



INVESTMENT LEGAL FRAMEWORK IN MEXICO

I. DIRECT INVESTMENT

A. COMMON FORMS (Choice of Business Entity)

Mexican and foreign investors, both private and public, may invest in Mexico through different vehicles.

It is important to analyze tax advantages, relationships with the parent company, need of technical assistance and technology, availability of deductions, type and size of market, competitors, suppliers, importance of imports and exports, projected business and financial plan including growth expectations, as well as limitation of liability and other similar factors, before choosing an appropriate vehicle or structure.

B. PURCHASE OF STOCK OR ASSETS.

Investors may purchase stock or assets of an existing company, which will enable them to enter into the Mexican market immediately, taking advantage of the existing operation and its infrastructure.

The first consideration of a foreign investor desiring to purchase shares should be possible restrictions on the purchase of assets or stock in a given activity as provided by Foreign Investment Law (FIL) or bilateral or multilateral agreements on trade and investment, i.e., NAFTA. The Competition Law may also impact the proposed purchase of shares or assets over a given threshold level.

Other corporate concerns should also be addressed. For example, the investor should analyze possible methods of financing the transaction. There also may be restrictive rights of first refusal or other limits on transfer in the charter or by virtue of a shareholders agreement, or the shares may be encumbered or pledged.

Apart from these and other concerns, a standard due diligence investigation should be conducted on, among other things, possible labor and tax liabilities; outstanding loans, liens or encumbrances on the company and/or its assets; rights of employees, i.e., seniority and fringe benefits; zoning or environmental problems; consumer protection considerations; standards (NOMS) and labeling concerns; export or import programs and related permits; intellectual property rights; immigration considerations; and contracts or leases.

The decision of whether to purchase shares or assets should also be analyzed from a tax perspective.

The acquisition of an ongoing business (assets and employees) entails the concept of "employer substitution" for labor purposes. The purchaser of the business becomes liable with the former employer for all labor compensations and obligations for a period of six months counted as of the date of notification of the substitution to the employees or to the union. After the six-month period only the new employer will be liable.

C. TAXES IMPOSED ON TRANSFER OF ASSETS OR STOCK:

A corporation that realizes profits derived from the sale of assets or shares (often referred to as "capital gains," although such income classification does not exist in Mexican law) is subject to tax on the profit obtained. The tax depends on the legal status of the seller. A Mexican corporation that realizes gains as a result of sale of assets or shares will include the proceeds of the sale with income derived from other sources and will pay tax at the rate of 35 percent on the total income less allowable deductions.

In case of sale of shares, whether seller is a Mexican individual or a foreign resident, company or individual, such sale is subject to payment of income tax at the rate of 20 percent of the total price, without any deduction. In some cases the purchaser who is jointly liable for such withholding must withhold such tax. The seller may, however, elect to pay an alternate tax (40 percent on the taxable profit) if certain requisites are fulfilled. Several tax treaties between Mexico and other countries contain different provisions on those transfers.

In case of a sale of assets, special attention should be given to the price at which each of the assets is sold to avoid tax problems resulting from application of transfer pricing rules, and prices should reflect market values. It should also be noted that goodwill is not deductible for income tax purposes.

The sale of shares through the Mexican stock market is a non-taxable operation.

D. REGISTRATION OF A BRANCH.

The investors may decide to open a branch of the parent company to simplify communication and accounting and consolidate advantages between the branch and the parent company.

1. GENERAL STATUS OF BRANCHES

There are no income tax advantages to operate through a branch rather than through a subsidiary. On the contrary, from a liability point of view, a foreign corporation acting in Mexico through a branch is not a separate legal entity therefore the foreign company may be liable for the branches obligations. A parent company is a separate legal entity, unlike a branch, and therefore, it has no liability for acts of its subsidiary.

2. APPROVAL REQUIREMENTS

As of the amendments to the FIL of December 24, 1996, a foreign company must obtain approval from the Ministry of Commerce to assure that the following requirements are being complied with:

- i) Said entities must prove their legal incorporation in their country.
- ii) The charter and bylaws of said foreign entities must not be against Mexican public policy.
- iii) The entity must have a legal representative located in Mexico to act on behalf of the foreign company.

The Ministry of Commerce has 15 working days to issue a ruling regarding the above-mentioned authorization. Lack of decision shall be considered as an approval. Upon obtaining authorization, a branch must register at the Registry of Foreign Investment.

Thereafter, the foreign company must file at the Public Registry of Commerce the charter and by-laws, a document detailing the location and its specific business activities, and the authorization from the Ministry of Commerce.

If a foreign company performs commercial activities in Mexico without having obtained prior approval, the Ministry of Commerce may impose a fine from 500 to 1,000 times the minimum salary.

Branches cannot operate in activities requiring Mexican participation, as required in certain activities under FIL.

3. TAXES.

Branches of foreign corporations have the same tax obligations as Mexican companies. Branches are considered "permanent establishments" for tax purposes and are not subject to any additional taxes to those paid by Mexican corporations.

However, there is an important disadvantage with respect to deductions. As a general rule the branch may deduct those expenses, which correspond to its activities in Mexico, but not remittances made by the branch to the parent company, or another establishment of the parent company abroad. These remittances are not deductible even if they are made as royalties, fees or similar payments, or as commissions for specific services or for services rendered, or for interest payments for money sent to the branch. On the other hand, the permanent establishment in Mexico is allowed to deduct an allocation of expenses incurred by the parent company or any other of its establishments abroad when such expenses relate to the Mexican branch.

E. REGISTRATION OF A REPRESENTATIVE OFFICE WITHOUT INCOME.

Frequently, foreign investors act as intermediaries or engage in promotion or similar activities in Mexico, from which they will not obtain income. Therefore, they may decide not to register a branch but only a representative office without income.

At present FIL provides that foreign companies with no income wishing to establish in Mexico must obtain prior authorization from the Ministry of Commerce and must register at the Registry of Foreign Investment.

Whether a representative office without income in fact performs commercial activities, i.e., intermediation, and therefore should request authorization from the Ministry of Commerce to open a branch and register subsequently in the Public Registry of Commerce, is still subject to differences of opinion.

F. JOINT VENTURE COMPANIES.

Foreign investors may enter into a business together with other persons or companies which often, in a generic way, is called a joint venture, which may either provide for a joint venture company or a joint venture agreement.

a) "Joint venture company

Various persons may decide to incorporate a joint venture company to take advantage of the partners' knowledge of the Mexican business and industrial sectors, and to join efforts by bringing capital, technical assistance and technology together. The new entity or entities, formed or restructured company or companies, will be used precisely for the purpose determined, for example, to commercialize products, render services, or build infrastructure.

Each one of the shareholders, or partners, of the new or restructured entities may contribute capital, goods, services, and technology, thus enabling them by their efforts and knowledge to comply with the corporate purposes. The new or restructured entity or entities will be a Mexican company, operating in accordance with the type of company chosen, will pay taxes and comply with its obligations as a normal company. The types of entities they may form are analyzed below.

b) "Co-Investment agreement" (*Asociación en Participación*).

If the parties to a project decide not to engage in the cost of creating a new company, but prefer to execute an agreement of "asociación en participación" by which they agree to join efforts for a specific purpose, when the identity of only one of the partners holds himself out before third parties (active partner), and the other is what often is referred to as a silent partner, contributing to the execution of the agreement with capital, services or otherwise. The parties will agree on how to distribute profits or share the losses derived from the operation.

Responsibility before third parties will be that of the active partner; but he will share responsibility with the silent partner if the agreement so provides. Therefore, there will not be any relationship between the silent partner and third parties.

Upon completion of the work or the desired objective the agreement will terminate. Such an agreement does not create a new entity, and each of the parties is liable to the other, without liability limits, as per undertakings in the contract.

The active partner is responsible for compliance with the joint venture's tax obligations, including registration with the Taxpayers' Registry and making required tax payments. For tax purposes, a joint venture is treated as a separate taxable entity from the joint venture partners. In the accounting for the joint venture, the active partner must keep the joint venture income separate from any other income or business activities he may have, and must file separate tax returns for the venture. Profits distributed to partners are treated as dividends, and deductions are not passed through to the partners.

G. CREATION OF A SUBSIDIARY.

For a variety of commercial and legal reasons and advantages, foreign investors may prefer to incorporate a new company in Mexico, enabling them to limit their liability, as the activities of the subsidiary are legally independent from those of the parent company.

1. GENERAL COMMENTS

The Companies Law requires that any company be legally incorporated and registered in the Public Registry of Commerce. The representatives of a non-registered company who enter into operations with third parties will be liable for the execution of the obligations assumed, jointly and severally, without limitation.

A non-incorporated or non-registered company can obtain government contracts, sometimes with the commitment to incorporate thereafter. From a practical viewpoint, however, a non-incorporated company will be unable to, among other things, hire local workers, open a bank account, import equipment, obtain work permits or import or export materials. Moreover, it will not have a tax number which will make conducting business transactions virtually impossible.

There are no financing restrictions on foreign-owned Mexican companies, i.e., required debt/equity ratio. Foreign companies may freely grant financing to companies or individuals resident in Mexico. Also, intercompany agreements, such as licenses, rental agreements and technical assistance agreements, are permitted.

Incorporation and registration costs vary depending on the complexity of the proposed structure and the type of investment method chosen. The time to incorporate may run from one to four weeks depending on availability of necessary documentation and the domicile of the company.

Business entities must comply, among others, with water, environmental, tax, federal housing, labor, health, consumer protection and social security regulations, among others.

II SUBSIDIARIES AND COMPANIES

Two laws, the federal Companies Law and the local Civil Code of the respective states, govern business entities. As discussed below, certain sectors are subject to foreign participation limitations. Another type of company with a different purpose, the cooperative company, is subject to specific regulation.

Professional partnerships are often organized as companies formed under civil, rather than commercial, law. A company formed in this way is called a civil company (*sociedad civil*—SC).

A. TYPES OF MERCANTILE COMPANIES

All these business forms possess a legal identity distinct from that of their members.

Stock corporations are generally the vehicles for foreign and national investments in Mexico, the most common of which is the Sociedad Anónima (S.A.). The S.A. may have fixed or variable capital, in which case the acronym "S.A." becomes "S.A. de C.V."

Any legal entity may adopt the variable capital form, and may increase and decrease its capital after incorporation pursuant to the conditions provided for in the charter and the law.

In most companies the minimum capital is fixed by law, and generally, the variable capital is unlimited. Companies may increase the capital to be subscribed by the shareholders or partners, which shall be paid in the time periods provided for in the charter or in the law. In the event shares are issued, but are not subscribed, they will be held by the company to be delivered after the subscription is paid.

The types of business entities provided for in the Companies Law are the following:

1. "SOCIEDAD EN NOMBRE COLECTIVO."

"Sociedad en nombre colectivo" is similar to a partnership, in which the partners are ultimately and unlimitedly liable for the company's obligations, jointly and severally.

