the temporary or permanent exploitation of the copyright, through license or assignment agreements.

Under the FCL, the following types of works, among others, may obtain copyright protection: literary, musical, dramatic, dance, pictorial or drawing, sculptural or plastic, cartoon, architectural, cinematic, audiovisual, radio and television, computer software (databases are included, but software created to produce harmful effects to other software or hardware is excluded from protection), and photographic, as well as compilations, provided they constitute intellectual creations.

As for enforcement of copyrights, copyright infringement is considered a crime subject to imprisonment. In addition, the FCL allows a copyright holder whose rights have been infringed to seek civil remedies, which include damages, lost profits and injunctive relief. These claims can be filed without the need to file an administrative infringement with the IMPI, as happens with trademarks.

The maximum amount of damages is not limited by statute; nonetheless, the FCL states that the amount shall be equal to at least 40% of the value of the total sales of the violator. Recently, in an attempt to further increase the protection granted to copyrighted works, the Mexican Criminal Code was amended with higher penalties for the unlawful use of copyrighted works without the consent of the rightful owner.

## **J. Real estate**

### **1. Introduction**

This memorandum provides a brief overview of selected aspects of Mexican real estate law that is relevant to non-Mexican investors considering commercial and industrial real estate opportunities in Mexico, including regulation of foreign investment, conveyance of title and financing. The memorandum begins with a short description of the various types of nonpublic land in Mexico.

### **2. Laws applicable to real estate transactions**

The Mexican legal system is a civil code-based system. A real estate transaction is generally governed by the local civil code and other local laws of the jurisdiction where the property is located.

Real estate transactions in Mexico are subject primarily to civil law as opposed to commercial law, to which they may be subject when the main corporate purpose of the parties involved in a given transaction is to commercialize real estate. Civil law is within the jurisdiction of the states; commercial law falls under federal jurisdiction, governed primarily by the Federal Code of Commerce. There is substantial uniformity among the different civil codes and related statutes of the states. In addition, other local codes and laws of the jurisdiction where the property is located may be applicable if there are, for example, zoning, infrastructure, environmental, subsoil rights and/or foreign investment matters related to the transaction.

### **3. Categories of real property**

Generally, nonpublic land in Mexico falls into two categories: "private" property and "social" property. In turn, social property is usually divided into two subcategories: "*ejido*" property and "communal" property. The owners of each type of land possess different rights to use and transfer their property, as outlined below:

#### **a) Private property**

Private property is owned by individuals or legal entities for their own exploitation and use. Private property rights are conveyed, in most cases, through sales contracts or trust agreements. Each of these methods is discussed in greater detail below.

Conveyances of title are recorded before the Public Registry of Property in the appropriate jurisdiction. Although there are some exceptions, such as subsoil rights, private property generally has no limitation on domain.

#### **b) *Ejido* property**

*Ejido* property is land granted by the Mexican government to individuals for agricultural and ranching purposes. *Ejido* property is governed by the Mexican Agrarian Law. *Ejidōs* are structured as communities or townships. They have internal administration and surveillance boards, respectively known as the "*Comisariado Ejidal*" and the "*Comite de Vigilancia*." *Ejido* property may exist either for the exclusive use of an individual beneficiary (the "*Ejidatario*") in the form of "*Ejido* Parcels", or for the common benefit of the *ejido* community in the form of "*Ejido* Community Parcels".

All *ejido* properties are inalienable and not subject to liens or attachments. Only through a complex and formal legal procedure may an *ejido* parcel be liberated of the *ejido* property regime and converted into private property. All *ejido* property is recorded before the National Agrarian Registry. In the event of liberation from the



*ejido* regime, the land would be registered before the Public Registry of Property in the appropriate jurisdiction and will be subject to civil law provisions (as opposed to agrarian law provisions).

### **c) Communal property**

Communal property shares virtually all characteristics of *ejido* property, with the exception that there are no exclusive parcels for individual beneficiaries. Communal property is also governed by the Mexican Agrarian Law. Instead, all parcels belong to the community for its common use and enjoyment. Similar to *ejido* property, and except for certain specific cases, communal property is inalienable and not subject to liens or attachments. Likewise, communal property is also recorded with the National Agrarian Registry. This kind of property can be liberated from its communal regime and converted into private property; however, this involves a complex and formal legal procedure. In the event of liberation from the communal regime, the land would be registered before the Public Registry of Property in the appropriate jurisdiction and subject to civil law provisions (as opposed to agrarian law provisions).

### **d) Public property**

Public property is land that belongs to the nation also referred to as national property. National property is property that: (i) has not been acquired as private property; (ii) has not been granted by the Mexican government to an *ejido* or community; or (iii) is under a federal regime, such as the federal zone, water bodies, or federal communication routes.

## **4. Foreign investment in real estate**

The (FIL and its Regulations impose special restrictions on real estate ownership by foreign investors, depending on where the property is located.

