CCN Legal Guide: Manufacturing in Mexico

Cacheaux, Cavazos & Newton

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ABOUT CCN

Cacheaux, Cavazos & Newton is an international law firm with offices located in San Antonio, Austin, Dallas and the Rio Grande Valley in Texas, and throughout Mexico in Mexico City, Monterrey, Querétaro, Ciudad Juárez, Reynosa and Matamoros. The firm is comprised of attorneys licensed to practice in the United States of America and Mexico. With an in depth understanding of the legal issues facing clients in both the U.S. and Mexico, CCN's attorneys advise clients on how to conduct business in the increasingly dynamic, complex and interconnected North American market. This expertise extends from the world's largest multi-national corporations to smaller, privately held enterprises.

The firm was founded by Rene Cacheaux, Daniel Cavazos and Joseph B. Newton on January 24, 1994, with offices in San Antonio, the Rio Grande Valley and Mexico City. Since its inception, CCN has built a practice emphasizing international business transactions in the U.S., Mexico, and Latin America. As commercial and investment ties between the U.S. and Mexico have grown, so has the firm. The firm's practice areas include manufacturing, automotive, electronics, real estate, textile, finance, agricultural and service sectors. is deeply involved in the automotive, electronics, real estate, financial services, textiles, agricultural and general manufacturing sectors.

FIRM PHILOSOPHY

Providing high quality legal services at a reasonable cost is the central element of the firm's philosophy. CCN understands and appreciates the needs of its clients to secure quality services at competitive rates. To accomplish this objective the firm strives to maintain an economically sound approach to its own costs. This approach supports another important principle on which the firm's philosophy is based: long term client relationships.

CCN's attorneys and staff focus on the success and interests of the firm's clients. In the modern North American market, clients' needs are best served by personnel who are well versed in the laws, languages and cultures of the U.S., Mexico, Canada and the Americas. As such, the firm places great emphasis on training and developing attorneys and professionals who, in providing legal services to clients, take into account the legal and cultural norms of such countries, and of the region as a whole.

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A. Practical Considerations

Over the past decade, the Mexican export industry has achieved a reputation as one of the most dynamic economic sectors in Mexico. After the Great Recession of 2008 and 2009, Mexico has emerged as one of the most attractive places to invest in manufacturing.

A February, 2010 study by the global business advisory firm AlixPartners LLP found that "Mexico continues to lead as the number one low-cost country (LCC) for outsourcing from the U.S., while China, improving considerably over last year's study, still came in 6th." Importantly, Mexico jumped ahead of both China and India to claim the top spot for sourcing manufactured goods to the U.S. market.

Mexico's surging manufacturing sector and success in attracting foreign investment results from its sound economic policies and healthy public finances. Mexico's privileged geography, skilled and productive labor force, competitive exchange rate, improved infrastructure also contribute to this upward trend. Mexico has one of the broadest networks of free trade agreements in the world, which allows companies from Europe, Latin America or Asia to export goods to the U.S. and Canadian markets, and therefore benefit from the provisions of the North American Free Trade Agreement (NAFTA).

Mexico has signed free trade agreements with the following countries: United States of America and Canada (NAFTA), Colombia and Venezuela (G-3), Costa Rica, Bolivia, Nicaragua, Chile, the European Union, El Salvador, Guatemala and Honduras, Iceland, Norway, Lichtenstein and Switzerland, Uruguay, and, most recently, Japan. Mexico has also signed international treaties for the promotion and mutual protection of investments with most of its major trading partners, including France, Italy, Portugal, the United Kingdom, Germany, Spain, Switzerland, Finland, Portugal, Sweden, Argentina, Panama, Uruguay, the Republic of Korea, Australia, India and China. Special provisions regarding protection of investment with Canada and the U.S. are contained in Chapter 11 of the NAFTA.

According to the Mexican National Institute of Statistics, Geography and Information (INEGI), notwithstanding the impact of the recent worldwide recession on Mexico, in November, 2009 approximately 1.65 million people were employed in the Mexican Maquiladora export industry. Such statistics, while lower than the record numbers reached in 2007, show the importance and size of the Mexican manufacturing industry, particularly in the northern region of the country.

The Mexican Department of Economy's (Secretaría de Economía or SECON) website features a document entitled "Mexico Economic Outlook and Investment Opportunities", which lists some of the competitive advantages Mexico has to offer, including:

1. Lowest ever country risk levels;
2. Investment grade economy;
3. Lowest inflation rates;
4. Healthy public finances: fiscal and monetary discipline;
5. Solid institutions; and

6. Highest levels of international reserves.

B. Benefits of Manufacturing in Mexico

Currently, numerous benefits are available to companies that establish manufacturing operations in Mexico. Examples of such benefits include:

1. The ability to better compete in world markets by combining advanced U.S. technology with a qualified and cost effective Mexican technical staff and labor force;
2. The ability to continue to employ U.S. personnel in U.S. facilities in administration, warehousing, product finishing, etc.;
3. The ability to own 100% of and efficiently control and administer a Mexican entity and its operations;
4. The ability to utilize U.S. technical and administrative personnel in Mexico operations (up to 10% may be non-Mexican and may obtain required working visas), and the ability of such U.S. personnel to reside in the U.S.;
5. The ability to acquire, through a Mexican entity, fee simple ownership of land and buildings for industrial operations in Mexico's border zone;
6. The ability to import NAFTA origin raw materials, components, machinery, and equipment on a duty-free or NAFTA duty-rate basis;
7. The ability to defer duties on imported raw materials until after the exportation of finished or semi-finished products, and the ability to take advantage of preferential duty rates under applicable Mexican Sectorial Programs;
8. The ability to avoid non-tariff barriers;
9. The ability to take advantage of preferential U.S. Customs and Border Protection programs which allow U.S. companies to import finished products and semi-finished products duty free or based on the value added in Mexico;
10. State of the art infrastructure for the efficient cross-border transfer of goods, and simplified U.S. and Mexican customs clearance procedures;
11. The ability to sell products in the Mexican market;
12. Proximity to the U.S. market; and
13. Access to Mexican and other Latin American markets.

II. Structure of a Mexican Manufacturing Operation

A. Choice of Entity and Practical Considerations.

Planning an appropriate corporate structure in Mexico generally involves the same types of factors that one would consider in forming a U.S. company: primarily limitation of liability and tax considerations. However, the international nature of such a Mexican operation requires the consideration of a broader base of applicable U.S. and international laws, and certain special factors including customs and tax matters. These issues include permanent establishment, transfer pricing, special taxes, mandatory employee profit-sharing, as well as issues related to the financing and capitalization of Mexican entitites. For example, U.S. tax considerations may be a determining factor in deciding which specific type of Mexican entity is suitable for a company's operations, as further explained below.

Many forms of entities for conducting business in Mexico exist, some of which are similar to the choices available in the U.S. The traditional investment vehicle for direct foreign investment in Mexico is the Sociedad Anónima de Capital Variable (S.A. de C.V.), which is similar to the standard business corporation in the U.S. Another common choice of entity is the Sociedad de Responsabilidad Limitada de Capital Variable (S. de R.L. de C.V.), which is similar to a U.S. limited liability company (L.L.C.). A Mexican manufacturing operation typically features one or the other of such types of entities, depending on the tax considerations present in a specific case. Each entity affords limited liability protection to its shareholders or owners.

For U.S. income tax purposes, and in particular the so-called "check-the-box" rules, the S.A. de C.V. is considered under U.S. law to be a corporation *per se*, whereas the S. de R.L. de C.V. is an entity which may be classified as a partnership for U.S. tax purposes, if such treatment is elected. If the parent company is a limited partnership, limited liability company or other entity that has elected partnership tax treatment in the U.S., it is possible for such entity to effectively consolidate its Mexican operations in its U.S. tax return and thereby improve its ability to take U.S. tax credits for the taxes paid in Mexico by its foreign subsidiary.

For purposes of Mexican taxation, the S.A. and the S. de R.L. are treated identically. From a corporate and legal standpoint the two types of entities are similar. Both require a minimum of two shareholders or members. The S.A requires a minimum capital of $50,000 pesos, while the S. de R.L. requires a minimum capital of $3,000 pesos. Each type of entity may be administered by a board of directors/managers, or by a sole administrator/manager. Each requires the appointment of an inspector or a board of inspectors - typically individuals who work with the company's auditors - to perform the oversight function for the shareholders/owners. Both may be structured as variable capital companies, as shown by the C.V. designation. The primary differences are as follows: (i) an S. de R.L. may not have more than fifty members, whereas an S.A. may have an unlimited number of shareholders; and (ii) interests in an S. de R.L. are represented by contribution certificates as opposed to stock certificates in the case of the S.A. In other words, the S. de R.L. may not as a publicly traded company in Mexico . This is

generally not an issue for a Mexican manufacturing operation.

In connection with the financing and capitalization of the Mexican entity, one should consider various factors relating to whether debt or equity will be used to fund the Mexican entity's operations. Although Mexican subsidiaries have traditionally been funded by equity financing, debt financing may be beneficial in certain ways, such as reducing the Mexican company's employee profit sharing and income tax liabilities from interest payment deductions, assuming that the company can obtain a deduction for such interest payment. Some of the factors to consider in choosing between equity and debt financing are: i) the effects of inflationary accounting in Mexico; ii) the interest rate of the debt for debt denominated in U.S. dollars; iii) fluctuations in the value of the Mexican peso relative to the dollar; iv) the rate of inflation in Mexico; v) the Mexican income tax withholding rate that applies to the interest payment; and vi) U.S. tax implications to the U.S. shareholder/owner.

Another planning aspect to consider in connection with a Mexican operation is whether more than one entity should be created in Mexico. For example, Mexico's mandatory ten percent (10%) employee profit-sharing payment imposed on employers may be addressed by creating a separate employment services company in Mexico in order to contract with the project's operating company to provide labor services to such operating company. In this manner, the amount of employee profit sharing payments would be based on the gross profit generated from furnishing personnel to the maquiladora at an "arms-length" price, as opposed to the gross profit generated by the maquiladora from its manufacturing operations.

One should also consider whether it would be prudent from a liability and tax standpoint to create a separate real estate holding company to acquire the project's industrial facility, if the company chooses to own its facility rather than simply leasing a facility.

Similar considerations apply in connection with planning the structure of a maquiladora services (as opposed to a maquiladora than manufacturing) company.

B. The Traditional Legal Structure for Manufacturing Entities.

The traditional legal structure for a maquiladora manufacturing company is a simple structure whereby the U.S. or Non-Mexican parent company forms an S.A. de C.V. or S. de R.L. de C.V. subsidiary. Such foreign parent acquires virtually all of the stock/ownership interests, together with a second shareholder/owner as required by Mexican law, which acquires a nominal interest.

The parent company furnishes the machinery, equipment, raw materials, components, and supplies on a consignment basis, pursuant to the terms of a bailment contract, for assembly or manufacture by the maquiladora manufacturing operation. The parent company retains title to all such materials, supplies, and equipment, as well as the semi-finished or finished products. The maquiladora operation invoices the parent company periodically and charges a service fee for assembly or manufacturing services, based on its costs, plus a markup on an "arms-length" basis, in compliance with Mexican transfer pricing rules. The parent company funds the maquiladora manufacturing operations by advancing funds for capital and operating expenses to the maquiladora on an as needed basis, in addition to paying the agreed upon manufacturing service fees from

time to time. An intercompany payable in favor of the parent company usually accumulates; however, this may need to be capitalized from time to time in order to avoid potential phantom Mexican income, and applicable Mexican income tax, on any resulting inflationary gains.

C. Formation, Administration and Management of a Mexican Entity.

The formation of a Mexican S.A. de C.V. or S. de R.L. de C.V. involves a process that is relatively similar in nature and time as that required to form a company in the U.S. The first step of such process is to request and obtain a permit from the Mexican Department of Foreign Relations to organize the entity under the proposed name, and ends with the recording of the new entity's formation documents with the local or state Public Registry of Commerce (*Registro Publico de Comercio*). It is very important to determine the shareholders or owners of the Mexican entity. Such may be individuals and/or entities. Mexican law requires a minimum of two (2) shareholders or owners, and once their identities have been determined, special powers of attorney for incorporation are prepared. The Spanish versions of the special powers of attorney for incorporation must to be formalized and delivered to the notary public in Mexico prior to incorporation.

The articles of incorporation/formation and bylaws of the company are similar in scope to those of a U.S. company. They include the structure for the governance of the company by the shareholders/owners, provisions for the administration of the company by a board of directors/managers, as well as the specific powers of attorney (e.g. powers for acts of ownership, acts of administration, lawsuits and collections, banking matters, labor matters, etc.) available to the board/sole administrator and other individuals invested with the authority to represent the company.