2. "SOCIEDAD EN COMANDITA SIMPLE" AND "SOCIEDAD EN COMANDITA POR ACCIONES "

"Sociedad en comandita simple" and "sociedad en comandita por acciones," are similar to limited liability partnerships (L.L.C.). These types of companies have one or more general partners who will be ultimately unlimitedly liable for the company's obligations, jointly and severally, with one or more partners having limited liability, who are only liable for the payment of their contributions. In the "sociedad en comandita por acciones" the capital will be divided into shares which represent the rights and obligations of each one of the partners. Such shares cannot be assigned without the agreement of all of the partners with unlimited liability and with the agreement of two-thirds of the other partners.

3. "SOCIEDAD DE RESPONSABILIDAD LIMITADA."

"Sociedad de responsabilidad limitada" (S.R.L.) is similar to a limited liability company, although not currently commonly used, this company may be incorporated with a minimum capital of \$3,000 pesos (whereas an S.A. requires \$50,000 pesos) and the partners' liability is limited to the amount of

their contribution. This type of company is oriented toward the personal capacities of its partners. Therefore, to assign or transfer partnership interests as well as to admit new partners, the consent of partners representing the majority of the capital is necessary, except when the charter provides for a higher percentage. If the assignment or transfer of partners' interests is to a third party, the other partners have a right of first refusal to acquire the partnership interest.

Since the S.R.L. appears to be similar to limited liability partnerships in the United States (L.L.C.); some observers comment that they may be considered partnerships for U.S. tax purposes.

4 "SOCIEDAD ANÓNIMA".

GENERAL COMMENTS.

The minimum number of shareholders required is two, with no maximum limit.

The S.A. provides limited liability to its shareholders. A sole administrator or board of directors may manage the corporation. The shareholders are the ultimate decision-making body of the corporation. Shareholders may call ordinary or extraordinary meetings, in certain cases under the law or as provided in the charter. The statutory quorum for shareholder meetings is one-half of the outstanding shares for ordinary meetings and three-fourths of the outstanding shares for extraordinary meetings.

The capital of an S.A. is provided by shareholders, whose liability is limited to the face value of their shares (the unpaid as well as the paid portions). Most investors use this form, although the S.A. de C.V. form has become popular in recent years.

a. FORMATION.

The fixed or normal requirements for establishing a Mexican corporation with fixed or variable capital are as follows:

At least two founder shareholders are required. This minimum number of shareholders must always be maintained.

An organization or general formation meeting of shareholders must be held to adopt the draft articles of incorporation, appoint board members and managers, and conduct other related business. Instead of traveling to Mexico for this meeting, founder shareholders may act through representatives in Mexico.

The founder shareholders in the presence of a notary public must sign the articles of incorporation, the minutes of the first shareholders' meeting, and other corporate documents. An application for registration, together with the corporate documents, must be submitted to the Public Registry of Commerce. This registration brings the corporation formally into existence.

The official domicile (registered address or legal seat) must be in Mexico.

Formation by public subscription involves a number of additional formalities.

An attorney usually handles formation procedures.

Incorporation costs vary, depending on the amount of capital and complexity of corporate structure, but the minimum cost is US\$3,000 to US\$5,000. The formation process takes from three to four weeks.

b Capital.

The minimum paid-in capital is Ps\$50,000. All shares must be in registered form. At least 20% of the issued capital must be paid in on subscription. The balance may remain unpaid for several years, but the shareholders will remain liable for any unpaid balance. Issued capital must be fully subscribed within one year of issue. Additional shares may not be issued until the existing shares are fully paid for. Shares issued for a consideration other than cash must be treated as fully paid. Noncash consideration for shares does not have to be independently valued, but the shares must be deposited with the corporation for two years to ensure that the shareholder's own valuation is a fair one. Shares can even be issued in exchange for personal services. An increase of capital requires the amendment of the articles of incorporation, except in the case of an S.A. de C.V.. Capital is often increased by capitalizing undistributed earnings and issuing new shares (a stock dividend or stock split). Capital may also be increased by the capitalization of revaluation surpluses, provided that the revaluations are supported by appraisals made by credit institutions, certified public brokers, or independent experts authorized by the Treasury Department.

c Legal Reserve.

Each year, 5% of a corporation's net earnings after taxes must be appropriated to a legal reserve. These appropriations may be discontinued when the reserve equals 20% of stated capital. The legal reserve may not be distributed as dividends.

d Management.

Shareholders may appoint either a sole administrator or two or more directors to function as a board of directors. A sole administrator is normally found only in small, closely held companies. The initial directors are appointed at the organization meeting. Shareholders may remove an administrator or director at any time with or without cause. Directors of a board are not required to be Mexican citizens, although foreign membership must generally be proportionate to foreign shareholdings.

General and special managers may be appointed at a general shareholders' meeting or by the board of directors to handle day-to-day operations.

Administrators individually and directors jointly and severally are responsible to the corporation for ensuring that shareholders' capital contributions recorded in the books are actually made. They are also responsible for the legality of dividends paid, maintenance of accounting records, and execution of shareholders' resolutions.

Foreigners, residents or non-residents, may be members of the board of directors. Meetings of the board of directors need not take place in Mexico, however, shareholders meetings must be held at the corporate domicile.

Resolutions adopted by directors or shareholders outside of a meeting, by unanimous vote of all of the directors or the shareholders of the company, by telephone or in any other manner, shall be valid as long as the resolutions so adopted are confirmed in writing and the charter so provides.

The shareholders must appoint at least one examiner whose responsibility is to oversee the administration of the company on behalf of the shareholders. The examiner may be any person except the directors of the company, their relatives or employees.

e. Shareholders' Meetings and Votes.

Shareholders' meetings may be held at any time, but the administrator, directors, or others must call them at least once a year, no later than four months after the close of the fiscal year. Meetings must be held at the corporation's domicile. Shareholders may vote by proxy.

In general, all shares carry the same voting rights. However, special classes of shares can be issued, such as preferential shares. Preferential shares carry the right to an accruable fixed dividend, but the holders of the shares can vote only at extraordinary meetings. A quorum at an ordinary or regular shareholders' meeting consists of shareholders owning at least one-half of the issued shares who are either present in person or represented by proxy. Resolutions can be approved by a simple majority of the shares represented. If a quorum is not available at the meeting, a second meeting must be called. At that second meeting, those shareholders present constitute the required quorum.

The articles of incorporation can be amended by resolution at an extraordinary shareholders' meeting. When approval is required of shareholders representing at least 50% of the issued shares, the quorum requirement is increased from at least one-half to at least three-fourths.

f. Publication of Information.

Every corporation must deposit a copy of its articles of incorporation and other corporate documents at the Public Registry of Commerce. Any amendments to these documents must be reported to the registry.

A corporation is required to publish its annual balance sheet in the official gazette of the state in which it is located (or if the corporation has locations in more than one state, in that of the federal government) fifteen days after its approval at the general shareholders' meeting. An S.A. de C.V. is not required to file copies of its annual financial statements at the Public Registry of Commerce. An S.A. de C.V. must display its name and registered address on its letterhead and other documentation.

An S.A. de C.V. may increase or decrease its capital without changing its articles of incorporation. Since this option saves time and money, the S.A. de C.V. is becoming more common. If capital changes, the proportion of shares held by foreign investors must not increase. The minimum authorized capital for such a corporation is Ps\$50,000. Increases and decreases in capital must be recorded in a register kept by the company for this purpose.

Shares must be in registered form. The rules applying to the S.A. also apply in general to the S.A. de C.V..

g. Incorporation and registration requirements

The incorporation and registration procedure herein mentioned applies to all types of commercial companies.

To incorporate a company the shareholders have to agree on a proposed charter and by-laws and must request prior authorization from the Ministry of Foreign Affairs for the use of the proposed corporate name. A Public Notary must protocolize these documents. Foreign shareholders shall grant a power of attorney to a resident in Mexico to represent them before the Public Notary for such purpose.

The public instrument issued by the Notary shall be registered at the Public Registry of Commerce of the domicile of the company. Other corporate documents, such as minutes of shareholder meetings, amendments to the charter and by-laws and general powers of attorney must also be recorded.

A newly-formed company shall register at the Taxpayers' Registry, as well as with other relevant federal or local agencies, depending on the nature of the business.

Under Mexican law, attorneys-in-fact acting for a company must be granted specific powers of attorney. Since there is no concept of "apparent or implied powers," such powers should be granted in the charter, or by specific resolution of the shareholders, the board, or by substitution and delegation from an attorney-in-fact.

The Civil Code provides for powers of attorney for lawsuits and collections, acts of administration and acts of dominion. Each power may be general or special, limited or unlimited, with respect to amounts or authority or term. To issue credit instruments, the Law on Credit Instruments requires that the attorney-in-fact be vested with a specific power for such purpose.

Any person acting on behalf of the company without such powers does not bind the company and becomes personally liable to the company and to third parties.

Directors, acting individually, may also have powers if granted by charter or specific resolution of shareholders. Directors resident abroad may act as such and exercise powers abroad. If they act as directors or exercise the power in Mexico, they must have proper immigration status.

III. Associations

The Civil Codes of the states of Mexico generally follow the Civil Code of the Federal District, which provides for two types of civil associations: the "asociación civil" (A.C.) in which the partners decide to carry out a common purpose not prohibited by law and without a preponderantly economic objective; and the "sociedad civil" (S.C.) by which the partners join their resources and efforts to achieve a common purpose, which might have an economic objective but which should not have profit as its primary motive.

Associations are incorporated following a procedure similar to that of commercial companies.

IV. MERGER, TRANSFORMATION AND DISSOLUTION OF BUSINESS ENTITIES

The Companies Law provides for several cases of dissolution of business entities, including dissolution and liquidation, merger, transformation and split-off.

Another form of extinction of a business entity is a consequence of bankruptcy proceeding.

A DISSOLUTION AND LIQUIDATION

Legal causes for dissolution

The Companies Law contains five causes for dissolution of business entities:

- a) expiration of the term provided for in the company's charter;
- b) impossibility to realize the principal purpose of the company as per corporate charter, or completion of said purpose;
- c) the agreement of all of the partners or shareholders adopted in accordance with the company's charter and the law;
- d) reduction of the number of partners or shareholders to less than the minimum provided for by law or ownership of all partnership interests or shares by one person; and
- e) loss of two-thirds of the capital stock.

Once the company has evidence of the existence of the causes of dissolution, the administrators should call for a general shareholders or partners meeting in order that this situation be noted and the proper measures taken. Although the law seems to call for an automatic dissolution, in practice there is no such automatic procedure. The partners or shareholders shall adopt a resolution at a meeting which will be recorded in the Public Registry of Commerce. The legal personality of the company continues until final liquidation. The auditors of the company will usually put a note on the balance sheet of the company reporting the cause of dissolution.

If the registration is not made, even though the cause for dissolution exists, any interested party may appear before the judicial authority in a summary proceeding in order that said authority orders the registration of the cause for dissolution.