## **5. Limitations on acquisition of property within the restricted zone**

Under the Mexican Constitution, foreigners cannot acquire land lying within 50 kilometers of the coastline or within 100 kilometers of the land borders (i.e., Restricted Zone). This area encompasses approximately 40% of land in Mexico. Under former foreign investment legislation, the only way foreign investors could own such land was through real estate trusts, with local banking institutions acting as trustees and foreign investors acting as beneficiaries/possessors/occupants. The creation of such trusts, with a term of duration of up to 30 years, required approval from the Ministry of Foreign Relations ("SRE") under the former foreign investment legislation. Under such regulations, in order for the SRE to approve the creation of such real estate trusts, the beneficiaries had to be foreign investors, and:

1. The real estate in trust had to be used exclusively to carry out tourism or industrial activities.
2. The companies engaged in the above activities had to be registered with the Foreign Investment Registry.

The former foreign investment legislation broadly defined "industrial and tourism activities" to include the construction, sale, lease, establishment, exploitation and operation, for the foreign investor's own account, of buildings and structures as disparate as industrial, hotel and residential parks and developments; housing facilities for employees of industrial and tourism companies; shopping centers; research centers; and tourism marinas.

Under the current FIL, foreign investors can now own nonresidential real estate through a Mexican corporation instead of a trust. While trusts are no longer necessary for foreign ownership through a Mexican corporation of real estate used for commercial, industrial or hotel-related purposes, they are still required for residential property and for direct foreign ownership in the Restricted Zone.

## **6. Limitations on acquisition of property outside the Restricted Zone**

Mexican law permits the acquisition of dominion or title over land and over mining and water concession rights by foreign individuals outside of the Restricted Zone under certain conditions. Individuals may acquire direct title over land and over mining and water concession rights by obtaining a special permit from the SRE and by agreeing to what is known as the “Calvo Clause”<sup>18</sup>

## **7. Sub-soil rights**

Pursuant to Article 27 of the Mexican Constitution, the State has direct dominion with respect to minerals, water and hydrocarbon resources that exist below the land’s surface. The exploitation of mineral and water deposits, excluding hydrocarbon fuels, may be carried out by private parties through a concession from the Federal Government. Concession rights on minerals are recorded in the Public Registry of Mining, while water rights are registered with the National Water Commission.

In addition, and as a result of the recently published Mexican Hydrocarbons Law, exploration and production of petroleum (upstream activities) are considered of social and public interest; hence, they should prevail over any other activity implying the exploitation of the surface or subsoil of lands affected by the same.

In connection therewith and pursuant to the terms of the Mexican Hydrocarbons Law and its Regulations, for the exploration and production of petroleum activities, the terms, conditions as well as the consideration for using, enjoying or encumbering lands, property or rights necessary to perform such activities must be negotiated by the contractors or entitlement holders (“Interested Party”) with the owner of the land, or with the holders of the rights or assets (the “Owner”). The negotiation will be carried out taking into account the following process<sup>19</sup>:

1. The Interested Party will express in writing its interest in using or acquiring the property, land or right to the Owner (the “Expression of Interest”).
2. The Interested Party must describe the project that it intends to develop under the corresponding entitlement or exploration and production contract.
3. The Interested Party must notify the Ministry of Energy (“SENER”) and the Ministry of Agrarian, Territorial and Urban Development (“SEDATU”) about the negotiations with the Owner.
4. The Owner’s property may be occupied by the Interested Party through a lease, easement, superficial or temporary occupation, sale or any other suitable contract for the development of the project, as long as it does not contravene the applicable legislation.
5. The consideration payable to the Owner should cover: (i) the payment for affecting property or rights, as well as the possible damages and lost profits arising from the performance of upstream operations;

---

<sup>18</sup> A foreign national must agree not to seek the protection of its government, otherwise being subject to forego its rights over the property acquired for the benefit of the Mexican State.

<sup>19</sup> According to Article 117 of the Hydrocarbons Law, this same procedure is also applicable to the acquisition, occupation or affectation of lands, assets or rights necessary to conduct activities of transportation through pipelines and Surface Acknowledgment and Exploration activities.



(ii) the rent regarding the occupation, easements, or the use of the land; (iii) in the case of extraction of petroleum projects, a percentage of the revenue of the Interested Party in the project. In such case, SENER assisted by the National Hydrocarbons Commission (“CNH”) will establish the methodology, guidelines and parameters for the determination of the revenue percentage. The consideration may be paid in cash.

6. The consideration, and the other terms and conditions for the occupation of property or affecting goods or rights, should be determined through a contract in writing, pursuant to the model contracts issued by SENER considering the opinion of SEDATU.

Furthermore, if the land, assets and rights fall within any of the regimes of the Mexican Agrarian Law, the provisions of this law will also apply.

The contract reached between the Interested Party and the Owner should be submitted before a civil district judge or before a Unitary Agrarian Court (jointly the “Courts”), in order to have full validity, by considering it as *res judicata*. The Courts will validate whether the contract complied with the requirements provided by the applicable regulations.

If parties do not reach a contract after 180 calendar days as of the date of reception of the Expression of Interest, the Interested Party may file before any of the Courts a request for the creation of a legal petroleum easement that will comprise the right for individuals to transit and the right of transportation, conduction and storage of materials of any kind. On the other hand, the Interested Party may also request before SEDATU a mediation that should deal with the forms or models of acquisition, occupation, enjoyment or encumbrance of the lands, property or rights as well as the relevant consideration.