Certain practical considerations should be taken into account when deciding whether it is more appropriate for the company to be managed by a board or a sole administrator, such as the decision-making structure of the U.S. parent company, the possibility that a sole administrator as opposed to a board may be named (perhaps unjustifiably) in a lawsuit against the company, etc.

Under applicable Mexican laws, S.A. de C.V. and S. de R.L. de C.V. entities must keep the following accounting books and records:

1. Daily ledger;
2. General ledger;
3. Shareholders/owners minute book;
4. Shareholders/owners registry; and
5. Registry Book of capital increases and decreases.

Mexican Companies must issue a financial report that will be submitted at the end of each fiscal year for the consideration and approval by their shareholders/owners. The annual financial report must contain the following:

1. Financial statements for the fiscal year;
2. Balance sheet;
3. Income statement;
4. Statement of changes in financial position;
5. Statement of changes in stockholder/owner equity; and
6. Notes to the financial statements.

For legal, tax and accounting purposes in Mexico, a company's fiscal year must end on December 31, in accordance with Mexico's

General Law of Business Organizations and Federal Tax Code.

D. Accounting and Tax Records Required by Mexican Tax Regulations.

1. Accounting Records

According to Mexican law, the accounting records of a Mexican entity must be kept and maintained at such Mexican entity's tax domicile. However, accounting data may be generated using software located in the United States, as long as the information can be properly accessed from the tax domicile of the Mexican entity or entities. According to Article 28 of the Mexican Federal Tax Code, the legal concept of accounting includes:

a. The accounting systems, records, entries and special accounts required by Mexican tax law and regulations;

b. The corporate books and other records required by other laws or regulations (as mentioned in subsection C above);

c. Other records, systems and special accounts kept by the taxpayer, even if such are not required by law;

d. Registered cash registers that have been approved by the tax authorities and the records contained therein;

e. Documents that verify the validity of the entities accounting entries and records; and

f. Tax returns, invoices, vouchers and any other evidence of compliance with the Mexican tax laws.

2. Accounting Methods

Mexican tax law allows taxpayers to use the equipment, resources and recordkeeping or processing methods most appropriate to the characteristics of their respective businesses. However, the accounting systems or methods used must meet the following minimum requirements, which allow taxpayers to:

a. Identify each operation, act or activity and its characteristics in connection with the documents that verify them;

b. Identify investments, and the documents that evidence such investments so that it is possible to identify the date of acquisition or investment, its description, the original cost of the investment and the amount of annual depreciation;

c. Relate each operation, act or activity to the balances resulting from the final amounts of the accounts;

d. Prepare the respective financial statements;

e. Compare the financial statements with the accounts for each transaction;

f. Assure the accounting entries for all the transactions, acts or activities and guarantee that such entries have been entered and are correct, using the necessary internal systems for control and verification;

g. Identify if any taxes have been paid as a result of any

reimbursement or offset resulting from the reimbursements received and/or discounts made by the authorities;

h. Prove compliance with requirements relating to the granting of government subsidies; and

i. Identify the assets and goods produced, distinguishing among goods purchased and produced, inventories, sales, donations and the destruction of goods.

3. Accounting Systems

Regulations to the Mexican Federal Tax Code provide for three accounting systems: (i) manual; (ii) mechanical; and (iii) electronic. Taxpayers may use any method or combination of methods so long as the requirements of law are fulfilled. If a taxpayer chooses to use the manual or mechanical method, it must keep, at minimum, the ledger and the daily book. If the company chooses the electronic method, it must keep at least the ledger.

a. The ledger must contain: (i) the names of the accounts; (ii) the final balance of the immediate previous registry period; (iii) the total movement of credit or debit for each account in the period; and (iv) the final balance.

b. The daily book must describe (i) all the operations, acts or activities in a chronological order; and (ii) indicate the credit and debit movement for each of the transactions, acts or activities.

If the taxpayer chooses the manual method, the taxpayer must keep its ledger and daily book duly updated, and all the pages must be numbered.

Taxpayers that choose the mechanical or electronic method must bind and number the pages in chronological order within three months following the end of the prior tax year. The accounting books must show: (i) the name and (ii) tax domicile and federal tax registry of the company. However, taxpayers may choose to save such information recorded onto disks or any other medium authorized by Mexican tax authorities when they audit their financial statements. In this event, the disks must not allow for the possibility that the information contained therein could be erased or modified in any manner. The disks must be labeled with (i) the name of the company, (ii) the federal tax registry number; (ii) the consecutive number of the disc; (iii) the total number of documents saved; (iv) the period of operations covered; and (v) the recording date. The last document saved must contain the total sum of the daily entries and identify the total monthly credits and debits recorded. The president of the board of managers or directors of the company will be directly responsible for complying with these requirements.

4. Language and Currency

Spanish is the official language of Mexico. Article 37 of the Mexican Commerce Code (*Codigo de Comercio*) provides that companies must keep their accounting records in Spanish. However, this refers only to the company's corporate

and accounting books (ledger and daily book).

Mexican law does not contain a specific provision regarding the language of private documents such as purchase orders and other agreements. Thus, such documents may be in the language agreed upon by the parties. It is important to consider the practical problems that arise when the authorities request information from taxpayers and the requested information is contained in documents written in a foreign language. In this case, the requested documents must be accompanied with their corresponding translations, which can be costly and take more time to produce than the time period granted by the authorities.

With respect to currency, Mexico's Monetary Law (*Ley Monetaria*) establishes that the legal currency in Mexico is the Mexican Peso. Any company incorporated under Mexican law is required to keep its Mexican accounting records denominated in Mexican Pesos.

5. Tax Domicile and Invoicing

Accounting records must be kept at the taxpayer's tax domicile for ten (10) years, unless a written authorization has been granted by Mexican tax authorities to keep such records at another place. Changes in tax domicile must be notified to Mexican tax authorities within one (1) month after the tax domicile change.

The Mexican Federal Tax Code, in articles 29 and 29-A, provides specific rules that apply to invoicing. Among other requirements, invoices must be printed by print shops that are expressly authorized by Mexican tax authorities, and must include all information (name, tax identification number and tax domicile) of the issuer. Invoices must also be numbered and include a breakdown of any applicable taxes.

As such, invoices may be prepared in the United States, provided that the pre-printed invoices used used for such invoicing purposes meet the requirements mentioned above.

Electronic invoicing in Mexico is possible only with prior authorization from Mexican tax authorities. Such authorization is relatively rare and granted only in special circumstances for businesses with high-volume operations.

E. Standard Registrations, Permits and Authorizations.

Once the Mexican entity is formed, certain standard registrations are required to be carried outwith various federal, state and municipal governmental authorities, in addition to the special requirements for registering as a maquiladora (IMMEX) company and applying for participation in the Sectorial Programs as described in Section IV below. Required registrations include:

1. Federal tax registration (RFC Number);
2. Registration with Social Security/Retirement and Workers' Housing Programs (IMSS, INFONAVIT and SAR);
3. State payroll tax registration;
4. Registration with National Registry of Foreign Investment (RNIE);
5. Information filing with respect to foreign shareholders/members;

6. Registration with the Mexican Business Statistics System (SIEM);
7. Registration with the Mexican National Institute of Statistics, Geography and Information (INEGI); and
8. Registration of Authorized Representatives (RUPA).

Various other federal, state and municipal permits and licenses for the operating company may be required, depending on the nature of the company's operations and its facility requirements. Such include health permits, permits for equipment subject to pressure, permits for propane tanks, permits for use of radioactive equipment, zoning and land use permits, environmental permits, licenses and authorizations, immigration permits/visas, permits for specialized communication and data equipment, among others.

III. Regulation of the Export Industries in Mexico

A. The Decree for the Promotion of the Manufacturing, Maquiladora and Export Services Industries (IMMEX Decree).

On November 1, 2006, the Mexican Department of the Economy published in the Official Journal of the Federation a new law known as the IMMEX Decree. Subject to certain phase ins of specific conditions, the IMMEX Decree entered into force on November 13, 2006 with the the main purpose of strengthening the competitiveness of the Mexican export sector and positioning Mexico as a leader in the global market, both in the manufacturing of goods for export and in the provision of exported services.

The IMMEX Decree supersedes the two programs on which Mexico traditionally relied for the promotion of exports: the Program for the Promotion and Operation of the Maquiladora Exportation Industry (Maquila Program), and the Temporary Importation for the Production of Exported Goods Program (PITEX Program). Consequently, the Maquila and the PITEX Programs are now integrated in one law: the IMMEX Decree. The IMMEX Decree applies to companies in the manufacturing, maquila and export services industries, as well as companies that had Maquila and/or PITEX Programs prior to November 13, 2006.

The stated objective of the IMMEX Decree is to contribute to the competitiveness of Mexican companies in the goods and services export industries by: i) creating new business structures and opportunities; ii) establishing a better business environment with respect to export regulation and compliance obligations; and iii) offering uniform tax treatment, while also establishing tighter control and verification procedures for the benefit of international trade and federal tax agencies.

B. Benefits and New Business Structures Under the IMMEX Decree.

The IMMEX Decree retains the maquila and PITIX Programs' basic structure whereby exporting companies are exempt from payment of value added tax when temporarily importing raw materials, goods and equipment into Mexico. IMMEX entities may temporarily import the following items:

1. Raw materials, parts and components (including packing containers, packing materials, fuel and lubricants);
2. Containers and trailers; and
3. Machinery, industrial equipment and tools, in addition to other equipment specified in the rules, such as laboratory, measuring and testing equipment.

Based on Mexico's Customs Law, the maximum time frames for temporarily importing the items listed above are as follows:

1. For the temporary importation of raw materials, parts and components, up to eighteen (18) months from the time of their importation;
2. For the temporary importation of machinery, industrial equipment or tools, for the duration of the IMMEX Program; and

3. For the temporary importation of containers and trailers, up to two (2) years.

The IMMEX Decree provides that companies may file for one program authorization (an "IMMEX Program") to carry out export-related operations under one or various different IMMEX Program legal mechanisms. There are five (5) types of IMMEX Programs: i) Holding (*Controladora de empresas*); ii) Industrial; iii) Services; iv) Shelter; and v) Third party company (*Terciarización*). Such options are intended to allow Mexican companies greater flexibility to be more innovative and competitive in a globalized economy.

Under the Holding option, manufacturing activities of controlled subsidiaries may be integrated with those of the holding entity, while individual programs granted to the controlled companies will be automatically cancelled. The Industrial option applies to processes for the production and transformation of goods normally carried out by Maquila entities. The Services option now includes not only services provided in relation to the production of export goods, but also activities which themselves are export services, such as design development, re-engineering, information technology related services, software development, administration, accounting, subcontracting, call centers and data processing services. Finally, the Shelter and Third party company options allow third parties to actually carry out production activities, with the aim of allowing medium sized Mexican companies to enter into the global market, by entering into agreements with companies that own technologies but do not intend to perform production activities in Mexico themselves.

Given that companies may have only one IMMEX Program, companies that hold a Maquila and/or a PITEX Program are automatically assigned an IMMEX Program with authorization to operate under the Industrial option, while companies that had been authorized Maquila programs under the Services, Holding or Shelter options now have an IMMEX Program for the corresponding areas. Companies with programs under the Decree that Establishes Various Sectorial Promotion Programs ("PROSEC Decree") remain in operation; and PROSEC programs may now be obtained simultaneously when filing for an IMMEX Program authorization.

C. New Regulatory Environment for IMMEX companies.

The IMMEX Decree simplifies the regulations to be observed with respect to the authorization of an export program, amendments to program approvals and reporting requirements to federal authorities. With the IMMEX Decree, the number of administrative procedures and formalities is reduced from 29 to 16, including the following changes: i) annual reporting obligations are limited only to annual sales and export volumes; ii) the information to file for authorization of an IMMEX Program with respect to items to be temporarily imported is now limited to a commercial description of machinery and equipment and HTS numbers for raw materials; iii) the export commitment to obtain all benefits of an IMMEX Program is annual exports for amounts equivalent or superior to $500,000.00 USD or 10% of actual sales (down from the previous 30% of actual sales in the Maquila Decree); iv) most filings will now be done through electronic means; and v) the Maquila services agreement no longer needs to be formalized through a Mexican Notary Public.

Certified companies with an IMMEX Program will receive additional benefits derived from the IMMEX Decree.