The directors or administrators of the company should not engage in new operations after the expiration of the term of the company, after the resolution of dissolution, or after having evidence of the existence of a cause of dissolution. If they breach these prohibitions, they may be jointly liable for the operations they perform.

B. LIQUIDATION.

After the partners or shareholders have agreed to the dissolution of the company, the company shall be liquidated. The liquidation shall be in charge of one or more liquidators who will be the legal representatives of the company and will be liable for the acts performed that exceed their authority. The partners or shareholders, by unanimous vote, should appoint the liquidators when approving the dissolution. The administrators of the company shall continue to discharge their duties until the designation of the liquidators is recorded in the Public Registry of Commerce.

Among the duties of the liquidators are the following: to conclude the operations of the company pending at the time of the dissolution, to collect all amounts due to the company and to pay its liabilities, and to sell the goods of the company.

The liquidators shall prepare a final balance sheet in which they determine the amount corresponding to each partner or shareholder of the remaining capital account. The final balance sheet of liquidation shall be published three times once every ten days in the Official Daily Gazette of the company's domicile. The shareholders may present their claims to the liquidators within the following 15 days counted from the date of the publication. After this term is over, the liquidators will call a general shareholders meeting for final approval of the balance sheet. Once the balance sheet is approved the liquidators will pay each partner or shareholder the corresponding amounts against cancellation of their share certificates and will proceed with the cancellation of the registration of the company at the Public Registry of Commerce once the liquidation is concluded.

Liquidation in kind is possible and may include assets such as patents and trademarks to which the shareholders may have attached a value.

1. TAX CONSEQUENCES.

Within the month following the date of termination of the liquidation, the liquidator shall file the final tax return of the fiscal year of liquidation. If the total liquidation of the assets cannot be terminated within the six months following the date in which the company started its liquidation process, the liquidator shall file tax returns every six months until total liquidation of the assets.

The liquidator must request the cancellation of the registration of the company at the Taxpayer's Registry. The amounts received by the shareholders as reimbursement of capital will be tax free, as long as they are paid out of the net taxed profit account.

Liquidators are jointly liable for tax amounts which should have been paid on behalf of the company during the liquidation process, except if the company filed all notices and information in accordance with and as provided by law.

2. LABOR CONSEQUENCES.

The liquidator shall have to pay the workers compensation calculated in the same terms as for termination of the labor relationship.

Provisions of the Labor Law contemplate the right of employers to demand the termination of the collective labor contract and of work relationships by bringing an action before the competent board of conciliation and arbitration when there are justified causes, including any clear evidence of unprofitability in the operation.

The purpose of formally notifying the labor board is to establish a basis for negotiation with the union or the workers, to pay a reduced compensation to the workers. If the union or workers object to said negotiation, they have the right to request payment of the total indemnity calculated on the basis of their "integrated" salary.

C. MERGER AND TRANSFORMATION

The merger of companies should be approved by an extraordinary shareholders meeting of each company and the resolution of merger should be recorded in the Public Registry of Commerce and published in the Official Daily Gazette of the domicile of each merging company. Each company shall publish its last balance sheet and those companies that are merged into the surviving company should also publish the manner in which their liabilities will be satisfied.

The merger will produce effects three months after the registration of the merger resolution in the Public Registry of Commerce giving creditors of the merged companies the opportunity to oppose such merger, in which case, the merger may be suspended upon court resolution recognizing the opposition.

Upon expiration of the three-month period the merger becomes effective; the surviving company or the newly-created company shall acquire all rights and obligations of the merged companies.

However, the merger may produce effects upon the registration at the Public Registry of Commerce if: 1. the surviving company agrees to pay all liabilities of the merged companies, or 2. the amounts owed are deposited in a bank, or 3. the creditors have granted their consent to the merger.

A business entity may change its legal form to another type of company by following the same procedure as herein mentioned, i.e., a S.R.L. or S.C. to S.A.

1. TAX CONSEQUENCES.

The merger of companies shall produce the following tax effects:

a) The surviving company shall present a notice of merger to the tax authorities within the month following the date of the merger.

b) It is necessary to present notices of cancellation of the registration at the Taxpayers' Registry for each merged company, attaching copy of the minutes of the shareholders meeting containing the resolution of merger. The merger of companies entails the obligation to audit the financial statements of the surviving company and of the merged company by an independent public accountant.

c) The surviving company shall present the last annual tax return of the merged company.

d) The Income Tax Law does not consider for income tax purposes that a merger produces transfer of property among the surviving company and the merged companies if the surviving company complies with the obligation mentioned in the previous paragraphs.

e) If real estate is transferred as a consequence of the merger, the surviving or newly-created company shall pay the Real Estate Acquisition Tax at the rate prevailing in each state, which currently throughout Mexico is between 2 percent and 4 percent on the value of the property.

f) No VAT shall be paid in connection with property transferred as a result of a merger of companies. The balance of the Net Taxed Profit Account and of the Net Taxed Reinvested Profit Account of the merged company may be transferred to the surviving or newly-created company. Fiscal losses pending amortization in the merged company are not transferable to the surviving company.

2. LABOR CONSEQUENCES.

A merger entails the transmission of an economic entity, therefore, for labor purposes, a substitution of employer takes place.

3. INDUSTRIAL PROPERTY.

The Industrial Property Law considers that a transmission of the rights on registered patents and trademarks takes place as a result of the merger of companies, unless the parties agree otherwise or the existing licenses prohibit such transfer. It is necessary to register the resolutions of merger at the Mexican Institute of Industrial Property for legal recognition of the new authorized user or owner of patents or trademarks.

D. SPLIT-OFF

A split-off takes place: 1. when a company, without continuing in existence, transfers all or part of its assets, liabilities and capital stock to one or more new companies; or, 2. when the company transfers part of its assets, liabilities and capital stock to one or more new companies and continues in existence.

A split-off can only be agreed by resolution of the partners' or shareholders' meeting adopted by the majority required for the modification of its charter.

Each one of the shareholders or partners of the original companies must have the same proportion in the capital of the new companies as they had in the original company.

The resolution approving the split-off must contain a description of the terms and mechanisms for the transfer of the assets, liabilities and capital that correspond to each new company. The original company must present audited financial statements. Also, the obligations to be assumed by each new company must be determined.

If any of the new companies breaches any of the obligations assumed by virtue of the split-off to creditors who did not approve said split-off, the original and other new companies shall be jointly liable for a three-year period counted as of the publications mentioned hereinafter. If the original company

continues in existence it will be liable for all obligations until the statute of limitations periods expire for each obligation, usually between five and 10 years.

The resolutions approving the split-off must be registered with a Public Notary and recorded in the Public Registry of Commerce.

Also, an extract of said resolution must be published in the Official Daily Gazette and in one newspaper of wide circulation at the domicile of the original company together with a summary of the information regarding transmission of assets, liability and capital stock. After a period of 45 days counted as of the registration in the Public Registry of Commerce and after the publication, without any opposition from creditors or from shareholders, the split-off will produce full effects. For the creation of new companies it will be necessary to register their charter with a Public Notary and to register it in the Public Registry of Commerce.

If the split-off entails the extinction of the original company, its registration will be cancelled from the Public Registry of Commerce, once the split-off becomes effective.

1. TAX CONSEQUENCES.

The Tax Code considers that there is no transfer of property in a split-off as long as the shareholders of at least 51 percent of the shares with a voting right of the original and new companies did not change in the year prior to and the year following the notice of the split-off presented to the tax authorities.

Tax losses pending amortization may be divided between the original and the new companies in proportion to the division of capital. The balance of the capital account and the net taxed profit account may be transferred proportionally by the split-off as well as the right to credit VAT.

The exemption to newly formed companies of the 1.8 percent Asset Tax is not applicable in this case.

A local Real Estate Acquisition Tax between 2 percent and 4 percent must be paid in connection with a transfer of real estate property as a consequence of split-off.

2. LABOR CONSEQUENCES.

Work relationships will be affected as the employer will change. The employee rights and obligations cannot be modified as a consequence of the split-off. Such rights and obligations continue against the original company and/or the new companies, the latter as substitute employer.

3. INDUSTRIAL PROPERTY.

Any industrial property rights or related licenses should be modified to reflect the change in ownership or right to use.

V- FOREIGN INVESTMENT LAW

Foreign Investment Law (FIL) establishes, as a general rule, which foreign investors may hold 100 percent of the capital stock of any Mexican corporation or partnership, except in those few areas expressly subject to limitations under the FIL. FIL grants all investors from NAFTA and non-NAFTA countries the same investment treatment in Mexico. In certain activities limited by FIL, investors from NAFTA countries enjoy greater access, as provided in NAFTA. There has been dynamic liberalization of previous restrictions in FIL by modification of various specific laws, applicable generally, as well as to specific provisions in NAFTA applicable to NAFTA Parties. To attract further flows of capital, changes have been accelerating to allow even greater foreign capital participation, for example, in railroad services, ports, airports, telecommunications, and certain financial services.

The following are the major categories of limitations on foreign investment contained in FIL. Where applicable, NAFTA provisions relevant to each sector are noted as well.

A. ACTIVITIES RESERVED FOR THE STATE.

The constitutionally-defined "strategic activities" continuing to be reserved exclusively for the State are the following, as per Article 5 of FIL:

- a) oil production and oil refining;
- b) basic petrochemical production;
- c) sale of electricity to the public (see Section XI.A.2.);
- d) nuclear power;
- e) telegraph and radiotelegraph services;
- f) local postal service;
- g) bill issuance and coin minting; and
- h) control, supervision and surveillance of ports, airports and heliports.

Consistent with FIL, Mexico has reserved these activities from NAFTA application.

B. ACTIVITIES RESERVED FOR MEXICAN INVESTORS.

Article 6 of FIL reserves the following activities of the Mexican economy for national investors:

- a. domestic land transportation of passengers, tourists and cargo not including passenger, or package delivery services;
- b. retail gasoline sale, and distribution of liquefied petroleum gas.
- c. radio broadcasting and television services (except cable television);

- d. credit unions;
- e. development banks;
- f. professional and technical services expressly defined by the applicable legal provisions;
- g. As of December 18, 1995, Transitory Article Sixth included activities of international land transportation of passengers, tourists and cargo between points in Mexican territory, and services of administration of central stations for passenger and auxiliary automotive service vehicles.

Foreign investment may participate up to 49 percent in the capital stock of Mexican companies operating in these areas. Beginning January 1, 2001 foreign investment may reach up to 51 percent in the capital stock of Mexican companies; and beginning January 1, 2004, up to 100 percent.