## **8. Property conveyance under Mexican law**

Real estate transactions in Mexico are subject primarily to civil law as opposed to commercial law, to which they may be subject when the main corporate purpose of the parties involved in a given transaction is to commercialize real estate. Civil law is within the jurisdiction of the states; commercial law falls under federal jurisdiction, governed primarily by the Federal Code of Commerce. There is substantial uniformity among the different civil codes and related statutes of the states, especially with respect to the conveyance of real estate. In most respects, the model for the various states’ civil codes are the Civil Code for the Federal District (now Mexico City) and the Federal Civil Code, which is also the applicable code when provisions of civil law are to be applied to federal matters. Judicial conflicts involving real estate are within the jurisdiction of the courts of the state where the property is located. Because the laws of all states are generally patterned after the Civil Code of the Federal District (now Mexico City), this discussion concerning the principal methods of property conveyances (sales and trust) will be based on said Code.

### **a) Funding of real estate transactions**

Real estate transactions are usually funded by institutional lenders such as banks, non-bank banks, and investment funds. Interest rates are based on the rate published by the central bank. A borrower usually pays for all costs, including the lender’s costs.

A lender usually asks for collateral security in real property and related assets. The formalities to create and perfect a lien depend on the type of goods or assets to be encumbered. Certain liens require to be recorded with the applicable Public Registry.

The following are the most common collaterals in Mexico:

- Mortgage or guarantee trust over a real property
- Stock pledge on the project entities
- Floating pledge over inventory
- Pledge without transfer of possession over nonfixed assets
- Personal guarantee granted by the holding entity or the majority stockholder

## **b) Types of conveyances**

### (i) "Fee simple" conveyance

The most direct way to convey property in Mexico is through the equivalent to "fee simple" conveyance when permitted. The buyer and seller simply execute a Public Instrument, prepared by a notary public, which contains the sales contract and title transfer, where the parties must express their mutual consent to all material terms applicable to the transaction, which include price, property boundaries, terms of payment, etc. Sometimes, a prospective seller and buyer will first sign a binding promise to purchase and sell agreement or a letter of intent, which typically contains contingencies and/or conditions precedent upon which compliance the actual obligation and/or decision to execute the purchase and sale is subject to. To be valid and enforceable, the preliminary sales agreement must contain the essential elements of the final sales contract that is to be formalized before the civil law notary public, such as identification of the parties, description of the real property subject matter of the agreement, price and term.

For a conveyance of title to be valid and deemed effective as against third parties, it must be recorded before the Public Registry corresponding to the place of location of the corresponding real property, which is the administrative entity in charge of maintaining the official records of the legal status of title and possession of real estate. A review of those records would reveal limitations of domain and/or use burdening the property such as easements, liens or encumbrances.

As discussed in more detail below, certain formalities must be observed when conveying title to real estate. In particular, the transaction must occur before a notary public and be recorded with the corresponding Public Registry of Property. A notary public is not necessary for adverse possession proceedings. However, a successful adverse possessor must record its title with the appropriate Public Registry of Property.

### (ii) Title retention and conveyances

In some instances, the seller of property may retain title until the occurrence of a contingency, usually a final payment agreed upon. Aside from the retention of title, the steps involved in the transaction are similar to those in a straight title transfer sale. Title passes upon receipt of the last payment. At such time, the buyer and seller must appear before a notary public and sign a Public Instrument indicating that full payment has been received and title has passed. This instrument then is recorded with the applicable Public Registry of Property.

In addition, the seller and buyer may agree that title to a real property is conveyed until certain conditions precedent are complied with or that the conveyance of title may be resolved if certain conditions subsequent are met, in which case the buyer and seller must appear before a civil law notary public and sign a public





instrument indicating the same. The instrument must then be recorded with the applicable Public Registry of Property.

Title may be conveyed subject to a mortgage. Often, the title and mortgage documents are prepared simultaneously before a notary public. The title document is registered before the mortgage document. In the event of the buyer's default, a summary judicial proceeding is initiated to foreclose. In certain circumstances, the mortgagee may be entitled to have the property adjudicated in its favor rather than publicly auctioned off.

(iii) The trust regime

Pursuant to the FIL, Mexican financial institutions (usually banks) authorized to act as trustees may acquire "fee simple" to real estate located in the Restricted Zone through an irrevocable trust. Under a typical trust arrangement, the Mexican financial institution acts as trustee. Foreign individuals, foreign legal entities or Mexican companies whose shares may be purchased by foreigners are designated as beneficiaries. These trusts have a duration of 50 years and may be renewed by the foreign investor.

The beneficiary's rights to enjoy the land, the rental proceeds and profits upon the sale of the property held in trust are freely transferable. Trust agreements must be recorded with the Foreign Investment Registry and the Public Registry of Property.