D. Applying for an IMMEX Program.

Pursuant to current rules, in order to obtain registration and an IMMEX Program number, the entity requesting the issuance of an IMMEX Program must prepare and present the application for issuance of an IMMEX Program in accordance with the authorized format, attaching the following:

1) Official transcript or certified copy of the public instrument evidencing the entity's formation and, if applicable, any amendments to its management system or ownership structure as it appears in the data of the corresponding Public Registry;

2) Copy of the document that establishes the entity's legal possession of the real property in which the company intends to operate under the Program, indicating the real property's location and attaching photographs of the location itself;

   (In the case of a lease or gratuitous use of real property, the entity must establish that the respective agreement establishes a mandatory term of at least one year and, said term will not expire in less than eleven months from the date the application is submitted);

3) A maquila or services agreement, purchase orders, or firm offers that establish the existence of an export project; and

4) Any additional information that the Department of the Economy requests in said form.

Additionally, the applicant must already have the following:

1) An advanced electronic signature (FEA) certificate issued by the Mexican Tax Administration Office (Servicio de Administración Tributaria or SAT);

2) An activated Federal Tax Identification Number (RFC number); and

3) Registered and activated domicile for tax purposes and other domiciles where the applicant performs operations under the IMMEX Program before the Federal Taxpayers Registry.

Applications that are filed, along with the exhibits, must be authorized within a maximum term of fifteen (15) business days. If there is no positive or negative response during this time, it is understood that the IMMEX Program has been authorized. The IMMEX program's approval will automatically result in registration of the company with the Mexican National General Importers' Registry.

The IMMEX program application is a summary of data including: a forecast of the company's production, a description of the company's production processes, information on the company and its employees, and information on the types of products to be produced. Additionally, a list of the tariff classifications of all products to be manufactured or assembled must be provided; along with the tariff classifications of the basic components, raw materials, packing and packing materials for each of the products. Applicants must also provide a list generally describing the machinery and equipment (including office equipment essential to productivity).

The IMMEX services agreement referred to above is a production agreement entered into between the parent company (or other

entity that will ultimately sell the finished or semi-finished products) and the IMMEX entity. It includes provisions for the company to furnish the materials, machinery, equipment and supplies to the IMMEX entity, the terms and conditions for providing the services (including a service fee in compliance with applicable transfer pricing regulations), and provisions for the care and maintenance of materials, machinery, equipment and finished goods, including a bailment clause consigning the goods to the IMMEX company, etc.

Once the application for the IMMEX program has been presented, the Department of the Economy will inspect the company's facilities in order to obtain additional information and verify the information on the application. The Department of the Economy normally approves the application in less than fifteen (15) business days. Once approved, the program and import permits are valid for an indefinite period. It is no longer necessary to request and obtain additional import permits from the Department of the Economy for the importation of components, etc. not originally listed in the application, provided that such components, etc. are to be used to produce a product with respect to which an import permit exists. Applications for import permits for new products or product lines may be submitted to the Department of the Economy at any time and will usually be approved in less than one (1) week.

E. Tax treatment of IMMEX companies.

The IMMEX Decree redefines the concept of a "maquila operation" contained in article 2 of the Mexican Income Tax Law, so that only companies that fall under this definition will receive certain tax benefits, such as: i) exemption from being deemed as having a permanent establishment in Mexico; and ii) access to safe harbor rules to comply with transfer pricing regulations. According to the IMMEX Decree, a "maquila operation" is one that is carried out by a company with inventories and other goods provided directly or indirectly by a foreign resident, for which purpose said company has entered into a maquila agreement to transform, produce or repair said goods or when services are rendered. With respect to reimbursement of value added tax (VAT), the IMMEX Decree provides that companies with an IMMEX Program which export goods will be reimbursed for the value added tax within twenty (20) business days, except in the case of "certified" companies, which will be reimbursed within five (5) business days.

F. Control and verification mechanisms, publicity.

While many of the IMMEX Decree provisions will benefit companies in the export industry, tighter control and verification mechanisms, as well as stricter penalties will also be enforced. Among others, companies with an IMMEX Program will be required to process a certificate for the "Advanced Electronic Signature" (*Firma Electrónica Avanzada* or FEA), have an active Federal Tax Identification Number (*Registro Federal de Contribuyentes* – RFC), and file an electronic annual report with respect to total annual sales and exportation volumes. The annual electronic report must be filed no later than the last business day in May of each year. If not filed, the benefit of temporarily importing goods into Mexico under the IMMEX Program will be suspended. If the annual electronic report is not filed by the last business day of August of the corresponding year, the IMMEX Program will be permanently cancelled. There are various other causes for cancellation of an IMMEX Program, among them: not filing annual tax returns; not carrying out import/export operations in the prior twelve months; not

having updated accounting records, corporate registries, and inventory control; not having proper customs documentation (filing inconsistent, false or altered declarations and/or documents); or illegally importing goods.

IMMEX entities are obligated to provide the Economy Department the following information on an annual basis:

1) IMMEX entities should present each year, no later than the last business day of May, a report of the IMMEX operations for the prior year;

2) If an IMMEX entity does not provide the information and report identified above to the Economy Department, the IMMEX Program and the benefits that this program grants shall be suspended until the respective information and report is filed;

3) If, by the first day of September, the information and report have not been presented to the Economy Department by the IMMEX entity, the IMMEX Program will be cancelled; and

4) The IMMEX entity should also have an automated inventory control system.

The IMMEX entity must maintain the temporarily imported goods at the domicile or domiciles that are registered with the Program.

G. Sales in Mexico by IMMEX entities.

It is important to take into account the minimum amounts of export or sales values in order to carry out temporary importations of raw materials, parts, components, machinery, industrial equipment and tools by the IMMEX entities. In order to carry out temporary importations of raw materials, parts and components, containers and trailers, it is necessary for IMMEX entities to have annual export sales in excess of $500,000.00 USD or to invoice exports of at least 10% of total invoicing.

Other important aspects that must be analyzed with regards to sales in Mexico are value added tax (VAT) issues, possible permanent establishment for the IMMEX entity's parent company, as well as deductibility and formal/substantive requirements to nationalize the parts, components and finished products that will be sold in Mexico.

H. Transfers of Goods.

The rules establish the possibility of two types of transfers of goods. One is the transfer of goods delivered on consignment, in which title is not transferred to the IMMEX entity that receives the transfer. The other is the transfer of goods that results from a sale or transfer of title of the goods involved in the transfer. With regards to the latter variation, it is important to carefully analyze the value added tax (VAT) aspects and possible permanent establishment implications when the owner of the goods, sub-assemblies and finished products is a foreign company that resides outside of Mexico.

The transfer of raw materials, parts, components and industrial equipment between IMMEX entities is subject to the following rules:

1) The transfers or sales made by companies in the auto parts industry with IMMEX programs to automotive terminal industry companies or manufacturers of auto transportation vehicles should be done in accordance with the

mechanisms and procedures established by Hacienda by means of the Foreign Commerce Regulations in effect;

2) The IMMEX entity may use the importation duty exemptions when they relate to raw materials, parts, components and sub-assemblies or finished products that originate from a NAFTA member country and in order to process a transfer of these goods to another IMMEX entity, as long as they use the virtual import and export mechanism by means of Customs declarations (*pedimentos)* signed by Customs brokers and following the rules contained in the Foreign Commerce Regulations in effect or even without virtual operations in certain cases according to the Decree; and

3) With regards to the value added tax (VAT), the Value Added Tax Law provides that the virtual exportation transfers shall be considered export operations subject to a 0% value added tax.

I. The Sectorial Programs (PROSEC).

The Sectorial Programs were established by Mexico to favor manufacturers that supply both the internal and external markets and to reduce the impact of the NAFTA limitations on the duty deferral programs. Mexico felt compelled to provide substantial relief to maquiladoras (now IMMEX) and other companies in Mexico who must import non-NAFTA origin raw materials, components, machinery, or equipment, from countries with which Mexico also does not have international trade treaties. Hence, Mexico created some twenty-two Sectorial Promotion Programs.

Sectorial Programs are used to obtain a reduction in the import duties as they relate to (i) industrial equipment, regardless of its origin, (ii) raw materials, parts and components of a *non-NAFTA origin* that are used for the production of products exported to the U.S. or Canada, (iii) the importations of raw materials, parts and components not originating in a NAFTA member country that are exported to countries not a part of NAFTA, and (iv) any type of permanent importations by manufacturing and production companies.

In these cases, and as an alternative, it is possible to apply tariffs from other free trade or commercial integration treaties signed with Mexico, such as the Free Trade Treaty with the European Union.

It should be noted that the Sectorial Programs apply to temporary importations subject to payment of import duties as well as to permanent importations. The preferential tariff rates contained in the Sectorial Programs also reduce the regular tariff rates contained in the General Import Law.

The Sectorial Programs apply to direct and indirect manufacturers of products providing that (i) the final products manufactured by the IMMEX and other manufacturers are included in the tariff classification lists for finished products contained in the Sectorial Program decrees; and (ii) the raw materials, parts, components and industrial equipment required by the importer for the production processes are also included in the lists of authorized merchandise, taking into account the preferential importation tariffs contained in these decrees.

1) Beneficiary Importers and Companies. The companies and importers that may use the Sectorial Programs and obtain the

necessary authorization to apply the preferential import tariffs contained in the decrees mentioned above are as follows:

a) Direct manufacturers, such as those companies or commercial entities that directly produce or manufacture the finished products authorized in the Sectorial Programs and that import the raw materials, parts, components and industrial equipment that also qualify for importation using the preferential tariff rates.

b) Indirect manufacturers, such as the companies or commercial entities that manufacture materials and sub-components used, among other uses, in the raw materials, parts and components that qualify for the preferential importation tariff rates under the terms of the Sectorial Program decrees as well as supply and deliver the subcomponents and manufactured materials to other direct manufacturers.

The possibility that indirect manufacturers may be registered with the Economy Department in order to supply direct manufacturers is an important possibility in order to integrate the various production phases of the product by the IMMEX and other manufacturers without incurring an increased importation cost for the imported materials that are part of the industrial production process.

IV. Mexican Taxes

A. Types of Taxes in Mexico.

The principal types of taxes in Mexico that apply to manufacturing operations in Mexico are the income tax (comprised of the corporate income tax and an alternative minimum tax referred to as the single rate business tax), the value-added tax, import duties and payroll taxes.

The following are the principal laws with respect to the mentioned taxes and social security contributions:

1) Income Tax Law (*Ley de Impuesto Sobre la Renta, LISR*);

2) Single Rate Business Tax Law (*Ley del Impuesto Empresarial a Tasa Única*);

3) Value Added Tax Law (*Ley del Impuesto al Valor Agregado*);

4) Import Tax Law *(Ley del Impuesto General de Importación);*

5) The Law for the National Funding Institute for Workers Housing (*Ley del Instituto para el Fondo Nacional de la Vivienda para los Trabajadores, INFONAVIT*); and

6) The Law of the Mexican Institute of Social Security (*Ley del Instituto Mexicano del Seguro Social, IMSS*).

B. Recent Tax Law Changes.

On October 31, 2009 Mexico's Federal Congress approved the Revenue Law (*Ley de Ingresos*) for 2010 with a clear purpose of increasing government revenue. The so-called "Fiscal Package" amends the Single Rate Business Tax (IETU) Law, the Fiscal Code of the Federation, the Income Tax Law, the Value Added Tax Law, the Cash Deposits Tax Law, the Federal Law of Fees and the Special Production and Services Tax (IEPS) Law. The following points are important to keep in mind:

1) Single Rate Business Tax (IETU) Law. *Credits and Deductions.* In 2010, the possibility of crediting in the same tax year amounts derived from an excess in deductions for purposes of the IETU Law against the income tax of the taxpayer has been removed. Such tax credit may now only be applied against IETU (and not income tax) in the ten following fiscal years, until exhausted.

2) Fiscal Code of the Federation. *Digital Receipts.* Various reforms taking effect on January 1, 2011, were approved, including the obligation to issue tax receipts through digital documents by means of the internet webpage of the Taxpayer Administration Service (SAT). Various requirements for this process have been established, and failure to follow the new digital receipt procedure will be a criminal offense.

3) Income Tax Law.

   a) *Tax Consolidation.* Taxes deferred as part of a tax consolidation must be paid by the holding company within a period of time not greater than five fiscal years from the date

on which the consolidation took effect. This term may not be renewed through corporate restructurings. The payment of deferred and updated taxes shall be made in the following manner:

i) 25% in the fiscal year in which payment of the deferred tax is due;

ii) 25% in the second fiscal year;

iii) 20% in the third fiscal year;

iv) 15% in the fourth fiscal year; and

v) 15% in the fifth fiscal year.