C. ACTIVITIES SUBJECT TO SPECIFIC PARTICIPATION PERCENTAGE.

Article 7 of FIL establishes the following three categories where foreign investment is authorized up to 10 percent, 25 percent, and 49 percent:

- a) 10 percent in cooperative production companies;
- b) 25 percent in domestic and specialized air transportation and air shuttle services;
- c) 49 percent, which is the most extensive category, includes the following activities:
 - i) insurance and bonding institutions, currency exchange houses, general deposit warehouses, financial leasing and factoring companies, special purpose financial companies (non-bank banks), companies mentioned in Article 12-Bis of the Securities Market Law which handle security portfolios in the name of third parties, investment companies' fixed capital and companies operating investment companies;
 - ii) manufacture and commercialization of explosives, firearms, cartridges, munitions and fireworks, excluding their acquisition and use for industrial or extractive activities, or the production of explosive mixtures for use in these activities;
 - iii) printing and publication of newspapers for circulation exclusively in Mexico;
 - iv) ownership of series "T" shares of companies that own agricultural, cattle-raising or timber land;
 - vi) fishing in fresh water, along the coast and in the exclusive economic zone, except aquaculture;
 - vii) integral port administration, piloting port services for interior navigation operations, shipping companies commercially using vessels for interior and coastal navigation, except for tourist cruise ships and for use of dredges and naval devices for port construction, conservation and operation;

viii) supply of fuel and lubricants for ships, aircraft and railway equipment; and

ix) Transitory Article Seventh of FIL establishes that as of January 1, 1999, 100 percent foreign investment is allowed in the manufacture and assembly of auto parts for the automotive industry without the requirement of prior authorization.

D. MAJORITY INTEREST UPON APPROVAL.

Finally FIL in Article 8 establishes categories of activities in which foreign investors may hold greater than a 49 percent interest subject to approval of the Foreign Investment Commission. These activities include the following:

- a) port services such as piloting, dock services, mooring and lighterage;
- b) naval companies using vessels exclusively for high-seas traffic;
- c) administration of air terminals;
- d) private educational services;
- e) legal services;
- f) credit information companies;
- g) institutions for categorization of securities;
- h) insurance agencies;
- i) cellular telephone services;
- j) construction of pipelines for transportation of petroleum and derivatives thereof. As of May 11, 1995, 100 percent participation is permitted by special law without specific authorization;
- k) oil and gas well drilling;
- l) erection, construction and installation of public works. Beginning January 1, 1999, foreign investment may participate up to 100 percent in these activities without prior authorization. (Transitory Article Ninth of FIL.)

E. ACQUISITION OF EXISTING MEXICAN COMPANIES.

Foreign investors may acquire up to 100 percent of the shares of any company unless one of the limitations previously mentioned applies to such company, requiring only registration with the Foreign Investment Commission. However, a resolution from the Foreign Investment Commission is required when foreign investors wish to acquire more than 49 percent of the capital stock of existing Mexican companies when the total value of the assets of the Mexican company is greater than \$712 million pesos (approximately US\$75 million).

NAFTA provides phasing for NAFTA parties.

VI.- THE TAX SYSTEM

GENERAL COMMENTS

The Mexican Constitution contains provisions that govern the separation of powers to tax among the Federal government, the states and municipalities, specifically enumerating the taxing powers of the Federation and in general terms those of the states and municipalities.

In line with such separation, the Federal government establishes the income and value-added tax as well as all taxes related to international commerce. Moreover, the Constitution reserves to the states the right to tax real property for the benefit of municipalities. As such, the principal state taxes are the Real Estate Acquisition Tax and the Real Estate Property Tax and in most of the states there is a payroll tax.

Any tax, either federal, state or municipal, must respect constitutional principles related to proportionality and equity. In addition, tax laws must establish with clarity the elements of the tax, such as the subject, object, taxable base, and the respective rate or tariff.

A. ADMINISTRATION

As of July 1, 1997, a new decentralized agency (Servicio de Administración Tributaria - SAT) took over the responsibilities of assessing and collecting federal taxes and customs duties, while the respective Departments of Finance of each state or municipality administer state and local taxes.

The Federal government, the states and Mexico City have entered into agreements providing for tax coordination and administrative cooperation, and, as a result, the states are now legally empowered to collect and audit the correct payment of federal taxes.

B. INCOME TAX

1 RESIDENCY.

The federal income tax, regulated by the Income Tax Law (the "Law"), is the most important tax in Mexico as it still produces the highest portion of the total tax collected. The Law establishes two criteria crucial to the imposition of the tax: residency and source of income. The Law integrates these two criteria into three separate chapters fundamental to the taxation of individuals and corporations:

a) Mexican establishment and fixed base in Subsection D. of this Section, hereinafter.)

c) Foreign residents with no permanent establishment or fixed base are taxed on income attributable to Mexican sources; and foreign residents, although having a permanent establishment or fixed base and taxed as per paragraph b) above, are also taxed on income attributable to Mexican sources not attributable to such permanent establishment or fixed base. (See discussion of Mexican source income in Subsection C.6. hereinafter.)

For tax purposes the Law defines "resident" as follows:

a) Individuals are considered to be residents of Mexico when establishing their dwelling place therein, except if they are in another country for more than 183 days during the calendar year, consecutive or non-consecutive, and demonstrate acquiring residence for tax purposes in that country.

b) Companies are considered to be residents of Mexico when the place of incorporation of the company is in Mexico or when they have in Mexico their main management or business decisions center.

2. MEXICAN RESIDENTS.

The Law establishes specific provisions to tax companies resident in Mexico, including rules for taxation of permanent establishments; and also specific provisions to tax individuals and fixed bases.

3. FOREIGN RESIDENTS.

The Tax Law contains a specific section addressing the tax treatment of both foreign individuals and companies and establishes specific instances in which income shall be considered to be from a Mexican source, providing the applicable withholding rate depending on the type of income.

4. RESIDENT MEXICAN COMPANIES.

a) Object of taxation.

Mexican resident companies are subject to tax on all income received in cash, in kind, in services, in credit or in any other form obtained during the fiscal year. Mexican resident companies are subject also to tax on income originating from permanent establishments abroad. Moreover, inflationary gain is also considered income.

b) Inflationary gains

The tax laws of countries with high inflation rates commonly contain provisions requiring that inflationary gain to be included within the concept of taxable income. Mexico's tax laws have required that inflationary gain be included in taxable income since 1987.

The Tax Law defines inflationary gain as income received by virtue of a real "decrease" in indebtedness. In the calculation of inflationary gains, which must be done on a monthly basis, the taxpayer must employ the National Consumer Price Index. This index measures price increases, i.e., inflation, on a monthly basis and is published once a month in the Official Daily Gazette.

c) Taxable base

The amount subject to tax, the "taxable result," is determined by subtracting the legally authorized deductions and losses carried over from prior fiscal years, from income for the given fiscal year. Authorized deductions and loss carry over, respectively, are more fully discussed in paragraphs f) and l) below.

d) Fiscal year.

The federal income tax must be calculated and paid each fiscal year. However, taxpayers must still make provisional monthly or quarterly payments. The fiscal year of companies must coincide with the calendar year. When a company begins operations after January 1st, the fiscal year is considered to be irregular, as the period will not include an entire year, and such period is considered to begin running on the date in which operations are commenced and ends December 31st of the same year.

e) Rate of tax.

The Law provides for a flat tax rate of 35 percent on all taxable income of Mexican corporations.

A 30 percent tax rate will be applied if profits are reinvested and the tax difference will be deferred until the date on which the profits are distributed.

The Law provides that certain Mexican companies will pay a reduced rate of tax if engaged in activities in specific sectors. There is a 50 percent reduction of the tax if the taxpayer exclusively engages in farming, ranching, fishing or forestry activities; the tax will be reduced by 25 percent if these taxpayers also commercialize their products, or carry out such commercial or industrial activities from which they obtain as a maximum 50 percent of their gross income. There is also a 50 percent tax reduction if the company carries out editing activities.

f) Authorized deductions

In general, the Law allows the deduction of all expenses and investments that are indispensable for the development of the business activity of the taxpayer for a given fiscal period. Deductions include the purchase of inventory.

g) Requirements for deductibility.

The Law is very formal and thus all requirements established for deductions must be precisely observed. If the rules provided are not observed, the deduction will not be permitted for the related expense.

Some of the more prominent legal requirements for deductibility are the following:

i) the taxpayer must possess documentation satisfying the respective tax requirements and such documentation must be included as part of the accounting records of the corporation;

ii) the taxpayer must withhold the proper amount of tax if withholding is required; and

iii) the payment of the deductible expenses must be made with a nominative check or a bank transfer.

h) Deductibility of interest.

The Law contains specific provisions related to the calculation of deductions for interest payments and the accumulation of interest profits to be taxed.

The concept of exchange gain or loss is included within the definition of interest.

The calculations of deductions or accumulation of interest are made monthly. In light of these provisions, there is no relevance given to the date on which interest payments are due and/or payable.

The mechanism for the calculation of interest consists of three fundamental elements:

- i) interest receivable: considered to be ordinary income of the taxpayer;
- ii) interest payable: considered to be the interest owed by the taxpayer; and
- iii) the inflationary component: serves to measure the effect of the inflation rate to eliminate from both interest receivable and payable the distortions caused by inflation in order to calculate the "real" interest which may be either deducted by the debtor or accumulated by the creditor.

In general terms, in order to calculate the inflationary component, the total of all credits and debts of the taxpayer during the month in question must be considered, averages obtained, and then multiplied by a monthly adjustment factor, based on the National Consumer Price Index. After the appropriate calculations have been made the taxpayer shall accrue any inflationary gains or deduct any inflationary loss.

- i) Deductibility of investments.

The concept of investments includes fixed assets, deferred payments and charges and payments realized during the start-up period. These investments may be deducted by applying in each fiscal year the maximum percentage authorized by law, which varies depending on the type of investment.

For example, the maximum percentage authorized for automobiles is 25 percent per year, for furniture and office equipment the maximum is 10 percent, for pollution control equipment the maximum is 100 percent, for buildings the maximum is 5 percent and for computer equipment the maximum is 30 percent.

The respective annual depreciation percentage must be applied to the "original investment amount" determined by adding costs, such as importation, transportation, and insurance costs, including commission fees, to the original cost of the asset as well as taxes, except the value-added tax. The taxpayer may decide to begin taking deductions in the year the asset is placed into use or in the following year.

To reflect the effect of inflation on investments, the Law permits the taxpayer to adjust the amount of the annual deduction utilizing the inflationary index. The annual adjustment to the deduction is considered to be the inflation that has existed from the month in which the asset was purchased until the last month of the first half of the fiscal period in which the asset has been utilized.

j) Non-deductible items.

Certain other items are not permitted as a deduction. Payments to employee profit sharing are not deductible, although a part of it may be deductible if certain specific requirements are met.

Expenses related to non-deductible investments, entertainment expenses, fines, indemnification for injuries, gifts that are not made to governmental or charitable organizations and premiums that the taxpayer pays in excess of the nominal value for the redemption of stock are not deductible. Goodwill may not be deducted or amortized.

The income tax, the asset tax and taxes paid on behalf of third parties are not deductible. Payment of value-added tax and the payment of the special tax on production and services paid by or charged to the taxpayer, are not deductible. These taxes are deductible, however, if the taxpayer is not entitled to a tax credit or refund and the expense incurred to carry out the transaction is deductible.

k) Fiscal losses.