**c) Formalities and procedural steps for the conveyance of title**

All state civil codes generally require that any contract whereby an interest in real estate is conveyed or otherwise affected, be formalized through a "notarial instrument" (*escritura pública*) and recorded before the corresponding Registry of Property (normally in the city or municipality where the real estate is located). In standard sales or trust conveyances, the parties appear before a notary public to request the preparation of the Public Instrument that contains the title conveyance. A civil law notary public is a quasi-public official who is vested with irrefutable authority to attest to the veracity of the legal transactions formalized before him/her. A civil law notary public is generally required to be a licensed attorney who undergoes substantial qualification procedures to ascertain his/her capabilities. A notary public will often participate in transactions on the basis of neutrality, although the party that acquires a legal interest on a real property customarily bears the expense of the notary's fees. In larger transactions, the parties are represented by separate counsel, in addition to the notary's participation.

The notary public generally requests a copy of title held by the seller/trustor (generally another public instrument), an expert's appraisal on the property, a certificate of no liens and encumbrances issued by the Public Registry of Property, a certificate evidencing nonfiscal or utility consumption fees indebtedness and, in certain cases, a sales or trust permit from the SRE. The notary public also will require information on the seller's legal capacity and marital status, as applicable. In case the party involved is a legal entity, the notary public will need information on the formation of the company as well as the legal capacity and authority of its representatives.

In addition to formalization through a public instrument, real estate transactions (namely acquisitions, mortgages, easements, leases for terms typically greater than five years, etc.) are instruments subject to be recorded in the Public Registry of Property. Thus, the status of title to a property may be verified through a search on public records. Also, the Registry must, upon request, issue a "Certificate of Liens" or no Liens, in its case, which reflects the identity of the holder of title and whether the property is subject to any liens or other real or personal interests (when the latter are subject to being recorded).

Upon execution of the notarial instrument through which the acquisition of the real property is formalized, the civil law notary public is required to immediately file a preventive notice before the corresponding Public Registry of Property. The preventive notice assures that all subsequent transactions dealing with the same real property will be subject to the effects of the transaction to which the preventive notice refers. It is imperative that the preventive notice be filed expeditiously since the public notice consequences of the transaction between the contracting parties will be effective only as of the filing of the preventive notice regardless of the moment in which the parties executed the document before the notary public. After the filing of the preventive notice, the notary public must pay the corresponding fees and taxes and file the documents as may be required for the formal recording to be effected.

Prior to the registration of a real property purchase and sale contract with the Public Registry of Property, the real property acquisition tax shall be paid by the buyer (as described in more detail below). After the payment is made, the public instrument containing the formalization of the sales contract shall be filed with the Public Registry of Property. According to the Regulations of the Public Registry of Property, it generally takes around 10 business days for the public instrument to be duly recorded. In practice, however, this term may either be limited to a few business days or last for weeks, depending on factors such as jurisdiction, the follow-up made by the notary public, the complexity of the real estate transaction being recorded, and on the general recording work then currently in process before the Public Registry of Property of other real property and commercial transactions.

#### **d) Warranties given by a seller to a buyer**

Generally, sellers tend to grant only limited representations and warranties, typically related to the absence of liens and encumbrances, and payment of real estate taxes, which provide an indemnity to the buyer in case of eviction. Thus, a buyer is generally responsible for conducting an extensive due diligence with respect to the legal and physical condition of the property to be acquired. It is also relatively common to include provisions and warranties that deal with liabilities arising from the environmental conditions of the property, hidden defects, conditions of title, absence of legal proceedings, infrastructure and utilities available on site, etc.

### **9. Ensuring good title**

Notaries play an important role in verifying the validity of title and ensuring its proper conveyance to acquiring parties. That being said, notaries rely on the validity and authenticity of documents furnished to them by the parties. As a result, a notary public is not likely to identify defects affecting the chain of title to a property or title problems not evident in the documents furnished in connection with the transaction. That is why it is advisable to perform further independent legal investigation. Unless otherwise stipulated in the contract, the party that conveys title would be liable for curing any title defects.

Generally, due to the conveyance system in Mexico, real property transactions result in a valid and unencumbered transfer of real estate. However, the only way to verify the validity of title and other related rights is to undertake an independent search of records with the Public Registry of Property and other applicable government agencies, such as the National Agrarian Registry, the Public Registry of Mining, the National Water Commission and local assessment bureaus (such as the Municipal Treasury, Public Works and Urban Development Department, etc.). This is especially advisable when a concern about an adverse possession claim exists. Under Mexican law, adverse possessors may claim title through a complex process that sometimes results in inconsistent, dual ownership title registration.



Due diligence in real estate transactions will typically include a title search and a title report by counsel. The search and report will cover issues such as the following:

- Limitations on the use of property as dictated by any applicable zoning ordinances, road expansions, etc.
- Limitations on the use of the property imposed by owner or governmental authorities, such as usufructs, easements, federal zone limitations, etc.
- Pending claims against the property by third parties or liens of record
- Limitations or requirements which may be contained in any restrictive covenants of record
- Conveyances of partial real interests on the property such as usufruct
- In some states, long-term leases

In addition, real estate may be affected by certain interests or liens which would not necessarily be revealed by a Certificate of Liens issued by the Public Registry of Property or by a search of such records. Some of these interests could run with the land and pass to succeeding holders of the estate, such as the following.