The reform establishes an option for calculating the deferred tax due in lieu of calculating the tax in conformity with the current formula used to calculate income taxes for the segregation of consolidated companies or termination of consolidated status. In addition, during fiscal year 2010, the holding company must report the deferred income tax corresponding to tax years prior to 2005 that remains unpaid as of December 31, 2009.

b) *Tax Rates*. For fiscal years 2010, 2011, and 2012 the corporate income tax rate will be 30%. For 2013, the rate will be 29%, and for 2014 the rate will be 28%. For individuals during fiscal years 2010, 2011 and 2012, marginal rates have been adjusted upward to a maximum of 30%, with a maximum of 29% in 2013 and 28% in 2014.

4) Value Added Tax. *Tax Rate*. The general value added tax rate will increase from 15% to 16%, and in the border region from 10% to 11%.

5) Cash Deposits. *Tax Law*. The amount of exemption received by individuals and corporations from the cash deposits tax for amounts maintained in cash deposits in Mexican banks, has been reduced to $15,000 pesos for each month during the fiscal year.

6) The Federal Law On Fees. A new section to this law has been added regarding payment of fees for the issuance of agriculture inspection certificates, as well as a section related to payment of fees for the processing of applications and permit issuance related to genetically modified goods. In addition, the decree establishes that it will enter into force on January 1, 2012, for concession and permit-holders of radio frequency bands from 1710 megahertz through 1770 megahertz and 2110 megahertz through 2170 megahertz when their concession was granted later than November 30, 2010, and on January 1, 2013 for concessions granted after December 1, 2010.

7) Special Production and Services Tax Law. The amendment establishes a tax rate of 3% for services provided in Mexico through one or more public telecommunication networks when all or a part of such services take place on the network. Exemptions to payment of the tax apply in the context of the following

telecommunication services (i) fixed rural telephone operations in towns of fewer than 5,000 people; (ii) public telephones; (iii) interconnection services; (iv) Internet access whether through fixed or mobile networks, consisting of all service applications and content through which said internet access is provided on a telecommunications network.

C. Permanent Establishment and Transfer Pricing Considerations.

Of utmost importance to manufacturing operations as relates to the tax considerations in Mexico, is the status of the permanent establishment and transfer pricing rules.

Under the current tax statutes and the Tax Treaties to Avoid Double Taxation, Mexico may impose income taxes directly on foreign companies that conduct commercial activities in Mexico. If a permanent establishment is found in Mexico, the Mexican tax authorities would impose taxation on taxable revenue effectively connected with the commercial activities carried out in Mexico.

A permanent establishment may be created by the direct activity carried out by the foreign company or alternatively, by the activities of agents in Mexico.

Export manufacturing activities meet the above requirements regarding the presence of a permanent establishment by allowing a Mexican subsidiary to assemble products and inventories (that belong to the foreign company) which are consigned with the Mexican IMMEX company. Notwithstanding the above new provisions, the law set forth an exemption for parent companies of IMMEX entities regarding the presence of a permanent establishment provided both the parent company and the IMMEX subsidiary comply with specific transfer pricing rules.

Mexico implemented particular rules for compliance with transfer-pricing for IMMEX operations. The law provides for different methods that satisfy proper pricing under the general principles of transfer pricing provided by international treaties and guidelines. Under current legislation, a foreign parent company and its Mexican IMMEX entity may comply with transfer pricing requirements by (i) adoption of the so called *safe harbor rules*; (ii) negotiating with the Mexican tax authorities an advance pricing agreement (*APA*), or; (iii) having a transfer pricing expert firm prepare a transfer pricing study using arm's length unrelated company comparables according to the different methods established in the Income Tax Law.

Under safe harbor rules:

1) The Mexican IMMEX entity agrees to generate a taxable income of at least 6.9% over the total value of all the assets used in its operation, including those owned by the IMMEX entity, foreign residents, and any of its related parties, notwithstanding the fact that such assets have been provided to the IMMEX entity for their temporary use and enjoyment; or

2) The Mexican IMMEX entity agrees to generate a taxable income of 6.5% over the total amount of its operating costs and expenses, computed in accordance with Mexican Generally Accepted Accounting Principles.

The Mexican IMMEX entity must use either option 1 or 2 above, whichever is higher. Under a special presidential decree

the Mexican government has provided for a 3% subsidy so in practice, the current safe harbor percentages are 3.9% or 3.5% respectively.

If the IMMEX entity considers that its taxable income under comparable references would be lower than 3.9% or 3.5% as applicable, it may obtain an advance pricing agreement (APA) from the Mexican taxing authorities.

The Mexican Income Tax Law also provides various methods to determine the appropriate transfer pricing profit margins that apply to generic commercial transactions carried out by related parties. Among the accepted methods are (i) the comparable price, (ii) resale price, (iii) cost plus, (iv) profit allocation, (v) residual profit allocation, and (vi) transaction profit margins. The Law sets forth the specific terms and conditions that apply to each one of these methods and provides for the appropriate formula in order to arrive at an acceptable profit margin.

D. Value Added Tax Considerations.

Mexico is one of the many countries that uses the value added tax system to tax final consumers with an 11% to 16% sales tax. Although the tax is imposed on the final consumer, all corporations and parties that participate in the production and distribution chain must pay the tax and apply for a tax reimbursement from the Mexican government or apply a tax credit against collection of value added taxes in case of sales performed in Mexico.

Export related services are subject to a 0% value added tax rate which means that the IMMEX services under the Maquila or IMMEX agreement are tax free and all value added taxes paid by the Mexican IMMEX entity to its providers of services and goods qualify for a tax reimbursement that may be obtained in the months that follow the filing of the monthly tax return in which the tax payment is reflected. The Mexican IMMEX entity may apply for a highly exporting license *(ALTEX)* to accelerate recovery of the value added tax. An IMMEX entity company will not generally be considered as a final consumer.

E. Employees' Profit Sharing.

Although not a tax in the strict sense, Mexico imposes the obligation on all employers, including Mexican IMMEX entities, to pay 10% of net taxable revenue as reflected in the annual corporate tax return, to its employees.

F. Import Taxes and Sectorial Programs.

In the past, importation of raw materials, parts, production components and equipment temporarily imported by Mexican Maquila or IMMEX entities were fully exempt from Mexican import taxes. As of 2003, new rules have been established in compliance with the requirements imposed by NAFTA. Under current rules, parts and components that originate in the NAFTA region are exempt from import duties. Parts and components that come from other regions and countries are subject to import duties unless they come from another country with which Mexico has executed a trade treaty. Every trade treaty has its own schedules and phase out provisions to reduce or eliminate import duties. Please note that some products originated from Asian countries, such as China, may be subject to countervailing duties that penalize unfair international pricing practices (dumping).

Concerning production equipment, the law has import schedules which may be reduced or eliminated by international trade treaties.

Most of the commodities that come from the US and Canada are duty free or subject to low import duties since the ten year phase out provision imposed by NAFTA in 1994 has been fully implemented.

In order to alleviate the imposition of import duties to raw materials, production components and equipment that are used to manufacture or assemble output that will be distributed outside Mexico, special sectorial programs have been implemented in Mexico to further reduce or eliminate import duties in connection with specific items that appear in the listings compiled by the these programs. Sectorial programs are organized by type of industry and are subject to frequent revisions and adaptations.

G. Single Rate Business Tax.

Mexico's Congress approved a tax reform package for the fiscal year 2008 that included the creation of a new Single Rate Business Tax (*Impuesto Empresarial a Tasa Unica* or IETU), which reflected the Mexican government's policy objective of collecting more revenue. In addition, Mexico's president, Felipe Calderon, issued a Tax Subsidy Decree in order to diminish the negative effects of the IETU in connection with particular industries including the maquiladora export industry.

With the advent of transfer pricing rules and greater regulation of related party transactions, Mexico attempted to change the cost center concept to one based on profits, thereby subjecting maquiladoras to paying taxes in Mexico. Notwithstanding the policy change, the maquiladora export industry has continued to enjoy a privileged tax status in order to maintain the attractiveness of its investments and to maintain global competitiveness.

The current trend in Mexico is to change the historic tax advantages afforded the maquila industry, as taxes such as the IETU seek to decrease the benefits provided under such traditionally protected tax regimes and eliminate the special treatment granted to this industry under Mexico's Income Tax Law (*Ley del Impuesto Sobre la Renta*).

Beginning January 1, 2008, the IETU replaced Mexico's Asset Tax (*Impuesto al Activo*), which placed the maquiladora export industry at a great disadvantage. This occurred because the foreign parent companies of maquiladoras were not subject to the asset tax on the parts, components, finished goods, machinery and equipment owned by the foreign parent (yet utilized by its maquiladora subsidiary company in Mexico, provided the maquiladora complied with applicable Mexican transfer pricing legal provisions and principles). The law, which created the IETU, provides no asset tax exemptions or reductions to maquiladora export operations.

In addition to the fact that the maquiladora industry was, in general terms, not afforded special treatment under the IETU, a specific negative effect of the IETU on the maquiladora export industry may be found in the definition of the IETU's tax base as compared to the rules for determining a taxpayer's tax base for purposes of Mexico's income tax. In the income tax scenario, the tax base is determined on amounts paid by the foreign parent for manufacturing or assembly services provided by the maquiladora company, according to applicable Mexican transfer pricing rules and methods.

The maquiladora industry still enjoys the benefits under existing Mexican tax laws described in Paragraph C above: (i) the *safe harbor* rules providing profit margins of 6.5% or 6.9% based on the value of assets used in

the maquila operation, or the operating cost of the maquila services, whichever is higher; and (ii) the tax subsidy that was granted in 2003 pursuant to the decree issued by President Vicente Fox to provide an incentive for maquiladora companies to locate or remain located in Mexico rather than establishing operations in China or South America. While the presidential decree remains in force, it still reduces, for income tax purposes, the income tax impact on maquiladoras using the safe harbor method by approximately fifty percent. However, this presidential decree is expressly not applicable for IETU purposes according to the Tax Subsidy Decree of November 5, 2007 hereinafter mentioned.

The IETU neutralizes the above special tax regime granted to the maquiladora export industry since the calculation of a taxpayer's tax base may not take into account such *safe harbor* rules or subsidies. Accordingly, the IETU taxes resulting from a stricter manner of calculating the tax base is payable as an alternative minimum tax, in addition to the income taxes payable by the taxpayer. The principal disadvantage of the IETU for the maquiladora industry is based on the fact that the majority of maquiladora companies will pay income tax at an amount lower than the final tax due under the IETU. Thus, the difference between the income tax and amount due under the IETU will be paid in the form of IETU tax.

In determining a taxpayer's tax base under the IETU, neither the *safe harbor* rules nor the presidential decree will apply. On the contrary, the IETU law establishes in Article 18(III) that when related parties are involved, the taxpayers must determine their income and authorized deductions using transfer prices and amounts paid as consideration for maquila services that would be paid by independent parties in comparable transactions, in accordance with the transfer pricing methods established in Article 216 of Mexico's Income Tax Law, in the priority order established in said article. In many cases, this means that maquiladora companies will be required to hire specialized firms to prepare transfer pricing studies in order to comply with their IETU obligations, which implies additional operating costs in Mexico. Furthermore, when determining the profit margin for an assembly operation in conformity with authorized transfer pricing methods, a tax rate of 17.5% will be applied to the taxable income of the maquiladora operations.

Finally, it is important to point out the fundamental problem maquiladora companies and their parents face as they seek to harmonize the international tax treatment of the parent as well as of the maquiladora subsidiary. An open question exists as to whether or not countries such as the United States will allow the IETU tax to be creditable. This means that these countries will be required to define, on an individual basis, the characteristics of the IETU in order to conclude whether or not the tax is considered as an income tax or a tax that affects the income of taxpayers, and allows the deduction of costs and expenses, including tax capitalization of assets. If the conclusion is that the United States, for purposes of its federal income tax, determines that the IETU is not an income tax creditable to the United States parent company, then IETU tax paid in Mexico will not be creditable in the United States, thus causing double taxation at the international level.

Notwithstanding the negative effects of the IETU discussed above, the National Council of the Maquiladora and Manufacturing Export Industry ("CNIMME") negotiated with Mexico's Department of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público* or SHCP) for the issuance of a decree containing tax incentives for the maquiladora

export industry that reduces the IETU's negative impacts. In accordance with information provided by CNIMME, more than 47% of maquiladora companies do not pay income tax because they have net operating losses, and another 20% do not pay the tax for other reasons. The Mexican tax authorities took the position that maquiladoras should pay 28% of their net earnings in income tax, while the CNIMME insisted that the global charge on maquiladoras for the income tax and IETU should not exceed 17.5%.