A fiscal loss results when the allowable deductions for a given fiscal period exceed gross income. This fiscal loss may be used to offset income in the next ten fiscal periods.

The taxpayer may adjust losses pending amortization to reflect the effects of inflation based on the inflationary index for the period covering the first month of the second half of the fiscal period during which the fiscal loss occurred until the last month of the same period. The fiscal loss may also be adjusted from the month of the last adjustment, until the last month of the first half of the fiscal period in which it will be offset based on the inflation during the given year.

l) Dividends

The Law establishes that companies distributing dividends or profits must calculate and pay a tax of 35 percent on the result derived from multiplying said dividends by a factor of 1.5385. The corporate tax on dividends is the responsibility of the distributing company, but foreign resident companies and foreign individuals resident in Mexico are subject to a withholding tax on dividends paid by corporations resident in Mexico. The tax rate is 5 percent on the result derived from multiplying the dividend by the factor of 1.5385.

However, not all dividend payments trigger a corporate tax. Any distribution made from the net tax profit account is exempt from the above-stated tax liability unless such distribution is made from the net tax reinvested profit account, in which case the deferred corporate tax must be paid applying the 5 percent on the distributed profit. (See paragraph e) above.)

The Law provides that these accounts may be adjusted annually to reflect the rate of inflation based on the National Consumer Price Index. The net profit account is increased by the net taxable profit of each period plus the dividends received from other Mexican resident companies and decreased by the amount of dividend distributions. The net tax reinvested account is increased by reinvested profits and decreased by the payment of same as a dividend.

m) Payment of tax

There is no obligation to make provisional payments in the initial year of operations. In the beginning of the second fiscal year taxpayers must make provisional payments either monthly or quarterly. Taxpayers who in the prior year have accrued income of less than approximately \$11,945,348.00 pesos at January 1st, 2000, (approximately equivalent to US\$1,257,405.00 at \$9.5/dollar) are required to make quarterly provisional payments while those who obtain an accrued income in the prior year greater than said amount are required to make monthly provisional payments. The above amount is adjusted quarterly as per the National Consumer Price Index.

Annual tax returns must be paid during the three-month period immediately following the end of the tax year. Taxpayers must also annually file in February an informational return detailing activities carried out with the 50 largest clients and suppliers, and for transactions with clients and suppliers that exceed \$50,000.00 pesos (equivalent to US\$5,102.00 at \$9.5/dollar).

In February of each year taxpayers must file information on investments made in tax-haven countries. If this information is not filed by May of each year at the latest, the omission is considered a criminal offense and the penalty ranges from three months to three years imprisonment. The list of countries considered as tax havens is published in the Law.

n) Information on loans from foreign residents

Taxpayers who receive loans granted from foreign residents or guaranteed by foreign residents, must file in February of each year to the tax authority, information setting forth the balance that will be outstanding as of December 31st of the prior year. The information must also include the type of financing, the identity of the actual beneficiary of the interest and the currency in which the loan payments are denominated, the applicable interest rate, and the due dates for payments of principal and interest.

o) Investments in low-tax jurisdictions.

The list of low-tax jurisdictions under the Law includes more than 90 low-tax offshore jurisdictions.

Investments by Mexican taxpayers in these jurisdictions are those made directly or indirectly in branches, legal entities, real estate, shares, bank or investment accounts, and any form of participation in trusts, partnerships, investment funds, as well as any similar legal structure created or constituted pursuant to foreign law located in said jurisdictions, including those made through third parties.

An investment is deemed to be located in a tax-haven when any of the following assumptions occur in such jurisdiction:

- i) There is a physical presence of the investment;
- ii) There are accounts or investments in banking institutions;
- iii) There is a domicile or post office box;

- iv) There is an actual or main address;
- v) It is the place where the company was organized; and
- vi) If a legal entity is created or constituted pursuant to foreign law of such countries and related to the investment in accordance with the laws of said jurisdiction.

Amounts received from an investment located in a tax haven are deemed to be income, profits or dividends, unless proved otherwise.

Taxpayers shall keep an account of the income, dividends and profits originating from investments in a low-tax jurisdiction.

Income derived from tax havens shall be deemed to be received at the time it is accrued. The income may not be commingled with other income; the profit will be taxed separately and such tax is paid annually. The applicable rate is 35 percent.

Companies who have a direct investment in a low-tax jurisdiction in which they do not have actual or administrative control may pay the tax when they receive the income, dividends or profits and not when they are generated. Except when proved otherwise, it is assumed that taxpayers have such control.

Companies whose accounting records for investments are available to the tax authorities and who file their tax return in February of each year may take the deductions to which their investments are entitled. They also may subtract losses from the preceding five fiscal years from the profits, but only starting with losses generated after January 1, 1997.

The following will not be deemed as investments in tax havens:

1. Those considered as entrepreneurial activities, provided that at least 50 percent of the total assets of the investments consist of fixed assets, land and inventories and that income from the lease of assets, dividends, interest, royalties or profits from the disposition of real and personal property does not exceed 20 percent of the total income obtained.
2. Indirect investments made in a tax haven through any legal structure created or constituted pursuant to foreign law in any country whose laws require that income be reported on an accrual basis and the taxpayer demonstrates that he has filed such report.
3. Those who have a per diem indirect participation that prevents the taxpayer, whether directly or through a third party, from having the control or administration of the investment to the extent that he can not decide on the timing of the distribution of yields, profits or dividends. It is assumed, except when proved otherwise, that the taxpayer has the administration or control of the investment.
4. Companies incorporated pursuant to Mexican law, even when they are located in a tax haven.

q) Tax Consolidation System.

Mexican law allows payment of taxes under a consolidated regime. Controlling companies are those that have a direct or indirect participation of more than 50 percent in the capital of other companies. Indirect holding shall be understood to be that held by the controlling company through another company or companies that in turn are controlled by the same holding company.

In order to limit the effects of consolidation in cases of controlling companies engaged in activities other than those related to the holding of shares, two categories of holding companies exist: "pure" and "impure." "Pure" controlling companies are those in which at least 80 percent of their income is derived from operations carried out with their controlled companies, and also from the sale of shares, interest and profits from derivative financial transactions of capital obtained from persons unrelated to the consolidated group. The dividends received by the controlling companies are considered income.

The provisions for computing the consolidated tax return establish that the participation to be consolidated shall be the direct or indirect participation that the controlling company has in the shares of the controlled companies at the close of the fiscal year, multiplied by a factor of 0.60. Thus, the participation to be consolidated by both "pure" and "impure" holding companies in their holdings in the controlled companies shall be 60 percent.

Besides, in connection with their own results, the "pure" holding company will consolidate 100 percent and the "impure" 60 percent.

r) Transfer Pricing.

Tax authorities have the power to impose transfer pricing rules on parties the Law defines as "related." Parties are considered to be related in the following two general cases: if one party participates, either directly or indirectly, in the management or administration of another party or if the former holds capital stock in or controls in any way the latter, and if one party or a group of parties participates, either directly or indirectly, in the management, administration or capital of the other parties.

There is a rebuttable presumption that operations carried out between Mexican residents and companies or other entities that are residents of or located in low-tax jurisdictions are operations carried out between related parties and that the agreed upon consideration is an amount not in line with the consideration that would have been agreed upon by independent parties.

Companies must make information available to the tax authorities when requested regarding the transactions carried out in the previous year with related parties resident abroad, and they have to file in February of each year a report on the transactions carried out in the previous year with related parties resident abroad. Companies carrying out operations with related parties must determine their accrued income and authorized deductions utilizing amounts that would have been agreed upon by independent parties for similar transactions.

The Law establishes that operations or parties are comparable if no circumstances exist that would significantly affect the price, amount of consideration or profit margin referred to in the methods established in the Law. If the application of these provisions suggests that a difference exists between the actual amount in question and the amount the Law determines as the equivalent of that which would have been agreed upon in an arm's-length transaction, operations or parties may be considered comparable if the difference is eliminated after a reasonable adjustment of the related amounts.

The following transaction-specific categories and their respective elements are taken into account to calculate the difference referred to in the prior paragraph.

- Financing.- Principal amount, term, guaranties, solvency of debtor and interest rate.
- Services.- Nature of the service and the experience and "know how" required to perform the service.
- Use, enjoyment or sale of tangible property.- Physical characteristics, quality and availability of property.
- Use or transfer of intangible property.- Length and type of protection granted and classification of property, i.e. patents, trademarks, commercial names or transfer of technology.

The following elements will also be taken into consideration in all cases:

- Operations or activities, assets utilized and risks assumed by each party.
- Contractual terms.
- Economic conditions.
- Business strategies, including those related to market penetration and preservation and those related to increasing market share.

Transfer prices may be determined using any one of the following six methods:

- Comparable uncontrolled price method.
- Resale price method.
- Cost-plus method.
- Profit split method.
- Residual profit-slip method.
- Transactional profit-margin method.

For effects of the transfer pricing provisions, revenue, costs, gross income, net sales, expenses, operating income, assets and liabilities shall be determined based on generally accepted accounting principles.

Moreover, after the application of the above-mentioned methods, a range of compensation levels or profit margins may be established when two or more comparable operations exist. The ranges shall be adjusted by applying statistical methodology. If the compensation level or profit margin falls within said ranges, the operation in question shall be considered to be between two independent parties. If the compensation level or profit margin falls outside the correct range, the median of the range shall be considered to be the compensation that would have been agreed upon by independent parties.

The Ministry of the Treasury and Public Finance shall resolve consultations as requested to determine the acceptable level of compensation of operations between related parties. (Advanced Price Agreements.) These resolutions may also result from an agreement with authorities of another country that has entered into a tax treaty with Mexico.

Resolution of consultations requested by taxpayers under the Law may be applicable for the fiscal year in which the consultation is requested, for one year before and for up to three years following the year of application, but if they result from a treaty as mentioned above, they may be extended for a longer period.

If competent authorities of another country with which Mexico has entered into a tax treaty adjust the compensation of a resident of that country and if Mexican authorities accept such adjustment, related parties that are resident in Mexico may file an amended income tax return to reflect such adjustment.

Tax authorities may consider interest payments to be a dividend if they are paid from one related party to another and if they represent payments for interest that exceeds the market rate. Interest payments related to back to back loans among related parties also may be considered dividends.

5. TAXATION OF INDIVIDUALS RESIDENT IN MEXICO.

Individuals resident in Mexico must pay a tax based on the income obtained during the given calendar year regardless of the location of the source from which the taxpayer obtained the income.

The Income Tax Law contains ten chapters that provide rules for authorized deductions in a given income category, as well as rules requiring provisional payments in some instances. The principal chapters cover salaries, fees, leases, transfer of property, entrepreneurial activities, interest and dividends. Individual taxpayers that receive income from fees, leases, transfers of property or entrepreneurial activities must make provisional payments.