- Agrarian or *ejido* interests
- Precautionary labor attachments
- Municipal assessments for public improvements and property taxes
- Street or municipal improvement dedications
- Unpaid utility charges or users fees or rights
- Nonconforming uses pursuant to restrictive covenants not of record
- Discrepancies, conflicts or shortages in area or boundary lines, encroachments and any overlapping
- Rights of third parties in possession

In light of the above, the legal counsel's title search and opinion should cover not only the records in the Public Registry of Property but also the elements necessary to ascertain that none of the above potential risks is present.

It is also relevant to perform certain technical assessments on the real property to ensure that it is in compliance with Mexican laws and is suitable for its intended use. Technical assessments include environmental, topographical, geotechnical, etc. surveys, which are typically coordinated by Mexican legal counsel with certified surveyors.

In the case of rural properties, it is vital to conduct the necessary research to verify that the property is not subject to *ejido* interests, which as mentioned above are rights afforded by the State to possessors who are entitled to benefit from the property but that may not have a conveyable interest.

In the case of industrial or commercial properties, which are already developed, it is important to verify the nonexistence of labor claims that may affect the property. In general, under Mexican law, employees' rights have preference over other creditors.

Insurance companies, mostly of US origin, offer title insurance for real property located in Mexico. When dictated by the buyer's corporate policy, and subject to exceptions made on a prospective policy and its cost, it may be convenient to negotiate and contract title insurance. Through these policies, adopted from the United States where the same are widely known and commonly used, if the title is validly challenged, the insurer will come to the buyer's defense. In the event of an unsuccessful defense, the insurer will indemnify the buyer for its damages up to the insured amount. Title insurance is not a legal requirement to convey real property in Mexico. For the most part, only larger real property transactions or those where institutional developers are involved are typically subject to the issuance of these policies, generally because of the cost involved and up to the limited coverage and endorsements included in the policies in this market.

## **10. Planning issues**

In general terms, municipal authorities have jurisdiction over land use (commonly enacting urban land use development plans), but federal and state authorities may also enact different general provisions (such as zoning laws), which set standards as to the use that may be given to determined areas.

The federal, state and municipal authorities may also establish limits to land uses derived from the enactment of different kinds of environmental regulations. Some examples of this would be the enactment of environmental land use programs or the creation of natural protected areas, which establish certain restrictions as to the activities that may be developed in a determined area and/or establish limits to the density of developments, where the same are allowed.

Federal land is regulated by the federal government, and depending on the kind of property, a specific ministry may have authority over land development. As an example, SEMARNAT has authority over the federal maritime land zone, which comprises 20 meters of beach adjacent to the seashore.

At the municipal level, land use and construction licenses are commonly required, as well as an occupancy (or work completion) license and an operating license, to be able to perform activities on the premises to be built or occupied.

Other permits, licenses or concessions commonly required either at the federal or local levels include the following:

- Environmental impact authorization
- Consolidated environmental license
- Concession for the occupation of a federal zone
- Federal permits to build on a federal zone

## **11. Environmental issues**

Per the General Law for the Prevention and Integral Management of Waste, whomever is in possession of a real property, before the environmental authorities, is jointly and severally liable with the owner of the property and with whomever contaminated the same, to carry out the remediation required by such contamination. In addition, on 16 June 2013, the federal government enacted the Federal Law of Environmental Liability (*Ley Federal de Responsabilidad Ambiental*), which determines the liabilities for environmental damages in addition to the civil, criminal or administrative liabilities for the same.



The aforementioned law regulates the liability derived from the damages caused to the environment, as well as the remediation and compensation of such damages when the same are enforceable through the applicable judicial or administrative procedures.

With regard to remediation, the General Law for the Prevention and Integral Management of Waste establishes that in case of contaminated land, where pollution exceeds the applicable standards, cleanup will be required. Five standards classify and/or establish specific limits to the discharge and use of certain pollutants:

- PCBs (NOM-133-SEMARNAT-2000)
- Hydrocarbons (NOM-138-SEMARNAT/SSA1-2012)
- Heavy metals and other hazardous pollutants (NOM-147- SEMARNAT/SSA1- 2004)
- Special waste handling (NOM-161-SEMARNAT-2011)
- Waste waters (NOM-001-SEMARNAT-1996/NOM-002-SEMARNAT- 1996/NOM-003-SEMARNAT-1997)

Other pollutants may require a risk study to evaluate if cleanup is required.

Aside from the above, it should be noted that the conveyance of contaminated land requires prior authorization from SEMARNAT and that the environmental authorities may request remediation either from the owner or current occupier of the property, even if the discharge, generation, management, leak or incorporation of materials and/or hazardous waste was caused by a third party or by the former owner.

In addition, the Law for Sustainable Use of Energy provides for a voluntary certification process for private parties to apply energy efficiency standards and sustainability measures in their operations before the National Commission for the Efficient Use of Energy and to implement energy efficiency standards in the buildings they occupy. Meanwhile, on a local level, different energy efficiency standards and incentives to increase sustainability practices may be available. Certain energy efficiency standards for residential and nonresidential buildings are also applicable to new buildings or expansions of existing ones; most of these provisions, however, are not applicable to buildings mainly used for industrial activities.