On November 5, 2007, a Tax Subsidy Decree was published in the Official Gazette of the Federation in Mexico, whereby a tax incentive in the form of a tax credit against the final accumulated IETU and income tax burdens has been granted to the maquiladora industry. This tax incentive will remain in effect for the years 2008 through 2011. It is very likely that during the life of this tax incentive there will be more revisions and adaptations to these rules.

It is important to mention that this new tax incentive, pursuant to terms of the Tax Subsidy Decree, would only apply to maquila entities that comply with their transfer pricing obligations by using the transfer pricing maquiladora methods set forth by Article 216 B of the Income Tax Law. If the maquila entity does not use these methods, or has an advanced pricing resolution from the Mexican government which uses a different transfer pricing method, that maquila entity is not allowed to benefit from this new tax incentive.

V. Real Estate Considerations for a Mexico Operation

The two options normally considered in arranging for a manufacturing facility in Mexico are direct ownership of the facility or a lease (sometimes coupled with an option to purchase the facility).

A. Purchasing Real Estate in Mexico

The considerations relating to direct ownership of real estate in Mexico are similar to the U.S. considerations, subject nevertheless, to a few particularities. Mexican companies with one hundred percent (100%) foreign investment may acquire a fee simple title of properties for industrial or commercial purposes all over Mexico, including the *restricted zone*, composed of land located in the restricted border (100 km) and coastal (50 km) zones, in which case an acquisition notice has to be filed with the Department of Foreign Relations.

Foreign companies or individuals may also acquire a fee simple title of properties for industrial or commercial purposes with the prior approval from the Department of Foreign Relations, however, in the restricted zone, foreigners are required to acquire a beneficial interest in a renewable fifty (50) year land trust administered by a Mexican bank as trustee. This requires a permit from the Department of Foreign Relations, and the payment of annual trustee's fees.

Pursuant to the traditional maquiladora structure, the normal option is for the maquiladora entity to acquire the real estate and thereby avoid the need for a trust or the need to create a separate real estate holding company in Mexico. This should be carefully considered, however, since it could make practical sense from a limited liability standpoint to own the real estate in a separate entity that is not subject to the claims of the creditors of the operating company, such as the claim of a wrongfully dismissed worker for severance.

A contemplated purchase is often first documented in a non-binding letter of intent, the terms of which provide the basis for the negotiation of a promissory purchase and sale agreement. This agreement typically provides for a due diligence period for the buyer to investigate all aspects of the property, in addition to the standard terms and conditions, including certain seller's representations and warranties, conditions to closing, etc. In recent years, many U.S. purchasers also require a title insurance policy, based on a title commitment issued upon receipt of an independent title report from a Mexican attorney. Such a title policy is now available from U.S. title companies or Mexican title companies backed by U.S. interests; however, it is important to arrange for required endorsements and negotiate deletions to certain exceptions to the title commitment issued by the title companies.

Before the closing, certificates of no liens and of no property taxes due are obtained. In some states, an appraisal and an official survey among other administrative requirements may be required. Upon closing, a deed of conveyance in the form of a public instrument formalized before a Mexican notary public is executed by the parties for subsequent recording at the Public Registry of Property. Among the closing costs typically paid by the buyer are: i) a two to three and a half percent (2% - 3.5%) acquisition tax depending on the state where the property is located; ii) value-added tax at the rate of fifteen percent (15%) on any improvements (land sales are not subject to value-added tax);

iii) recording costs which vary from state to state from a fixed fee to a percentage. In some states costs can be as low as and capped around $1,100.00 USD while in other states costs may be as high as one percent (1%); and iv) notary public fees and expenses. The seller is responsible for the payment of its own income tax, however if the seller is an individual, it may be necessary to withhold the corresponding tax and deliver the amount directly to the notary public, who is responsible for calculating the withholding amount and paying the tax on behalf of the seller.

Property taxes are payable every two months, however, most of the companies elect to pay the complete year in advance to receive a ten to twenty percent (10% - 20%) discount. Property tax is calculated based on the tax value of the land and improvements. In some states, property taxes can be as low as zero point three percent (0.3%) while in other states such may be as high as one percent (1%).

Among the due diligence items that should be investigated by a buyer are: (i) review of seller's fee simple title including, and if necessary, a review of possible *ejido* land restrictions; ii) the environmental condition of the property including environmental studies as necessary; (iii) condition of soil and improvements; iv) land use/zoning; (v) rights of way; (vi) construction and operating restrictions applicable in the area where the property is located; vii) density of construction requirements; viii) location in approved industrial park or industrial zone; ix) availability and cost of utilities and of required utility infrastructure (for example, a substantial per KVA cost for substation and transmission line infrastructure is normally payable to the industrial park or the Federal Electricity Commission (*Comisión Federal de Electricidad, CFE*; or water feasibility and source of supply); and (x) cost of common area assessments at the industrial park.

B. Leasing Real Estate in Mexico

A lease of an industrial facility may be the desired option depending on the nature and extent of the contemplated operations, plans for expansion, the company's general policy with respect to leasing versus direct acquisition, the need for a temporary facility, etc. The usual variables for the structure of a standard lease are normally available and include build-to-suit provisions, options to purchase the facility, rights of first refusal, options to terminate the lease early in exchange for certain payments, etc. State law generally provides that industrial or commercial leases may not exceed a term of twenty (20) years; however, an option to enter into a new lease upon the expiration of the term may be negotiated.

All of the usual terms and conditions should be expressly set forth in the lease agreement, since the result under the state landlord/tenant laws may be different from what the parties intend, in particular, the extent of the maintenance costs allocated to each party.

Before leasing or buying a property, it is important to carry out an environmental study to ensure the property is received clear and clean of contamination; this study is also recommendable upon the re-delivery of the leased property or its sale in order to be released from liability for contamination on the site after such date.

VI. Labor Considerations

A. Regulation of Labor Relations.

Labor relationships in Mexico are created by factual circumstances, regardless of whether or not a written agreement exists. According to the Mexican Labor Law, a labor relationship exists whenever there is rendering of a personal service by one person to another, under the latter's direction and control in consideration for payment of a salary. Besides provisions contained in the Mexican Labor Law and other laws and regulations, written agreements between parties (union and employer or individual and employer) will typically establish certain specific rules.

These rules are contemplated in several regulatory provisions, such as the Federal Labor Law, the Federal Regulations on Health, Safety and Labor Environment, the General Regulations for Inspections and Imposition of Sanctions for Violations to the Labor Law, as well as several Official Mexican Standards, or NOMs.

1) The Federal Labor Law. The Federal Labor Law, is the highest ordinance in Mexico after the Mexican Political Constitution, that regulates the labor relationships. The Federal Labor Law is applicable in the entire Mexican Republic and, in addition to regulating labor relationships between the employee and the employer, it also regulates, in a detailed manner, the labor litigation procedure, the strike procedure, and the scope of work and duties of the officials that work in the federal labor boards. As all aspects of the labor relationships in Mexico are governed by this law, it serves as a handbook of the rights and obligations of the employer and the employee, and is the best human resources tool available. Always consider that the Mexican Labor Law is employee oriented, as evidenced for example, by the provisions of Article 18 of this law, which state that in case of any doubt in the interpretation of the law, the interpretation most favorable to the employees will prevail. Currently, a wide labor reform is being discussed, and amendments to the Labor Law have gained widespread support among various sectors of the Mexican population. Such changes, which are oriented towards providing more equitable treatment to employers, do face strong resistance by some unions and politicians;

2) Labor Regulations and NOMs. The Federal Regulations on Health, Safety and Labor Environment were enacted on July 20, 1997. The main objective of these regulations is to reinforce the protection and health of the Mexican workers and simplify the rules regarding the labor obligations of employers. On August 5th, 1998, the General Regulations for Inspections and Imposition of Sanctions for Violations to the Labor Law entered into effect. The main purpose of these regulations is to promote (among employers)

compliance with the labor regulations based on a principle of permanent tutoring of both the companies and the workers. Although the imposition of fines is an enforcement mechanism, the main idea of these labor regulations is to prevent violations and correct problems rather than punishing offenders; and

3) NOMs. NOMs are issued by each of the federal governmental ministries with respect to the area over which they have control (Environmental Department, Labor Department etc.). These are a set of rules which typically describe the exact technical specifications, criteria, instructions and parameters of how various activities should be conducted in Mexico in a manner calculated to protect the health and safety of the workers. The creation of the NOMs is based on a three-step process in which various groups (including the industry branch), can make proposals or provide comments with respect to the proposed NOM. Many of these suggestions are relevant to labor issues.

B. Labor Contracts.

Labor relationships in Mexico differ substantially from those in the U.S., particularly when compared to a termination-at-will/right to work jurisdiction such as Texas. In Mexico, the labor relationship between the employer and the employee is controlled and governed by certain mandatory aspects of the Labor Law. Accordingly, there are certain criteria which the applicable contracts must meet before said contracts are considered legal.

1) Collective Bargaining Agreement. The Collective Bargaining Agreement is a document that is executed by and between the union, as the legal representative of the employees, and the employer. In this document, certain aspects can be modified for the benefit and protection of the employer; however, certain legal provisions specified in the Labor Law must be met in order to protect the rights of the workers.

Among the provisions that may be included for the protection of the employer are, for example, a provision specifying the work shift requirements based on the company's needs, provisions allowing the company to change the work shifts as necessary and to transfer the workers among shifts, provisions specifying when the company may temporarily suspend operations due to lack of raw materials, electricity, etc, provisions detailing training and trial periods for the workers, and provisions for special incentive plans, etc.

Among the obligatory provisions that a Collective Bargaining Agreement must have are the following: i) the name and address of the parties; ii) the companies or branches governed by the contract; iii) the duration of the contract, or an indication that it is for an undetermined period of time, or for a determined type of work; iv) the

work shifts; v) the rest days and holidays (mandatory and discretionary); vi) the wages to be paid to the workers; vii) the contract must be in writing and in triplicate, if not the contract is void under the law; viii) provisions for the training of the workers; ix) the basis for the formation of the five various mixed committees (see paragraph E below), and any other provisions mutually agreed upon by the parties.

The Collective Bargaining Agreement is typically entered into for an undetermined period of time. The wages are renegotiated on an annual basis in accordance with the guidelines established by the federal government upon increase of the applicable minimum wages, and the fringe benefits are negotiated every two (2) years in accordance with the law.

The Collective Bargaining Agreement, for its enforceability, must be filed before the labor authorities;

2) Individual Labor Contract. This contract may be tailored as the employer sees necessary, to fit the specific job category of the specific employee, taking into account whether the employee is a union or a non-union employee. A contract should be entered into with every employee, union and non-union, because in the absence of a contract, one will be implied under the Labor Law, and this contract would contain terms more favorable for the employee.

The labor conditions that must be included in this contract are as follows: i) name, nationality, age, sex, marital status and address of the worker and the employer; ii) the duration of the working relationship or an indication that the labor relationship is for a determined type of work or a undetermined period of time; iii) the type of services the worker will be rendering to the employer (this provision should be as specific as possible so that together with the provisions of the internal workshop rules, sufficient grounds for terminating the employee when indicated may be easily established); iv) the place or places where the services will be rendered (as many places may be specified as desired concerning where the job will take place; however, if the worker will need to travel more than 100 km the employer must provide the means for transportation); v) the work shift; vi) the wages and manner of payment of the work shift; vii) the place and date where the employee will get paid; viii) the provisions for the training of the workers; ix) the rest days and holidays (mandatory and discretionary), and any other provisions that the parties may mutually agree upon; and

3) Internal Workshop Rules. This is a set of rules that the employer imposes at the plant to govern the labor relationship with respect to the technical, health and safety aspects of the production processes, as well as the discipline the worker must observe within the

plant premises. These rules cannot in any way be contradictory to the provisions set forth in the law, the collective labor contract or the individual labor contract.

The internal workshop rules allow the employer to address particular areas where the acts or commissions of the workers may cause problems for the company, the production processes, the health and safety of the workers, the security of the company and its property, etc., and to provide for warnings or the imposition of sanctions on the workers that do not comply with their obligations within the limits of the Labor Law.

This set of rules can be applicable to the union workers or the confidential workers if so specified. Also, since these rules affect the entire working population, this document must be signed by the union and/or a joint committee of employees and filed before the labor board in order to be enforceable.