The individual taxpayer's annual return must be filed between the months of February and April of the year following the year in which the income was obtained. The individual tax rate for individuals resident in Mexico is progressive and runs anywhere from 3 percent to 40 percent.

6. TAXATION OF FOREIGN COMPANIES AND INDIVIDUALS.

Non-resident companies or individuals, without a permanent establishment or fixed base in Mexico, are liable for tax on any income that falls within the definition of Mexican-source income. The term is defined broadly and the specific activities included within the definition will be discussed below.

The tax liability of the foreign resident is generally satisfied through a withholding by the Mexican party making the payment to the foreign resident who will be liable for the tax if not withheld.

The withholding must be made on the date of payment or on the date the debt becomes payable on demand, even if payment to the foreign resident is not made. The withholding and payment of the tax is considered to be a conclusive payment.

a) Salaries and fees.

When a service is provided in Mexico, the source of income is considered to be Mexico. In the case of salaries, the first \$115,661.00 pesos (approximately US\$12,174.00 at \$9.5/dollar) of salary earned in a given calendar year shall be exempt from tax. A withholding tax of 15 percent is made on the earnings from \$115,661.00 pesos to \$931,710.00 (approximately US\$98,074.00) to the 1st of January, 2000, and a 30 percent withholding is made on earnings above this amount. The above-mentioned amounts are adjusted quarterly as per the National Consumer Price Index.

The tax rate for payment of fees for independent services is 21 percent.

b) Leasing of real estate, property and time-sharing services

The source of income is considered to be Mexico when the real estate or chattel is located within Mexico or when capital goods are used therein. The income derived from the use of these assets is subject to a 21 percent withholding tax and no deductions are permitted. The maker of the payments is responsible for withholding the tax.

The withholding rate for income obtained from time-sharing services is 21 percent and 40 percent if the recipient is resident of a tax haven country.

In some cases the foreign resident of a country with a tax treaty with Mexico has the option to pay a 40 percent rate on the net income.

c) Sale of real estate.

The proceeds from the sale of real estate in Mexico is considered to be Mexican-source income. There are two methods by which to pay the tax on the transaction. The first is through a withholding by the purchaser of an amount equal to 20 percent of the amount obtained without deductions. In the second scenario, the foreign seller must appoint a representative resident in Mexico, who shall notify the person authenticating the public instrument (notary, judge, broker) of any deductions to which the taxpayer is entitled. The person authenticating the public instrument will file the tax return within 15 days following the date of signature of the instrument and in such case a 40 percent tax rate will be applicable to the profit.

d) Sale of shares

The proceeds from the sale of shares are considered to be Mexican-source income when the company issuing the shares is resident in Mexico or when more than 50 percent of the accounting value of the shares transferred represents real estate located in Mexico.

The proceeds from the sale will be taxed at 20 percent unless the foreign resident appoints a representative in Mexico as mentioned above. In this case, the tax is 40 percent of the net profit on the transaction. Residents in tax haven countries or countries with a territorial system of taxation do not have this latter option.

Residents of a country that has signed a tax treaty with Mexico could have a better treatment under the terms of the treaty.

e) Dividends

The distribution of a dividend of a company resident in Mexico is considered to be Mexican-source income. The tax rate is 5 percent on the amount resulting from multiplying the dividend by a factor of 1.5385.

Residents of a country that has signed a tax treaty with Mexico usually benefit from a reduced withholding rate.

f) Interest

When capital is invested or placed in Mexico, or when interest is paid by a Mexican resident or a non-resident with a permanent establishment or fixed base in Mexico, the interest income derived therefrom is considered to be Mexican-source income. Depending on the liability underlying the credit and the specific characteristics of both the creditor and debtor, one of four withholding rates will be applied to such interest income:

- i. A 15 percent withholding tax is applied to interest payments made to, among others, foreign banks upon compliance with disclosure requirements imposed by tax authorities.
- ii. A 21 percent withholding tax is applied to interest payments made to Mexican credit institutions or to creditors different from those contemplated in (i) above, or when the credit is used to pay foreign suppliers for the sale of equipment or machinery and in general for credits used to purchase inventory or for marketing, provided that the tax authorities are provided the required financial information.
- iii. A 15 percent withholding tax is applied to interest payments made to reinsurance companies.
- iv. A 4.9 percent withholding is applied to interest payments made to foreign financial entities in the capital of which the Mexican government has an interest.
- v. A 40 percent withholding rate is applied to interests deriving from credits used for other purposes.

Reduced tax rates could be applicable to residents of countries that have a tax treaty with Mexico.

Interest paid in the cases mentioned in i) and ii) above up to June 30, 2000 will be subject to a 4.9 percent and 10 percent withholding, respectively.

In addition, interest payments for credits granted to the Mexican government, or credits granted for terms greater than three years guaranteed by financial institutions located abroad dedicated to the promotion of exports when such institutions are registered with the Ministry of Finance, or credits issued by foreign financial institutions in favor of institutions authorized to receive deductible donations, are exempt from income tax. Income from interest, capital gains and proceeds from rents of real estate are exempt when received by foreign pensions and retirement funds from investments in Mexico, complying with some requirements.

g) Financial leases.

When the property leased under a financial lease is located in Mexico, the proceeds are considered to be Mexican source income. The withholding rate is 15 percent of the amount considered to be interest payments.

h) Royalty payments.

The definition of royalty includes payments for the use or exploitation of intangible goods as well as the payments for information relative to industrial, commercial or scientific know-how, and in general, for payments made for technical assistance or transfers of technology. The source of income is considered to be in Mexico when the property or rights for which royalty payments are made are utilized in Mexico, or when the payments are made by a resident in Mexico or by a non-resident with a permanent establishment or fixed base in Mexico.

Two withholding rates exist and are applied depending on the concept for which the payment is made. When the payment derives from the right to use patents, invention certificates, trademarks, trade names, commercial names or advertising, the applicable withholding rate is 40 percent. When the royalty payments are made for the use of commercial or scientific information, technical assistance or the transfer of technology and, in general, for the use and exploitation of works protected by copyright or other intangible goods, the applicable withholding rate is 15 percent.

Payments of royalties to residents in tax haven countries are taxed at a rate of 40 percent in all cases.

Residents of a country that has signed a tax treaty with Mexico usually benefit from a reduced withholding rate.

i) Construction services.

When the services of construction, maintenance, installation, inspection or related supervisory services are provided inside Mexico, the source of income is considered to be Mexico. The withholding rate will be 30 percent on the total revenues obtained without the benefit of deductions. There is an

option, however, if a representative is appointed in Mexico to pay 40 percent on the net profit derived from the transaction instead of 30 percent on the total revenues. The tax is payable in the month following that of conclusion of the work.

If the services last more than 183 days in a twelve month period, a permanent establishment will be deemed to exist.

j) Payment of commissions.

Payment of commissions to foreign residents is exempt but if paid to residents in tax haven countries, a 40 percent withholding tax applies.

C. PERMANENT ESTABLISHMENT AND FIXED BASE

Non-residents with a permanent establishment or fixed base in Mexico are taxed on income attributable to such permanent establishment or fixed base. Non-residents without a permanent establishment or fixed base in Mexico are taxed on Mexican-source income only.

1. DEFINITION OF PERMANENT ESTABLISHMENT.

For income tax purposes the term "permanent establishment" means any place in which business activities are wholly or partially carried on. The term incorporates branches, agencies, offices, factories, workshops, installations, mines, quarries and any other place of exploration for or extraction of natural resources. The federal tax law stipulates that the following activities do not constitute a permanent establishment:

- a. the use of maintenance or facilities solely for the purpose of storage or display of goods or merchandise belonging to the non-resident;
- b. the maintenance of a stock of goods or merchandise belonging to the non-resident solely for the purpose of storage or display, or for processing by another person;
- c. the maintenance of a place of business solely for the purpose of acquiring goods or merchandise, or for collecting information for a non-resident;
- d. the use of a place of business by a non-resident solely for the purpose of carrying on any activity of a preparatory or auxiliary character, such as advertising, supply of information, scientific research, preparation for loan placements and similar activities; and
- e. the deposit of goods or merchandise of a non-resident in a bonded warehouse, or the delivery of such goods or merchandise for import into Mexico.

2. AGENCY RELATIONSHIP.

The activities of an individual or legal entity acting on behalf of a non-resident in Mexico may be considered a permanent establishment or fixed base with respect to all the activities performed on

behalf of the non-resident. In the following situations an agency relationship will lead to tax liability as a permanent establishment or fixed base:

- a. if the agent has and exercises authority to conclude contracts in the name of the non-resident to carry out business activities in Mexico or to render independent personal services;
- b. if the agent has a stock of goods or merchandise out of which he makes deliveries on behalf of the non-resident;
- c. if the agent incurs risk on behalf of the non-resident;
- d. if the agent acts under detailed instructions or under the general control of the non-resident;
- e. if the agent engages in activities that economically correspond to the non-resident and not as a person acting independently; and
- f. if the agent receives a fixed remuneration which is not dependent on the results of his activities.
- g. if the agent conducts activities for the non-resident by setting prices or amounts of compensation other than those that would have been used by unrelated parties in comparable transactions.

3. DEFINITION OF FIXED BASE.

A fixed base in Mexico through which a non-resident individual, association or company renders independent personal services is treated as a permanent establishment. Fixed base is defined as any place in which independent personal services are rendered or where an independent profession is exercised.

4. TAX RULES.

- a) General requirements.

Permanent establishments and fixed bases must keep records separate from their head office, and their net profits must be determined on the basis of the accounting records of such offices.

Business companies not resident in Mexico that have one or more permanent establishments in Mexico must, in calculating taxable profits, compute all receipts attributable to those establishments and claim deductions attributable thereto, including those incurred abroad.

Likewise, non-resident entities with one or more fixed bases in Mexico may take the deductions corresponding to the activities of such bases, whether incurred in Mexico or abroad, even if they are allocated on a proportional basis between the Mexican base and the head office or establishments located abroad provided certain requirements are fulfilled.

- b) Remittances to head office.

Remittances by a permanent establishment located in Mexico to the head office or other establishments located abroad are not allowed as deductions even if they represent royalties, fees or similar payment for patents or rights, commissions or interest.

c) Computation of taxable income

The cost of goods purchased by permanent establishments in Mexico is deductible under the general rules previously discussed for resident entities. The cost of goods received from the head office or from another foreign establishment of the taxpayer may not be greater than the value declared for customs purposes.

The profits of permanent establishments of foreign entities are subject to corporate income tax in a similar manner as local corporations. Permanent establishments of foreign entities must keep a special account known as a capital remittances account. Distributable profits of each tax period and remittances received from the head office or other establishment abroad are added to this account. Conversely, cash payments and other remittances made to the head office or other establishments reduce this account.

All profits remitted to the head office or other establishments located abroad, including those arising from termination of activities, are exempt from income tax when remitted out of the capital remittances account. They are, however, subject to a withholding tax of 5 percent on the amount resulting from multiplying the profit by a factor of 1.5385.