## **12. Taxes and fees on real estate transactions**

Taxes and fees payable in respect of real estate transactions in Mexico include the following:

### **a) Real Estate Acquisition Tax**

An irrevocable conveyance of title to real estate is subject to the Real Estate Acquisition Tax. The REAT applies upon the formal conveyance of title to any real estate, with certain exceptions. Generally, the tax rate is between 2% and 3% of the highest of appraised cadastre value or transaction value of the real property subject matter of the transaction.

### **b) Value Added Tax**

Mexico imposes VAT on all purchases of goods and services in the country, with certain exceptions. The general rate is 16% of the value of the product or service, subject to certain exceptions where special rates apply. The VAT applies to the acquisition of buildings, constructions or improvements on land, as well as construction services, but does not apply to acquisition of land itself, with certain exceptions such as the acquisition of residential real property. The VAT normally operates by having each party in the chain of production collect tax

from its customer and pay to the tax authority the difference between the tax paid to its suppliers and the tax collected from its customers. Therefore, parties that acquire real estate and that are engaged in commercial activities may generally claim a credit or refund of the VAT paid.

### **c) Recording fees**

Although most states have a set maximum for recording fees, recording fees in certain states have no limit and are set as a percentage over the transaction value of the real estate conveyance. In states that do not have a limit, recording fees typically range from 0.4% to 0.8% of the transaction value.

### **d) Appraisal fees**

By law, appraisals must be performed in all real estate transactions in order to determine the tax base for the transfer. In certain states, the appraisal issued by the Municipal Treasury (cadastre office) is not sufficient and an appraisal must be performed by a commercial broker or a certified appraiser certified by a banking institution. The normal cost for the appraisal and the bank's certification is 1% of the transaction value, although such compensation is often negotiable.

### **e) Brokerage, notarial and legal fees**

Commercial brokerage and notarial fees in Mexico are normally in the 0.5% to 1.0% range, which can usually be negotiated and vary widely. Legal adviser fees for a real estate transaction are typically charged on an hourly basis.

## **13. Leasing**

Mexican applicable law recognizes the following forms of leases:

- **Civil:** The civil leases may be determined by exclusion, such as when a lease is not commercial, administrative or financial. According to Mexican law, commercial transactions include acquisitions, transfers and leases executed with the intent of commercial speculation.
- **Commercial:** Commercial leasing of real estate is not recognized, even if there is intent to obtain profit, due to the lack of recognition from Mexican laws and the provisions of the Mexican Supreme Court, which holds that real estate leases are always of a civil nature.
- **Administrative:** A lease is administrative in nature if the leased premises belong to the Mexican federation, states or municipalities and is regulated by the applicable administrative law.
- **Financial:** Financial leases are regulated in the General Law of Auxiliary Credit Organizations and Auxiliary Activities of Credit.

Most of the provisions governing lease agreements are included by statute in Mexican civil codes; each state has its own applicable civil code. However, parties may freely discuss and determine other terms to regulate the lease and all its legal consequences, except for those provisions that by law are not subject to be waived.

With regard to the term of a lease, most state codes provide that a lease term shall not exceed a certain term specific to different types of use, generally 10 years for residential use and 20 years for commercial and industrial use. When the parties do not stipulate the term of the lease, the lease may be terminated generally upon two months' prior notice from one party to the other if the property is urban, and one year's notice if the property is rustic. In addition, the landlord and the tenant may freely agree in the lease agreement on the extension options



that they may deem mutually convenient. Likewise, most civil codes provide a one-year statutory extension right for the tenant, as long as the tenant is current with rent payments. In addition, if upon the termination of the lease term and renewal, if any, the tenant continues with the use and enjoyment of the leased premises without opposition from the landlord, the lease will be deemed to continue for an indefinite time as a month-to-month lease. On leases where tenant has had possession of the premises for a term over three to five years, the tenant will have the right to be preferred, under equal conditions, over any other interested party for a new lease, provided it fulfilled all of its obligations and performed timely payments of the rent.

## 14. Landlord/Tenant Law

The following is intended to provide a brief overview of some of the more pertinent provisions of Mexican law and practice affecting landlords and tenants.

1. Rent controls: The only important rent control statute in Mexico is the one that applies in the Federal District (now Mexico City), which provides that in certain leases annual rentals may not increase by more than 85% of the percentage of increase of the minimum wage for the renewal year.
2. Net-Net and Triple-Net Leases: Net-Net and Triple-Net leases are the norm for industrial and commercial facilities.
3. Right of first refusal: Landlords are required to grant all tenants occupying space for a certain term a right of first refusal in the event the premises are sold. This right may be waived in the lease by the tenant, and such waiver is customary.
4. Payment in foreign currency: Leases may provide for payment in foreign currencies provided, however, that a Mexican tenant has the legal right to choose to pay such rent in pesos at the then-prevailing official exchange rate as published by the Bank of Mexico in the Federal Official Gazette.
5. Withholding tax: In general terms, lease payments made to foreign landlords are subject to income tax withholding at a general flat rate of 21%.
6. Eviction procedures: Eviction procedures in Mexico are more lengthy, cumbersome and expensive than in the United States. Although the landlord has the legal right to evict a tenant under the lease for a default in payment of rent for more than two months, misuse of the premises and breach of the lease terms, in practice the tenant is provided with procedural advantages that can significantly delay the eviction process. Notwithstanding the above, in some states of the Mexican Republic there are summary or oral trials for leases that significantly reduce the time and difficulty in these processes, in which even judges tend to favor landlords in clear cases of noncompliance on the part of the tenants.
7. Guaranty: A security deposit equal to one or two months' rent is a common requirement for commercial and industrial leases. It is also common for a landlord to require that rental interruption insurance, a bond or a corporate guaranty of lease be granted by the tenant's parent company as further security of the tenant's obligations under the lease.
8. Warranty of habitability: Mexican law does not impose upon the landlord special or implied warranties with respect to the suitability or habitability of the leased premises for their intended purpose, except for certain health conditions.