C. Nature of Workforce and Benefits in Mexico.

In Mexico, there are only two types of workers based on the nature of their rights and obligations: those workers that are represented by a union, and those who work under their own representation.

1) Union Workers. The union worker is an employee that is not subject to the provisions set forth in Article 9 of the Labor Law. In other words, someone who is not in charge of the management, direction, or care of the company or whose scope of work performed at the plant is not in the nature of personal work for the employer;

2) Confidential Employees. In accordance with Article 9 of the Labor Law all workers or persons with duties or functions in representation of the company, in administration, management, office, technical specialties, security, consultation, supervision, control, finance, accounting, warehouse control, training, and in general all persons that handle or have access to confidential information of the company, will be considered as confidential employees.

Accordingly, the following employees, among others, are considered confidential: officers, managers, superintendents, heads or assistants of departments, drivers, security guards, maintenance, technicians, professionals, administrators, accountants, programmers, warehouse personnel, personnel from the finance department, nurses, doctors, quality assurance technicians/auditors, inspectors, instructors, receptionists, secretaries, and in general all administrative and manufacturing personnel other than operators of the company.

The company may create new categories of confidential employees according to its needs;

3) Benefits. The benefits received by the workers with respect to the performance of their work can

apply to both confidential and union personnel. These benefits can be divided into two categories, mandatory benefits and discretionary benefits, or benefits given by mutual agreement. As opposed to the discretionary benefits, the mandatory benefits should be received by all workers (union and non-union).

a) Mandatory Benefits. Mandatory benefits are those that are required by law to be granted to the workers. The mandatory benefits cannot be waived and the in case that some of them are not properly given to the employees the contract will be void by operation of law and the employer will be fined by the labor authorities.

The following benefits are mandatory benefits, which cannot be waived or contractually avoided:

i) Salary;

ii) Vacations;

iii) Vacation bonus;

iv) Right to be indemnified (severance) in accordance with the law;

v) Seniority benefits;

vi) Right to receive profit-sharing from the company;

vii) Christmas bonus; and

viii) A thirty-minute paid break for lunch for a continuous work shift (although it can be scheduled in accordance with the company's needs).

With specific reference to salary, a federal commission determines the minimum wages that employers must pay with respect to three geographical zones in Mexico. The minimum wage that is in effect beginning January 1, 2010, for geographical zone "A" is 57.46 pesos daily; for the geographical zone "B" it is 55.84 pesos daily and for geographical zone "C" is 54.47 pesos daily.

For example, the current general daily minimum wage for the Reynosa, Tamaulipas, Mexico, D.F., Tijuana, Baja California, and Ciudad Juarez and, Chihuahua, Zone "A" areas, for 2010 is $57.46 pesos; the current general daily minimum wage for the Monterrey, Nuevo Leon and Tampico, Tamaulipas, Zone "B" area, for 2010 is $55.84; and the current general daily minimum wage for the Queretaro, Queretaro and San Luis Potosi, San Luis Potosi, Zone "C" area, for 2010 is $54.47. Professional minimum wage rates also apply with respect to certain job categories based on the nature of the economic activity or area of expertise. In addition to the fact that the right to receive wages cannot be waived, no amount may be offset from wages for debts, etc., nor may a worker's wages be subject to garnishment other than

for alimony, child support and similar situations outlined in article 110 of the Mexican Federal Labor Law.

There are other mandatory benefits that also cannot be waived; however, the worker may decide whether or not to work to obtain such benefits when offered by the employer, as follows:

i) Overtime. (In Mexico to work overtime is not an obligation or part of the duties of the employee, nevertheless, if such time is worked the employee must be reimbursed for it.);

ii) Weekly rest day. (The worker can agree to work on such day in exchange for a special rate salary.);

iii) Sunday Premium. (If the employee works on Sunday as part of his regular work shift an additional 25% premium should be added to his salary.);

iv) Mandatory holidays. (The worker can agree to work on such holiday in exchange for a special rate salary.).

b) Discretionary Benefits. Discretionary benefits are those that the worker and the employer mutually agree upon and may or may not be given to them at the employer's discretion. However, once the worker has received these benefits, they are considered by the Labor Law as earned rights and cannot be taken away from the worker. Some examples of these benefits are the following:

i) Paid or Unpaid Breaks (other than for lunch);

ii) Additional holidays (e.g. Holy Thursday and Good Friday);

iii) Marriage (e.g. the company may grant to the workers three days paid leave for marriage and an additional bonus);

iv) Birth of a child (e.g. the company may grant three days paid leave to the worker when his wife bears a child, plus an additional bonus);

v) Life insurance (e.g. the parties may agree that the company may provide its workers with life insurance coverage in case of natural death or in case of accidental death at work);

vi) Scholarships (e.g. the company may create annual scholarships to promote and support the education of unionized workers,

their children, and possibly confidential workers);

vii) Death of a relative (e.g. the company may grant three days paid leave and a bonus to the workers in case of the death of a relative in the first degree, such as parents, brother or sister, spouse or children);

viii) Cafeteria (e.g. the company may provide a place, apart from the production area, to serve as a dining area and equip the same with a microwave oven, tables and chairs so that the workers may warm up and eat their meals during the lunch breaks or use it for the other breaks);

ix) Water fountains;

x) Sports (e.g. the company in order to encourage sport activities among its workers, may sponsor a sports team on an annual basis, providing the required uniforms);

xi) Perfect attendance bonus (e.g. the company to promote the attendance of the workers, may grant a prize for perfect attendance);

xii) Food coupons (e.g. to assist the workers, the company may provide a basic benefit per day worked, and said benefit may be paid weekly to the workers in the form of food coupons.);

xiii) Lunch (e.g. the company may give the workers a food subsidy per day worked, which may be given in the form of a meal, with the workers paying an amount equivalent to 20% of the minimum daily wage in force in Mexico City, using the concessionaire selected by the company);

xiv) Transportation (e.g. the company may provide to the workers an amount of money per day worked for transportation to be used as a work related expense and not as a fringe benefit for their services); and

xv) Savings fund (e.g. the company and the union may agree to establish a bi-partisan savings fund for the benefit of the permanent workers).

These benefits are usually given to union workers; however, non-union workers could be entitled to them as well.

4) Employees of Suppliers and Vendors. It is very important for the companies to establish a proper contractual relationship with their vendors and suppliers in order to avoid possible labor problems with the workers of said suppliers or vendors, including indemnity provisions for such purposes;

5) Work Shifts. There are several types of work shifts aside from the three most commonly known shifts. These work shifts have been defined by the Mexican Supreme Court,[24] through the interpretation of Articles 59 through 66 of the Labor Law and such are as follows:

   a) Day shift of eight hours from 6:00 a.m. to 8:00 p.m.;

   b) Mixed shift of seven and one half hours (comprised of both the day and night shift, however the portion of the night shift cannot exceed three and one half hours or such will be considered a night shift);

   c) Night shift of seven hours from 8:00 p.m. to 6:00 a.m.;

   d) The continuous shift which includes a recess period of thirty minutes;

   e) The non-continuous shift, where the employee can use his or her own time freely and is not under any kind of supervision from the employer;

   f) The special shift, which can exceed the above shifts in terms of hours per day, but which cannot exceed the constitutional duration of the weekly shift of forty-eight hours;

   g) The extraordinary shift is one that extends beyond ordinary limits due to special circumstances and it cannot exceed three hours per day nor can such be done more than three times in a week; and

   h) The emergency shift, which is one that goes beyond the limits due to an imminent risk of a casualty or a risk to life of a worker, employer, fellow worker, or when the safety of the plant is at stake.

6) Overtime. Overtime payment is regulated by the Labor Law, pursuant to Articles 66, 67 and 68. Such articles explain in a detailed manner the way to compute and pay overtime.

   The first nine hours of overtime (which can never exceed three hours a day, nor more than three times a week) must be paid at an additional one hundred percent of the rate that corresponds to the regular hours of shift.

   The extension of overtime beyond nine hours a week obligates the employer to pay the worker the excess time at an additional two

hundred percent of the rate that corresponds to the regular hours of the shift, without prejudice to the right of the Department of Labor and Social Welfare ("STPS") to impose sanctions on the employer, with respect to such situation, in accordance with the law.

7) Unions. Mexico today should be considered as an employee rights oriented country. The union climate in Mexico today as compared to 20 years ago has changed drastically and now more and more unions are working hand in hand with Mexican and foreign companies in order to provide a more relaxed and mutually cooperative environment. In Mexico, there is an option to structure the labor relations of a company with either the establishment of a company union or through the use of an existing local or national union.

The strongest unions are the *Confederación de Trabajadores Mexicanos* (Mexican Labor Confederation or CTM) along with the *Confederación Revolucionaria de Obreros y Campesinos* (Revolutionary Confederation of Workers and Farmers or CROC), both of which are based in Mexico City, but have local chapters or branches to serve the needs of the companies located in rest of the Mexican Republic.

Important items to keep in mind when considering the viability of using a company union includes the necessity of choosing strong individuals to serve as union leaders. Having these strong individuals will allow the company to retain a higher degree of control over union policies and will prevent a possible undesirable scenario in which company union leaders could be co-opted by representatives of the other existing local unions, thus presenting the possibility of threatened strikes and judicially-imposed votes of plant personnel to choose the union they desire. This type of unstable situation could also lead to an additional disadvantage, high employee turnover.

It is advisable to seek counsel in order to obtain more information about the various unions available in the city where potential operations will be located.

D. Severance Issues.

The severance payment is a right that workers have when they are terminated without a proper cause. Therefore, to allow workers to defend their rights in case of wrongful dismissals, the Labor Law gives them the right to a labor trial in which they have the right to request either their reinstatement or indemnification.

It is recommended that in case the cause for the dismissal is not sufficiently clear or it is difficult to prove, the company should either attempt to convince the employee to present his/her voluntary resignation for personal reasons or execute a labor termination agreement by mutual consent and ratify this agreement before the labor court in exchange for a bonus for services rendered in order to avoid high severance payments such as:

1) Three months salary;

2) Twelve days per year worked, seniority bonus (using a salary of up to two times the minimum wage in the area);

3) Accrued Benefits; and

4) Twenty days for each year worked at his/her current salary. (In case of a lawsuit in a situation where reinstatement is denied to the employee by the employer.)

In addition to the severance payments, workers are entitled to the prorated fringe benefits, such as any bonuses mutually agreed and the profit-sharing, among others.

E. Mixed Committees.

In order to satisfy the needs of employers and the employees, the Labor Law has established certain provisions (Article 132, Section XXVIII and Article 134, Section IX) which states that both parties must join efforts in order to satisfy certain obligations. Given that fact, there are several mixed committees that the employer and employee must form in order to comply with such provisions, such as:

1) Safety and Health Mixed Committee;

2) Skills and Training Mixed Committee;

3) Company's Profit Sharing Mixed Committee;

4) Seniority Mixed Committee; and

5) Internal Workshop Rules Mixed Committee.

F. Social Security (IMSS).

The Mexican Social Security Institute (IMSS) is a public governmental agency whose coverage goes beyond that of the U.S. social security system in certain respects as follows:

1) Work related accidents;

2) Diseases and maternity;

3) Retirement and unemployment for the elderly people;

4) Disability and life; and

5) Childcare and social benefits.

G. Assignment of U.S. Personnel to Mexico Operations.

1) Practical Considerations. It is important for each company to properly plan an employment relationship with key U.S. personnel that will assist in Mexico operations, considering, for example, whether such employees should be on the U.S. or Mexican payroll based on the permanent establishment considerations, and their possible entitlement to benefits under the Mexican Federal Labor Law. The traditional approach is to place such employees on the U.S. company's payroll. If this is the case, it is important to limit such employees' authority to represent the Mexican entity, etc., such that the likelihood of claims for Mexican benefits may be minimized. Additionally, it is important to enter into proper contracts with such personnel in the U.S. with adequate provisions for indemnification of the company from such claims;

2) "Gringo" Tax. If a company's U.S. personnel work in Mexico more than one hundred eighty-three (183) days in any "year", they are subject to Mexican income tax. The payments are retroactive to day one, and the amount subject to income tax is all inclusive. The arrangements for the proper withholding of this tax should be made; and

3) Work Visas. The Labor Law establishes in its Article 7 that an employer may only hire up to ten percent of foreign nationals for its workforce. Such non-Mexican employees may start working in Mexico with a temporary permit called an FMN (or FMVC for Non NAFTA Foreign Nationals) which has a term of 180 days, and can be renewed. After this temporary permit has been obtained, it may be exchanged for a permanent permit called an FM-3 visa. This permanent visa is valid for a stay of one year and may be renewed for a total of four years, after which, it is possible to request a new FM-3 visa through a procedure of renewed stay. This permit may be obtained through the immigration offices in Mexico. Additionally, for employees or executives that will be visiting the plant or offices on a temporary but frequent basis, a visitor's FM-3 may be obtained from a Mexican Consulate and is valid for one year but must be cancelled prior to renewal or if it will no longer be used.