Interest paid by a resident company or permanent establishment of non-residents located in Mexico, to a resident or non-resident company, may be treated as a dividend in certain instances.

D. OTHER TAXES ON CAPITAL AND TRANSACTIONS

1. ASSET TAX.

A tax on assets must be paid in addition to income tax. Corporate and individual income tax actually paid on business income during the same period may be credited against this tax.

This tax must be paid by resident legal entities, resident individuals engaging in business activity, non-residents with a permanent establishment with respect to assets attributable to the establishment, non-residents maintaining stock that has been transformed or will be transformed by a taxpayer, and entities and individuals granting the use or temporary enjoyment of assets used in activities by the aforementioned taxpayers but only with respect to such assets.

The taxable base is the annual average of assets less the annual average of eligible liabilities with resident enterprises. A set of rules exists to determine net worth for the purposes of this tax.

The tax is not levied during the year in which activities are started (independent of the year in which the company was incorporated), and the following three years of operations, or during liquidation. Since the fiscal year must coincide with the calendar year, the first year may be a partial year. This exemption does not apply to companies that have as main purpose the leasing of assets and to those that have simply changed their corporate structure, for example, a company that is the result of

a merger. The tax is levied at a rate of 1.8 percent. Taxpayers are required to make advance payments on the same dates on which advance payments of income tax are due.

2. VALUE-ADDED TAX.

Mexico has a value-added tax (VAT) which is levied on the transfer of goods, rendering of independent services, granting of temporary right to use goods, and import of goods and services. Exports and some other specified items are subject to the zero-rate, such as basic foodstuffs (meat, milk, corn, wheat), medicine and agricultural services related to the production of basic foodstuffs. The general VAT rate is 15 percent, except in the border area where the general rate is 10 percent.

a) Transfers

A wide variety of transfers in Mexico are defined as transfers of goods and thus are subject to VAT. Any transfer of property leads to VAT liability, including sales where the seller holds title from the outset, as in installment contracts.

A transfer is considered to be carried out in Mexico under the following circumstances:

- i) if the transferor physically delivers the goods in Mexico;
- ii) if the goods are located in Mexico when shipped to the buyer.
- iii) if the property in question should be registered in Mexico, regardless of the physical location of the property, provided the transferor is a resident of Mexico or a permanent establishment or fixed base of a non-resident; and
- iv) with respect to intangible property, if both the transferor and the recipient are residents of Mexico.

Several transfers are exempt from the VAT. Transfers of land and houses or any property destined for residential use (condominiums) for dwelling are exempt, as are gifts in certain instances. Transfers in trust with the right of reversion also are exempt from the VAT. Perhaps most importantly, transactions involving foreign currency, stocks and bonds may also be exempt.

b) Temporary use

The temporary use of goods also is included and generally incorporates the leasing of machinery or other intangible property for consideration.

c) Imports

A wide variety of imports is subject to VAT. Any use of intangible property granted or transferred to a Mexican resident by a non-resident also is subject to VAT, as well as services rendered by non-residents that benefit companies or enterprises inside Mexico.

Services provided with respect to international transportation, imports in several instances, temporary imports, goods in transit or transshipment are not subject to VAT. Imported goods and services are exempt if such are exempt from VAT inside Mexico or subject to the zero rate.

d) Services

Numerous services are covered under the Law. Any act carried out to discharge an obligation is taxed regardless of the underlying obligation. Specific services are also covered, such as transportation of goods and individuals, insurance and reinsurance, guarantees, mediation, agency, representation, brokerage, technical assistance and transfer of technology.

A service is considered to be provided in Mexico if a resident of Mexico wholly or partially provides the service.

A special case exists for international transportation. If the trip begins in Mexico, the service is considered to be provided in Mexico regardless of the nationality of the operator. For air transportation, including transportation to border areas, only 25 percent of the service is considered provided in Mexico.

Numerous services are exempt, such as services provided by employees, interest in certain instances, i.e. interest on the financing of transactions not subject to VAT or those subject to the zero rate and interest received for financing secured by mortgage.

e) Exports

Most exports are subject to the zero rate. Any enterprise resident in Mexico qualifies for the exemption. The definition of export is complex and includes the following transactions:

- i. any export of a good which is considered as definitive under the customs law;
- ii. any transfer of intangible property from a resident to a non-resident;
- iii. any granting by residents of Mexico to non-residents of the right to use intangible property abroad;
- iv. the providing of technical assistance, technical services, or intellectual interchange abroad by residents of Mexico;
- v. the transportation of goods exported abroad by residents of Mexico;
- vi. the providing of maquila services for export;
- vii. the providing of services to non-residents related to publicity, commissions and brokerage, insurance, reinsurance, guarantees and other financial transfers by a resident of Mexico; and
- viii. transfer of goods between enterprises under a PITEX program or exclusively engaged in the export of goods as well as to in-bond assembly enterprises in compliance with rules established by the Ministry of Finance.

ix. the providing of independent personal services to non-residents.

f) Computation of tax and miscellaneous

The computation of VAT is based on the value of the goods or services. Provisional payments must be made on the same dates as provisional payments for income tax purposes. The amount of the provisional payment will be the difference between the tax which corresponds to the total of activities carried on in the period for which payment is made and the amounts for which accreditation is due.

Creditable tax is understood to be an amount equivalent to VAT which has been transferred to the taxpayer, plus the VAT that he has paid for the importation of goods or services in the corresponding period. If the creditable tax is greater than the VAT due for the period, resulting from the taxpayer's income from transfers, services or use, the difference will be considered a tax credit. The taxpayer may apply this credit to VAT due in subsequent provisional payments or may apply for a refund.

The only instance in which a creditable tax may be transferred is through merger.

Taxpayers who have the legal obligation to pay the VAT to the tax authorities are required to specifically and separately shift VAT to persons in receipt of the goods, enjoying the use of or right to use the goods, or receiving services subject to VAT, indicating such tax on the invoice. Nevertheless, VAT must be included in the quoted price of goods and services purchased by the final consumer.

When tangible goods are imported they are subject to customs duties and VAT. Both must be paid before customs clearance is granted. If a sale is made on credit to consumers with terms exceeding twelve months, and more than half the price is paid after six months, regulations allow for the deferment of VAT payments.

E. MEXICO'S TAX TREATIES

Mexico has treaties in effect to avoid double taxation and prevent tax evasion with Belgium, Canada, Chile, Denmark, Finland, France, Germany, Great Britain, Ireland, Italy, Japan, Korea, Norway, Singapore, Spain, Sweden, Switzerland, the Netherlands and the United States.

Tax treaties, among other things, reduce withholding taxes on dividends, interest, royalties and capital gains.

The Mexican government has also concluded tax treaty negotiations with Ecuador, India, Israel, Poland and Venezuela.

VII.- LABOR

The labor force in Mexico is generally young (one half of the population is under 20) and readily available for unskilled and semi-skilled work throughout the country. Skilled and managerial level employees, many of whom are bilingual, are also available in the large metropolitan centers.

The Federal Labor Law of 1970 governs all aspects of the employer-employee relationship, including collective bargaining, the right to strike, minimum wage rates, work hours, compensation, and

occupational health and safety. The Law establishes employee rights that go well beyond the guarantees provided in many industrialized countries. For example, employees are entitled to mandatory profit sharing, may only be dismissed for a limited number of justifiable causes and enjoy the right to severance pay and seniority pay upon unjustified dismissal.

As of January 2000, business organizations and labor unions were negotiating legislative proposals to raise worker productivity without curtailing traditional principals of worker protection.

State labor boards may enforce the Federal Labor Law within their jurisdiction, except for specific cases in which the federal government maintains exclusive enforcement jurisdiction.

Any person rendering services to another individual or entity is considered an employee if that person works under the supervision of, or is subordinate to, the contracting individual or entity. Care must be exercised in drafting service agreements in which the intent is not to form an employment relationship.

In the acquisition of an on-going business, the purchaser becomes a substitute employer for the seller, and acquires all the seller's labor obligations. The purchaser and seller remain jointly liable for labor obligations for six months after acknowledgment by employees of the notice of the transfer.

A. UNIONS

The Law provides that groups of 20 or more employees, irrespective of whether or not they are employees of the same company, may form a labor union. If a company has fewer than 20 employees, its employees may affiliate with another union and request the company enter into collective bargaining. More than half the nonagricultural labor force is unionized. Labor unions are particularly strong in the oil, petrochemical, mining, education, banking, transportation, entertainment, textile, restaurant, electric energy, soft drink, automobile and communications industries. The largest and most influential labor union in Mexico is the Confederation of Mexican Workers (CTM).

The main unions frequently support the ruling party, the PRI. Many of their members form part of the government as municipal authorities, state governors, representatives and senators.

Strikes are recognized and protected by law as a tool available to workers for obtaining improved benefits and working conditions. Although legally the labor authorities may only resolve the legality of a strike once started, as a matter of practice, they may intervene in labor disputes in order to avoid work stoppages.

B. FOREIGN EMPLOYEES

Pursuant to the law at least 90 percent of a company's employees must be Mexican nationals, except for directors, administrators and other managerial-level employees. In practice, this rule is not significant since foreign nationals require proper immigration documentation in order to be employed, and such immigration authorizations are normally restricted to upper level positions.

Foreign personnel are subject to the same legal requirements as Mexican employees and are treated equally, both in benefits and sanctions.

C. GENERAL LABOR REGULATIONS

1. INDIVIDUAL EMPLOYMENT CONTRACTS.

It is mandatory for employers to execute individual employment agreements in writing. The law protects employees' job stability; hence their contracts are usually entered into for an indefinite term.

Nevertheless, hiring for a definite term for a specific project is permitted provided that the nature of the job is truly temporary.

2. WAGES.

The government is not empowered to mandate salary increases, with the exception of the minimum wage. The National Minimum Wage Commission periodically sets the minimum wage rate by geographical area. At present, the daily minimum wage in Mexico City is \$37.90 pesos, equivalent to approximately US\$4.00. The Commission also sets specific ranges of minimum wage rates for a number of occupations.

3. WORKING HOURS.

Under the Federal Labor Law, the maximum work week is determined depending on the work shift.

There are three types of work shifts:

a) Day shift.- From 06:00 A.M. to 08:00 P.M., with a maximum of forty-eight hours per week.

b) Night shift.- From 08:00 P.M. to 06:00 A.M., with a maximum of forty-two hours per week.

c) Composite shift.- Includes hours of the day and night shifts. The night shift hours may not exceed 3½ hours. If there are more night hours, it then becomes a night shift. The maximum number of hours permitted per week is forty-five.

Workers are entitled to at least one thirty-minute break. Overtime is permitted by the law.

4. RATE OF OVERTIME.

Workers are entitled to double pay for the first nine hours of overtime worked in a given week; overtime exceeding this limit must be paid at three times the rate paid during normal work hours.