## **15. Mortgagor/mortgagee law**

Mortgagees in Mexico typically utilize the following arrangements to secure the borrower's payment obligations:

### **a) Mortgages**

Mortgages, still the most common means of security in Mexico for real estate financing transactions, must be granted in a contract executed before a notary public. Notarial fees vary but normally are in the 0.5% to 1% range. In most cases, foreclosure of a mortgage requires that a special summary judicial procedure be undertaken. If the cause of action were proven, a court order would be issued for the public auctioning of the mortgaged estate to satisfy the debt. The mortgagee may also be entitled, under certain conditions, to have the mortgaged property adjudicated to it instead of being publicly auctioned. If a foreign lender were to have the property adjudicated in its favor, it would have to do so with authorization from the SRE, which would be granted subject to the condition that the lender transfers the property in favor of a qualified third party within five years after the adjudication.

### **b) Guaranty trusts**

Under certain circumstances, loans are secured through a guaranty trust. Guaranty trusts operate as follows:

- (a) Title to the assets which secure the loan (i.e., real estate, equipment, inventories, etc.) in Mexico are conveyed in trust by the debtor to a Mexican bank (the "Trustee") through the execution of a guaranty Trust Agreement. The Trustee holds the fiduciary title for the exclusive purpose of guaranteeing compliance by the borrower with the terms of the loan, and until such time as the borrower has paid all amounts owed to the lender.
- (b) In case of default, assets may be liquidated either through an out-of-court or a judicial procedure to satisfy the debt.

### **c) Assignment of rents**

The assignment of lease payments is becoming quite prevalent in real estate financing transactions. In cases when a non-Mexican entity has guaranteed the payment of rentals by the tenant, the borrower also usually assigns the guarantee to the lender.

### **d) Assignment of tourism proceeds**

In tourism projects, it is common for the operator of a tourism facility in Mexico (such as a hotel, marina, etc.) to have contracts with non-Mexican agents who sell the services of the Mexican facility to foreign tourists. As additional security, the Mexican developer or operator will often assign the proceeds of the contract with the foreign agent to the foreign lender. This can normally be structured as a non-Mexican source of repayment.

### **e) Assignment of performance bonds**

In construction projects, the borrower will offer the assignment of performance bonds posted by the general contractor. The lender will normally participate during the negotiation and formalization of the construction contract to ensure that its interests are protected in the event project difficulties arise as a result of default on the part of the general contractor.





## 16. FIBRAS, FIBRAE, CKDs and CERPIs

Below is a brief description regarding FIBRAS, CKDs and CERPIs in Mexico.

### a) FIBRAS (Infrastructure and Real Estate Trust) or REITs

Infrastructure and Real Estate Trusts or FIBRAS are the Mexican version of Real Estate Investment Trusts or REITs, which have existed in the US for years. Real estate developers create the FIBRA by contributing real estate in exchange for certificates. Afterwards, the FIBRA makes a public offering based on certain eligibility criteria set forth in the FIBRA documents, and funds received from the public offering are used to develop and/or purchase real estate. Subsequently, the developer carries out all real estate management activities that form part of the FIBRA through a management agreement executed between the FIBRA trustee and the developer.

Upon investing in a FIBRA, investors receive (i) distributions from leased property owned by the FIBRA; and (ii) capital gains from any purchased or developed real estate part of the FIBRA assets, in addition to certain tax benefits as holders of certificates.

FIBRAS are traded in the Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A.B. de C.V.*) and must comply with the following:

- It must be a trust incorporated pursuant to Mexican Law through a Mexican trustee.
- Its main corporate purpose must be to acquire or develop real estate to be leased or hold rights to receive distributions from the leased real estate.
- The acquired or developed real estate may not be transferred four years from the date it was acquired or developed by the FIBRA.
- At least 70% of the FIBRA must be composed of investments in real estate or rights to receive distributions from the real estate leases.

### b) Fibra E (Energy and Infrastructure Investment Trust)

Energy and Infrastructure Investment Trusts are the Mexican version of MLPs and YieldCos, which are focused on mature projects that deliver stable cash flows. These trusts issue publicly traded securities in the form of certificates or *Certificados Bursátiles de Inversión en Energía e Infraestructura* ("CBFEs") listed in the Mexican Stock Exchange and registered with the National Securities Registry. They have an external manager or general partner *who* invests the resources obtained from the offering in Mexican resident private companies ("Sponsored Companies"), which activities must include: (i) hydrocarbons and natural gas (with some rules and exceptions); (ii) generation, transmission and distribution of electric energy; (iii) infrastructure; and (iv) management of other Energy and Infrastructure Investment Trusts.