VII. Environmental Issues

A. Environmental Authorities.

After having entered into the North American Free Trade Agreement (NAFTA), Mexico undertook efforts to adapt and change certain aspects of its internal laws, regulations and official standards, including its environmental laws, regulations and standards. Among the many changes that occurred in the environmental arena, is the change in approach which occurred in connection with enforcement at the federal, state and local levels, whereby the enforcement authorities assumed a supervisory role in order to avoid environmental problems instead of reacting in a police enforcement type manner.

The environmental penalties and sanctions outlined in the different laws and regulations were modified and are now more strict; however the supervisory role of the environmental authorities will allow companies to remedy most of the regulatory non-compliance issues that companies may have, as explained below.

Companies established in the Mexican territory must comply with the environmental laws and regulations. For industry related business operations, there are basically three types of obligations: i) environmental protection obligations, in which water, soil, air, noise, waste, environmental risks and environmental impact, are the main focus, ii) working environment obligations, which pertain to the safety measures required at the work place, and iii) health and safety obligations, which pertain to the well being of every employee at the work place.

1) Environmental Obligations. Environmental laws and regulations are enacted for the main purpose of protecting the ecosystems and the natural resources of the area where the industry is located, protecting, as a consequence, the environment outside the facility. The federal and local (state and municipal) authorities, within the scope of their authorities, regulate the activities of the industry in order to avoid any imbalance in the ecosystems.

2) Federal Environmental Authorities. The federal authorities that actually enforce the environmental laws, regulations and Official Mexican Standards (NOMs) are the following:

   a) Department for the Environment and Natural Resources. The Department for the Environment and Natural Resources (*Secretaría del Medio Ambiente y Recursos Naturales, SEMARNAT*) is the governmental agency in charge of creating a state policy for the protection of the environment and setting the rules for the sustainable development of Mexico;

   b) The National Environmental Institute. The National Environmental Institute

(*Instituto Nacional de Ecología, INE*) is the leading agency in environmental investigations, which develops and promotes projects that support SEMARNAT's objectives. This agency is in charge of receiving many notices and requests to obtain the proper environmental permits to operate in Mexico;

c) The Federal Environmental Protection Agency. The Federal Environmental Protection Agency, (*Procuraduría Federal de Protección al Ambiente, PROFEPA*) is in charge of verifying compliance with federal environmental laws, regulations and applicable standards as well as the parameters of the licenses, permits and authorizations given to the companies established within the Mexican territory by other environmental agencies. PROFEPA is the agency in charge of administering the voluntary self-audit program, in which companies may choose to register in order to comply with the environmental laws, regulations and NOMs. This self-audit program allows companies to correct any type of administrative irregularity that they may have. Once registered in the program, the companies may enjoy a certain period of time without been audited or inspected by PROFEPA, as long as they provide and file the reports required under the self-audit program on a scheduled basis.

d) The National Water Commission. The National Water Commission (*Comisión National del Agua, CNA*) is the agency of the Mexican government in charge of administering and preserving the national waters with the participation of the community in order to assure the sustainable usage of this resource. This agency authorizes the usage of the national waters for industry as well as the discharge of waste or residual waters into federal reserve canals; and

e) Labor and Social Welfare Department. The Labor and Social Welfare Department (*Secretaría de Trabajo y Previsión Social*, STPS) is the agency responsible for regulating the labor relationships between employers and employees, and is also in charge of regulating the health and safety conditions all over the Mexican territory. Among other powers, it is empowered to grant permits, issue authorizations and verify the fulfillment of a company's obligations with respect to such health and safety matters.

3) Federal Prosecutor's Office (*Procuraduria Federal de la Republica, PGR*). This agency of the federal government is in charge of prosecuting any illegal activity of which the company is notified of by PROFEPA or any other agency, authority or concerned citizen. This agency is often used as the last resource to punish a person that has failed to comply with an environmental obligation where the non-compliance is so grave that the administrative measures otherwise available to be imposed on such person are inadequate.

4) Mexican Accreditation Entity (*Entidad Mexicana de Acreditacion EMA*). This entity was created in 1999 for the purpose of granting authorizations to evaluating entities, such as laboratories, verifying units, etc. The legal support for the creation and operation of EMA is found in i) the Federal Law on Metrology and Standardization; ii) the Regulations for the Federal Law on Metrology and Standardization; and iii) the Mexican Federal Official Gazette of January 15, 1999. It is important that any company doing business in Mexico that is obligated to obtain certain certifications, permits or licenses from a federal governmental agency and has the need to use a third party service provider makes sure that said third party has the proper EMA certification in order to provide such services. If the third party does not have proper certification, the Mexican agency may deny the request for a certification, permit or license.

5) Department of Communications and Transportation. This agency is responsible for enforcing the Regulations for the Land Transportation of Hazardous Materials and Hazardous Waste. These regulations along with the applicable NOMs dictate the requirements for the transportation of hazardous materials and waste outside the Mexican territory as well as the delivery of such waste to its final confinement within the Mexican territory. For the transportation of hazardous materials and waste it is necessary for the transportation company contracted for this purpose to have a special permit or license issued by the agency.

6) Health Environment Authorities. The Health Department (*Secretaría de Salud, SSA*), through its internal agencies, is the federal authority in charge of the health environment conditions all over the Mexican territory. On the State and Municipal level, the names of the authorities as well as the scope of their authority may vary from state to state and from city to city; therefore, it is very important to locate the city or state authority in charge of the health procedures in order to avoid problems such as fines.

7) State and Municipal Authorities. The names of the authorities as well as the scope of their authority may vary from state to state and

from city to city; therefore, it is very important to locate the city or state authority in charge of the environmental procedures in order to avoid any problems such as fines, partial or total shut downs and possible criminal sanctions. Additionally, state and municipal labor governmental entities have the authority on labor environment issues as auxiliaries of the STPS (*Secretaría del Trabajo y Prevision Social*, STPS).

B. Environmental Laws and Regulations.

General Law for Ecological Equilibrium and Environmental Protection (LGEEPA). This law implements (for regulatory purposes) certain provisions of the Mexican Constitution that reference the preservation and restoration of the ecological equilibrium, as well as the protection of the environment within the Mexican territory and those zones where Mexico exercises its jurisdiction and sovereignty.

The Mexican federation, the states, the Federal District and the municipalities exercise their authority for such purposes in accordance with the distribution and scope of authority prescribed in this law and other legal provisions.

This law establishes in a very detailed manner the scope of authority for each level, leaving to the states and municipalities most of the regulatory work. However, the federation can always use its authority to maintain jurisdiction over those cases that are important and relevant to the environment and society.

General Law for the Prevention and Integral Management of Waste (LGPGIR). This law addresses in a more detailed manner the way in which waste in general (not just hazardous waste) should be handled by companies and individuals. This law not only regulates the handling and management of waste at the federal level but also sets parameters for the scope of regulation that the states should consider when creating their own internal environmental laws and regulations to handle non-toxic waste.

Although the LGEEPA and the LGPGIR are not the only laws that regulate environmental matters, they are considered to be the most important since they cover most of the environmental obligations with respect to the environmental issues in Mexico.

For the sole purpose of assuring sustainable economic activities in Mexico, the Environmental Department issues the Official Mexican Standards (NOMS), which describe the technical aspects that certain activities should meet, set forth the obligations of industry in Mexico in the resolution of environmental problems, and encourage industries to reorient their production processes in order to avoid environmental problems, etc.

There are several environmental regulations that complement the Environmental Law. Such regulations are issued with respect to specific areas. The regulations that refer to industry and that are obligatory are the following:

1) Regulations for Environmental Impact Matters;
2) Regulations for the Prevention and Integral Management of Waste;
3) Regulations for the Prevention and Control of Atmospheric Pollution;
4) Regulations for Environmental Audit Matters;

5) Regulations for the Protection of the Environment with respect to Noise Pollution;

6) Regulations for the Land Transportation of Hazardous Materials and Hazardous Waste;

7) Regulation for the Registry of Emissions and Transferring of Pollutants; and

8) Regulation for the Ecological Codes

C. Start Up Environmental Procedures.

Companies must comply with the federal laws, regulations and NOMs in connection with their operations in Mexico. They must also comply with the laws, regulations and codes of the state and municipal authorities.

There are certain steps that a company must take prior to commencing operations. Some companies fail to obtain certain permits, licenses and authorizations that should have been obtained prior to commencing operations, deferring these responsibilities until after they have started their operations. In most of the cases they are obtained later without problems or repercussions for the companies. In some other cases, however, sanctions are imposed. Those sanctions may vary from a small fine, to a temporary or permanent partial or total shut down of operations, depending on the nature of the non-compliance and the type of industry or operation in question.

It is important to verify and determine whether the company is subject to the federal or state requirements before complying with the environmental procedures. Most of the time, the same procedure (i.e. MIA or IP described in paragraphs 1 and 2 below) requires different information, depending on whether the federal or state requirements apply. The information required may also vary from state to state. The authorizations necessary to be obtained before commencing operations are as follows:

1) Environmental Impact Statement. The Environmental Impact Statement (*Manifestación de Impacto Ambiental, MIA*), is a detailed report written by the company with respect to its contemplated industrial activity whereby the environmental impact that activity may cause will be determined. The LGEEPA gives SEMARNAT the authority to impose special conditions on a company in connection with the activities it will perform in a certain geographical area. These conditions are established based upon the information provided by the company in the MIA. The information contained in an environmental report will be verified by the inspectors appointed by the environmental agency; therefore, it is important that the information presented be true and correct. The sanction for turning in false or misleading information is a significant fine of varying degrees based on a multiple of the daily minimum wage of the region;

2) Preliminary Environmental Report. The Preliminary Environmental Report (*Informe Preventivo or IP*) is a more general report that basically summarizes the industrial activity to be performed by the company. It is intended to inform SEMARNAT of the possible ecological damage that the proposed industrial activity may cause to the environment. The

LGEEPA establishes the cases where an MIA is not needed and an IP may be filed instead with the environmental agency. In general terms, when a company establishes operations in an approved industrial park, the requirement of MIA can be avoided and an IP may be filed instead;

3) Industrial High Risk Study. Any company that wishes to start operations in an activity subject to federal jurisdiction because of the nature of the activity, such as certain chemical industries or hazardous waste management activities, needs to determine if this activity is considered to be "*high risk*". In order to determine this, it is necessary to consult the two listings issued by the environmental authority. Each of these two listings contains information with respect to the parameters applicable to substances that the company is handling. If a company exceeds the limits set forth in these listings, the activity is considered to be "*high risk*", and a study must be filed before the federal environmental authority. Several state environmental authorities also require high-risk industry type studies, with varying requirements.

   Additionally, once the company has determined that its contemplated activity involves a high-risk industry, it must prepare a program to prevent accidents and file it before the federal labor authorities (STPS);

4) Annual Operating Certificate. The Annual Operating Certificate (*Cédula de Operación Anual, COA*) is a document that must be filed with the federal authorities within the first four (4) months of every calendar year. It helps authorities to keep track of a company's various emissions. It also allows the company to provide updated information to the environmental authorities;

5) Sole Environmental License. The Sole Environmental License (*Licencia Ambiental Única, or LAU*) is required to be obtained by new industrial companies considered to be of federal jurisdiction with respect to the prevention and control of the contamination of the atmosphere. It is also applicable to those companies that are not in compliance and need to update their environmental information or need to be re-licensed.

   This license integrates in one document all the permits related to the following areas: environmental impact and risk, air emissions, hazardous wastes and permits relating to water resources. It is a one-time procedure that only needs to be updated through the COA. However, if the company is relocating or changes its industrial activity, a new license must be obtained.

   In regards to companies subject to state jurisdiction, it is important to refer to the local laws and regulations applicable to the state where its operations are located.

a) Hazardous Waste Materials. The law defines these materials as the elements, substances, compounds, waste or combination of them that, independently of their physical state, represent a risk towards the environment, health, or the natural resources, given their corrosive, reactive, explosive, toxic, inflammable or biological-infectious characteristics. The way the law explains it, hazardous waste and hazardous materials are the same thing.

In accordance with the environmental law the generator of the hazardous waste is the responsible party. The generator is also co-responsible along with the hazardous waste storage facility for proper final disposal of hazardous wastes.

On June 23, 2006, a new Official Mexican Standard, NOM-052-SEMARNAT-2005 (The NOM), was published in the Mexican Federal Official Gazette and became effective on September 21, 2006. This NOM establishes the characteristics and procedures for identification, classification and listing of hazardous waste.

All hazardous waste generated or located in Mexico regardless of its point of origin, its intended final treatment or disposal destination will be governed by this new NOM.

This NOM contains a set of definitions that are applicable to all environmental matters, five hazardous waste classification lists, two tables and one attachment.

The NOM, classifies a waste as hazardous if it appears in the following lists:

b) List 1: Classification of hazardous waste by specific source (Code E).

c) List 2: Classification of hazardous waste by non-specific source (Code NE).

d) List 3: Classification of hazardous waste resulting from disposal of out-of-specification or out-of-date chemical products (Code H, Acute Toxics).

e) List 4: Classification of hazardous waste resulting from disposal of out-of-specification or out-of date chemical products (Code T, Chronic Toxics).

f) List 5: Classification by type of waste, subject to Specific Management Conditions (Code RP).

This NOM establishes that if a waste does not appear in Lists 1 through 5 but it is regulated by another Official Mexican Standard (NOM), then the waste will be subject to the provisions of said NOM.

Wastes that are not located or do not fall into the criteria of other NOMS must be evaluated to

determine if they meet any of the hazardous characteristics described in this NOM, and that could be determined through the following steps:

a) Characterization or analysis of the waste according to the CRIT method, including the determination of Explosive and Biological-infectious characteristics;

b) Declaration made based upon scientific knowledge or the gathering of empirical information about the materials and processes used to generate the wastes such as:

   i) Generator is certain that the waste has any of the hazardous characteristics outlined in the NOM;

   ii) Generator is certain that the waste contains a toxic material that makes it hazardous; and

   iii) Generator states that the waste is not hazardous.

Table 1 describes the Waste Hazard Codes or CPR's corresponding to Corrosive, Reactive, Explosive, Flammable, Toxic (environmental, acute, and chronic), and Biological-infectious.

Table 2 lists the Maximum Permissible Limits for Toxic Constituents of the PECT (extraction test) extract for 40 substances, including metals, volatile and semi-volatile organic compounds.

The Attachment 1 of the NOM consists of a list of hazardous substances that classifies waste as hazardous under the Specific Source, and Non-specific Source categories based on their environmental, acute and chronic toxicity.

This NOM establishes a proceeding to obtain a Non-Hazardous Determination, which will result in less regulatory requirements for waste management and disposal. The NOM allows the generator to make a determination through the CRIT method or simply based on the generator's knowledge. Furthermore, the NOM will allow the generator to continue with its current practices regarding the hazardous waste management and disposal in Mexico.

6) Usage of Water and Discharge of Residual Waters. The first thing that a company that wishes to use water for human consumption, its production processes, or for any other purposes must do is investigate whether the source of such water is considered national water or water that belongs to the state or municipality. If the water to be used is distributed by the local water services then it belongs to the local authorities, however if the source of the water to be used is a well, a river, or any other national reservoir, then that water is considered national water.

If use of the local water system is intended, a request for the feasibility of use from the local water authorities must be submitted. Once an answer is given the company may sign the water service contract, pay the connection fees, set the meter, and start receiving the water. A discharge contract must also be executed with the authority in order to obtain the corresponding permit. This permit will impose specific conditions on the discharge of the wastewater. Among those conditions, an analysis of the residual waters may be requested, and sometimes a wastewater treatment system must be installed in order to discharge directly to the public sewer.

On the other hand, if the water to be used is considered national water, then several steps must be met before receiving the service as follows:

a) Obtain a concession from the federal authority for the usage of the national water;

b) Obtain a permit to discharge the residual waters in federal zones;

c) Obtain a concession to use federal zones where the infrastructure will be installed;

d) Obtain the proper permits to be allowed to construct the necessary infrastructure for the usage of the national waters.

The National Water Law and its regulations, as well as three NOMS, have set the rules for prevention of water pollution. NOM-001-SEMARNAT-1996 sets the maximum permissible limits of contaminants for the discharge of residual waters into the federal canals or reservoirs; NOM-002-SEMARNAT-1996 sets the parameters for discharges into the local sewer and NOM-003-SEMARNAT-1997, sets the maximum permissible limits of pollutants for treated residual waters to be re-used for the general public.

The companies using national waters must pay consumption fees as well as fees for discharging residual waters into federal canals or reservoirs.

7) Noise Emissions. In Mexico, noise pollution is also regulated through the LGEEPA and its regulations. The federal government sets the rules and criteria to be followed, however, in some cases they are executed by the state and municipal authorities. Most of the state authorities in Mexico delegate this function to the municipal authorities.

VIII. Industrial and Intellectual Property Issues

A. General Considerations.

Mexico's economic growth has been linked to a more adequate and effective protection of industrial property rights, supporting the promotion of foreign and national investment, innovation, technological development and transfer of technologies, and international trade.

As part of the opening of the Mexican Economy, specifically after the North America Free Trade Agreement (NAFTA) was adopted, the Mexican government carried out an extensive modification of the Industrial and Intellectual Property Laws, resulting in the current Industrial Property Law. The main objective of the Industrial Property Law was to harmonize Mexican legislation in accordance with the international legal framework, particularly with the NAFTA and the Trade related Aspects of Intellectual Property Rights Agreement (TRIPS). Moreover, it is very important to mention that the 1994 amendments consolidated the Mexican Intellectual Property Institute (IMPI) not only as an administrative authority to handle the system, but also as an administrative authority to prevent and sanction infringements of industrial property rights.

Mexico's Industrial Property Law recognizes and protects patents, utility models, industrial designs, industrial secrets, trademarks, collective trademarks, commercial slogans, trade names and appellations of origin, and it recognizes and protects copyrights.

B. Intellectual Property Rights Protected in Mexico.

1) Patents. A patent is a right granted to exclusively exploit an invention for a twenty year, non-renewable, period beginning from the date of filing the related application. To be patentable, an invention must meet the following requirements:

   a) It must be the result of an inventive activity not readily deduced from the state of the art or which may be evident or obvious to an expert in the subject matter;

   b) It must be capable of industrial application; and

   c) It must be a human creation which allows the transformation of matter or energy in a manner which may be used to satisfy a concrete need.

   All inventions that satisfy these conditions are patentable except for:

   a) Biological processes for production or reproduction of plants or animals;

   b) Biological or genetic material as found in nature;

   c) Animal breeds;

   d) The human body and the parts or organs thereof; and

   e) Vegetal varieties.

Mexican Law incorporates the first-to-file principle. Mexico is a party of, among others, the Paris Convention, and the Patent Cooperation Treaty, thus the date of filing a patent application in another country member is treated as the date of filing in Mexico.

There is no express obligation to work an invention, but the Law does provide that anyone may apply to the Institute of Industrial Property for a compulsory license if the patent is not worked within longer than three years following issuance of the patent application or four years following the filing of the application, provided the applicant or patentee has not worked it without a valid reason.

2) Utility Models. Utility models are objects, utensils, apparatus or tools that, as a result of a modification to their arrangement, configuration, structure or form, perform a different function with respect to the parts forming them or represent advantages with respect to the usefulness of said parts. Utility models may be registered before the IMPI if they are absolutely new and capable of industrial application. Protection is granted for a non-renewable term of ten years from the date of filing.

3) Industrial designs. Industrial designs include industrial drawings and models. Industrial drawings are any combination of figures, lines or colors incorporated to an industrial product as an ornament giving it a peculiar aspect of its own. Industrial models are three-dimensional models that serve as molds to manufacture industrial patterns giving a special appearance, provided they do not imply technical effects. Industrial designs may be registered before the Institute if they are new and are used as a type or mold to make industrial products. They are granted protection for fifteen non-renewable years.

4) Industrial secrets. Industrial secrets are defined as any information capable of industrial application maintained in confidence which may be useful to obtain or to maintain a competitive advantage in the performance of economic activities, the owner has taken measures to preserve confidence by labeling information as "confidential" "secret", or in a similar other manner. An industrial secret must necessarily relate to the nature, characteristics or purposes of products, production methods or processes, the means or forms of distribution or marketing of products, or the rendering of services.

Information in the public domain, information that may be obvious to an expert, or information that must be disclosed by law or by court order, is not considered an industrial secret. Any confidential information shall not be deemed to be in the public domain if the information is disclosed to any authority for the purpose of obtaining any permits, registries, authorizations or similar requirements. The protected information may be set forth in documents, electronic or magnetic

media, optical discs, microfilms, films or other similar instruments.

Industrial secrets may be transferred or licensed to third parties. Individuals with access to industrial secrets may not reveal them without justified cause or consent from the owner or licensee. Individuals or entities hiring employees, or contracting services from competitors, with the purpose of obtaining industrial secrets may be liable for damages. Individuals unlawfully obtaining industrial secrets may also be liable for damages.

5) Trademarks. A trademark is defined as a visible sign or symbol that distinguishes products or services from others of the same species or class in the marketplace. In Mexico, trademarks may be:

a) Nominative (word marks);

b) Design;

c) Nominative and Design; and

d) Three-dimensional.

Article 90 of the Industrial Property Law establishes the non-registrable trademarks, which, among others, include the following:

a) Words or designs which are not sufficiently distinctive;

b) The proper, technical or commonly used names of products or services as well as words which are the usual or generic designation of the products to be covered;

c) Descriptive names or designs;

d) Geographic names or any name designating the place of manufacture of products or rendering of services; names of places which are known for the manufacturing of certain products;

e) Names, figures or designs which are famous or well known (notorious) in Mexico;

f) Any name, form or design confusingly similar or identical to a previously applied for registered name, trade or service mark or design to cover the same products or services; and

g) The translation to other languages of non-registerable marks.

Trademarks and service marks must be registered in order to grant exclusive right of use thereof. As a general rule, registration is granted to the first applicant; however, the first user in Mexico or abroad has a preferential right to register. Trademarks may be registered for up to 10 renewable years from the date of filing of the registration application with the Institute. Use of a trademark may not be discontinued for more than three consecutive years without justification, otherwise the registration could expire.

Trade or service marks cover only specific goods or services within a

single class of products. There are no multiple class registrations.

a) Collective trademarks. Collective trademarks may be registered by legally incorporated associations of producers, manufacturers, business people or service providers in order to distinguish their products or services from those of non-members. A collective trademark may not be transferred to third parties, and its use is reserved for the members of the association.

b) Commercial slogans. Commercial slogans are phrases or legends that have the purpose of announcing businesses, commercial, industrial or service establishments to the public to easily distinguish them from others of their kind. Commercial Slogans may be registered for up to 10 renewable years from the date of filing of the registration application with the Institute

c) Trade names. Commercial names of companies and trade names of commercial, service or industrial establishments are protected without need for registration. The protection is granted in the geographic zone of the effective clientele of the company or establishment using the trade name, and may be extended throughout the country if there is massive and constant diffusion thereof at national level. A user may apply for publication of the trade name in the Gazette of the Institute thus establishing a presumption of good faith in the use of such name. The publication is valid for ten years and it may be renewed.

d) Appellations of origin. Appellations of origin are names of geographic regions used to designate a product that originates from said region, and whose qualities or characteristics stem exclusively from the region. Mexico is a party to the Lisbon Convention.

e) Copyright. According to the Mexican Copyright Law the following works may be protected as copyrights:

Literary works, musical with or without letter, dramatic, dance, picture or drawing, sculpture or plastic, cartoon, architectonic, cinematographic, audiovisual, radio and television programs, computer software (data bases are included, but software created to produce harmful effects to other software or hardware is excluded from copyright protection), photographic, of compilation, provided they constitute intellectual creations.

As mentioned, databases are also copyrightable as compilations, as far as the selection and arrangement of their data constitute intellectual creations. This protection is not bestowed to the data itself or to the material contained therein. Non-original databases shall be protected only for 5 years, while copyrightable works will be protected during the author's life plus 75 years. The Copyright law also comprises another figure called "reserve", which is not a registration, but a mere reservation, and does not contain the same degree of creativeness as an intellectual work. The reserves can be obtained for i) titles of periodical publications, ii) advertising promotions, ii) human characterization or fictitious characters, iii) periodical publications, iv) names of persons or groups engaged in artistic activities, etc.