The Sponsor contributes its interest in the Sponsored Companies and in return receives certificates. A manager or general partner manages the Fibra E and is entitled to receive a management fee. The manager's variable fee or success fee is subordinated to the holder's right to receive distributions.

Further, 70% of the annual average value of the Fibra E assets must be invested in the Sponsored Companies' stock and the remaining 30% in Federal Government securities or debts instruments issued by investment grade companies. About 90% of the Fibra E annual taxable income must come from the Sponsored Companies engaged in the activities mentioned herein.

All investments must be made in mature projects, which means that at no time must more than 25% of the accounting value be invested in new tangible assets or with a maturity period of less than 12 months. The Fibra E must distribute 95% of its annually determined tax result once a year.

### **c) CKDs (Development Capital Certificates)**

Development Certificates ("CKDs," as abbreviated in Spanish) are funds created through a Mexican trust structured to receive money from public investors through a public offering of trust certificates, which income will be invested in certain projects whose eligibility requirements are provided in the issuance documents. The CKDs were created mainly to offer an investment alternative to the Mexican pension funds or Retirement Funds Administrators (*Afores*).

CKDs mainly seek to (i) finance infrastructure and real estate projects; and/or (ii) make private equity investments, provided these investments are performed in Mexican companies. All investments made through CKDs are subject to the eligibility criteria stipulated in the CKD documents.

The yield value or returns on investments depend on the underlying assets of the CKD trust. The returns come from the profit of each project financed by the CKDs.

The information reporting and disclosure obligations of the CKDs are similar to those of any listed company. These obligations include the filing of annual reports, audited financial statements and relevant information that could determine any investor's decision-making concerning investment in securities.

### **d) CERPIs (Project Certificates)**

Project Certificates ("CERPI," as abbreviated in Spanish) are funds created through a Mexican trust, structured to earn income from qualified institutional investors through a restricted public offering of trust certificates. These instruments were created to provide an equivalent instrument of the international private equity funds. Their total offering can be completed in several public offerings, and shall be conducted for a one-year period starting from the date of the first issuance.

A CERPI fund may be invested in certain Mexican or foreign projects or companies, which eligibility requirements are specified in the issuance documents. CERPIs may also issue several series of certificates under the same trust, limiting certain rights to the holders of each series.

As with CKDs, the returns depend on the underlying assets of the CERPI trust. The returns come from the profit of each project financed by its issuance.

Yet CERPIs, unlike CKDs, may invest in projects and companies without authorization from the certificate holders or the technical committee. The purpose of CERPIs is to speed up investments by giving the manager broader authority than those of the CKD manager. To appoint representatives in the technical committee, the holder must own at least 25% of the issued CERPIs instead of the 10% for CKD's.

The reporting obligations are different from those of a CKD, since they were created to be agile. There is no obligation to disclose information of the sponsored companies or projects that represent more than 10% of the CERPI's value, although investors may request information.



## About Baker McKenzie

With our international network of 77 offices in 47 countries and national presence in Mexico's five most important economic centers, we provide you the highest quality legal advice with a unique business approach, global perspective, and local knowledge.

## Recognitions



IFLR



## Locations

### Guadalajara

Paseo Royal Country 2 #4596,  
14th, 15th and 16th floors  
Fracc. Puerta de Hierro 45116  
Zapopan, Jalisco  
Tel: +52 (33) 3848 5300  
Fax: +52 (33) 3848 5399

### Monterrey

Oficinas en el Parque,  
Torre Baker McKenzie 10th floor  
Bvd. Antonio L. Rodríguez 1884 Pte.  
Col. Santa María 64650 Monterrey, N.L.  
Tel: +52 (81) 8399 1300  
Fax: +52 (81) 8399 1399

### Juárez

P.O. Box 9338 El Paso, TX 79995  
P.T. de la República  
3304, Piso 1 32330 Juárez,  
Chihuahua  
Tel: +52 (656) 629 1300  
Fax: +52 (656) 629 1399


### Tijuana

Bvd. Agua Caliente  
10611, 1st floor, 22420 Tijuana, B.C.  
Tel: +52 (664) 633 4300  
Fax: +52 (664) 633 ff4399

### Ciudad de México

Edificio Virreyes  
Pedregal 24, 12th floor Lomas  
Virreyes / Col. Molino del Rey  
11040, Mexico City.  
Tel: +52 (55) 5279 2900  
Fax: +52 (55) 5279 2999

[Get in touch with us](#)



## Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 65 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instill confidence in our clients.

[www.bakermckenzie.com](http://www.bakermckenzie.com)    

© 2018 Baker McKenzie. All rights reserved. Baker & McKenzie International is a global law firm with member law firms around the world. In accordance with the common terminology used in professional service organizations, reference to a "partner" means a person who is a partner or equivalent in such a law firm. Similarly, reference to an "office" means an office of any such law firm.

This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.