If workers render their services on their day of rest, they are entitled to double pay plus their salary corresponding to that rest day.

If workers render their normal services on Sunday they are entitled to a 25 percent premium for that day's work.

5. REST DAYS.

Workers shall enjoy one fully paid day of rest for each six days of work. Saturday working hours may be spread on the other weekly working days.

Compulsory holidays are observed on January 1st, February 5, March 21, May 1st, September 16, November 20, December 1st every six years, December 25 and the day fixed by the Elections Law to exercise the right to vote.

6. SAFETY AND HEALTH CARE.

The law places special importance on safety and health care in the workplace. A number of administrative regulations exists in this regard which employers must comply with and which are amended from time to time.

7. JOB-RELATED RISKS.

All job-related risks, defined as those risks to which an employee is exposed as a result of, or while performing, his particular occupation or job, are the responsibility of the employer. In localities where the Social Security System operates, employees must be insured against these types of risks (See subsection 10 below). In localities where the Social Security System does not yet operate (which are increasingly fewer), employers are required to pay directly to employees and their beneficiaries the indemnities provided in the law.

8. TERMINATION OF EMPLOYMENT CONTRACTS.

An employer may justifiably dismiss an employee without liability only if the employee commits any of the acts listed in the law, such as dishonesty, mistreatment of employer, insubordination, disobedience, disclosure of trade secrets or having more than three unjustified absences within a 30-day period.

The employer dismissing an employee with cause is bound by law to deliver him a notice in writing stating both the grounds for dismissal and the date of termination.

Should the employee refuse to receive the written notice of dismissal, the employer must, within five days of such refusal, notify the Labor Board and request the Board to serve notice of the dismissal to the employee at his registered home address.

In cases of unjustified dismissal employees are entitled to demand either reinstatement or payment of an indemnity equal to three months' salary plus 20 days' salary per year of service, seniority premium, back pay and the outstanding balance of any earned and unpaid benefits. Moreover if the employer fails to prove in court that there was sufficient cause for dismissal and that employer complied with the notice requirements for dismissal, the employer will be required by law to pay to the employee back wages from the time of dismissal to the date of the judgment, including any salary increase that the employee might have been entitled to (for example, under a labor contract, etc.).

In the case of employees with less than one year's seniority; confidential employees, house servants, temporary employees as defined in the law and employees having direct and permanent contact with the employer, the law grants the employer the privilege of refusing to reinstate the employee and paying him instead an indemnity equal to twenty days' salary per year of services, in addition to the three months' salary severance indemnity. This option, however, is available only with the approval of the Labor Board.

Although the indemnity of twenty days' salary per year of service technically applies only in the foregoing cases, in general practice such payment is incorporated into the proposed severance package to make it attractive to the employee and thus prevent his suing for reinstatement. However, if the employee rejects said payment and demands to be reinstated, and does not fall under any of the five above-mentioned employee categories, he is entitled to be reinstated regardless of the amount of money offered to him by the employer.

Under the law the basis for calculation of the indemnity payments is the "integrated salary," so called because it results from adding the base salary to the proportional part of other benefits, such as bonuses, commissions, Christmas bonus and vacation premium.

In addition to the indemnity payments employees must also be paid any earned and unpaid benefits they may be entitled to, such as salaries, vacation days, vacation premium and Christmas bonus. Among the benefits requiring indemnity payment also is a seniority premium consisting of twelve days' salary per year of service calculated on a basis limited to twice the general minimum salary in force in the location of the employment.

An employee may claim termination of his employment contract if the employer commits any of the acts listed in the law, such as insults, salary reductions or unilateral modification of existing conditions of employment. If the employee proves in court that the employer committed any of these acts, the employee will be entitled to payment of three months' salary plus 20 days' salary per year of service, seniority premium, back pay and the outstanding balance of any earned and unpaid benefits.

Employees may voluntarily resign their job at any time without any liability on their part and without any obligation to advise employer in advance.

An employee voluntarily terminating his employment is entitled only to payment of the outstanding balance of any earned and unpaid benefits. Exclusively in the case of employment for more than 15 years, the employee will be entitled to the payment of a seniority premium, which, as previously discussed, is equal to 12 days' salary per year of service calculated on a salary basis limited to twice the amount of the current minimum salary.

9. BENEFITS.

Fringe benefits are high relative to total payroll costs. Employee benefits are compulsory under the Labor Law. The most significant fringe benefits are the following:

a) Paid vacations

After one year of employment, an employee is entitled to a paid vacation of six working days, increasing by two days for each of the next three years of service. Thereafter, the vacation period increases by two days for every additional five years of service.

Years of Service No. of vacation days

1	6
2	8
3	10

4	12
5 to 9 etc.	14

Workers are entitled to a vacation premium in addition to their vacation days' salaries in an amount equal to 25 percent of their daily wages.

b) Christmas bonus.

Employees are entitled to an annual bonus of not less than 15 days' salary payable on or before December 20.

c) Housing fund

Employers must contribute 5 percent of payroll to the National Workers' Housing Fund Institute. At this time, the base salary for contributions has a cap of 17 times the minimum daily wage in Mexico City. This cap will rise annually until it reaches 25 times the minimum daily wage in 2007. The housing contribution and the social security payments into pension and retirement funds are part of the Retirement Savings Plan. (See section 10 below). Employees may use the funds to purchase, repair, or remodel their homes based on a preference policy followed by the Institute. The net fund balance, if any, will be paid to the employee in the case of total disability, retirement or death.

d) Profit sharing

Profit sharing is compulsory for all businesses, regardless of size or organizational structure (i.e. whether organized as a partnership, corporation or sole proprietorship). Employees are entitled to receive an amount equal to the percentage determined by the National Commission on Profit-Sharing. This percentage currently amounts to 10 percent of the taxable income as calculated for income tax purposes under the terms of the Income Tax Law.

In businesses whose income is derived exclusively from personal services, the amount of profit share is capped at one month's salary.

The mandatory profit sharing does not apply in the following cases:

- i. newly established entities, during the first year of operation;

- ii. newly established entities engaged in manufacturing a new product, during the first two years in operation;
- iii. entities engaged in mining, during the exploration period;
- iv. public and private welfare institutions; and
- v. businesses whose capital and/or gross income do not meet certain minimums established by the Ministry of Labor.

Distribution of profit-sharing must be made no later than May 30 of the following year.

The officer with the highest level of authority is not entitled to participate in the compulsory profit-sharing program for workers. Employees holding confidential positions will have a share in the company's profits; however, if their salary is higher than that of the highest paid unionized worker (or in the absence of a union, the non-confidential worker), such salary plus 20 percent will be considered as the maximum salary for profit sharing. The distribution is made on the basis of salary earned and days worked during the fiscal year.

Temporary workers are entitled to their share of the profits, provided they have worked at least 60 days during the year.

10. SOCIAL SECURITY.

All employers must register themselves and their employees with the government Social Security agency known as IMSS (its acronym in Spanish). Social Security dues are paid by both the employer and the employee (via withholding) every month, taking as a basis the daily salary received by the employees. This contribution basis generally is capped at 25 times the minimum wage. Social Security benefits cover job-related risks; general illnesses and maternity; disability and life; retirement, old age and unemployment at an advanced age; children's nurseries and social benefits.

IMSS maintains medical clinics and hospital facilities throughout Mexico and provides services free of charge to eligible employees and their families. IMSS subsidizes 100 percent of an employee's salary in the event of temporary disability due to job-related accident or illness, and 60 percent of the salary in case of general accidents or illnesses. Employees may receive a pension in the event of permanent disability, and heirs may also receive a pension in the event of the death of the employee.

An employee may obtain pension benefits upon retirement at age 60. There is no legal mandatory retirement age.

The new law that took effect on July 1, 1997 introduced important modifications to the Social Security system, the most relevant of which involves replacement of the administrative system for employee retirement funds that had been controlled by the IMSS since its commencement in 1943. As of July 1997 such funds are administered by private, specialized financial entities known as AFORES, their acronym in Spanish.

To this effect a complex network of organizations, rules and related procedures has been created to extend the Retirement Savings System known in the country as SAR. The main emphasis of this system is in the individualization of retirement accounts for workers. The funds in the individual accounts are invested by specialized subsidiary companies of the AFORES.

Because Social Security contributions are of a tax nature, the law uses concepts from the Federal Tax Code to regulate sanctions.

Employer penalties for noncompliance with contribution payment requirements, along with updating and delayed payment surcharges, include fines from 70 percent to 100 percent of the omitted payments.

VIII.- IMMIGRATION

The General Law of Population (the Law) establishes both the rights and obligations of foreigners and the various degrees of immigration status permitting foreigners to enter Mexico for the purposes described therein, such as to carry out business and remunerative activities. Such status, rights and obligations are specified in individual authorizations granted by the Ministry of the Interior.

The Law establishes the following three general groupings: non-immigrant, immigrant, and permanent resident.

A. NON-IMMIGRANT

Foreigners may enter the country temporarily within the following categories:

1. Tourists: foreigners entering the country for entertainment, health, artistic, cultural or sporting activities, without receiving remuneration, who will be granted a permit for a non-renewable period of up to six months.
2. Travelers in transit: foreigners entering the country in transit to another country who will be granted a permit for a non-renewable period of up to thirty days.
3. Visitors: this is the most common category for foreigners entering the country for business meetings, market studies, to carry out any technical or management activities for Mexican companies, or to attend corporate shareholders or board of directors meetings, among others. Such visitors will be granted a permit for up to one year, renewable four times, for a total potential time period of five years. The permit shall specify the place and activities to be carried out by the foreigner. When a remunerated activity is performed for a Mexican entity, the Mexican entity will be jointly responsible for any sanctions imposed for violations of the terms of the permit.

This category includes investors and businessmen, scientists or technicians, professional, confidential employees and retirees as defined in the Regulations to the Law. Certain requirements have to be complied with. For example, businessmen are required to deliver documentation evidencing the activities to be performed and their economic solvency. In other cases, they must substantiate their technical or professional capabilities.

4. Religious Ministers or Members of Religious Associations: to perform the religious duties inherent to any religion and to carry out social services. They must register with the Ministry of the Interior and prove their qualifications as minister or member of the religious association under the terms of the Religious Associations Law.
5. Political asylum: at the discretion of the Ministry of the Interior this authorization is granted to foreigners to protect their lives or liberty from political persecution. Such grantees will be allowed to remain in the country for the duration of the threat of persecution.
6. Refugees: A refugee is a foreigner who is granted entry into the country to protect his life, security or liberty when they have been threatened by general violence, foreign aggression, internal conflicts or a massive violation of human rights. Refugees will be allowed to remain in the country while such conditions continue to exist.
7. Students: foreigners entering the country to study in official or private educational institutions. To obtain authorization, students must prove economic solvency and adequate accreditation. They will be granted a permit for up to one year renewable for as long as they remain students in Mexico.

8. Distinguished visitors: prominent individuals at the discretion of the Ministry, who will be granted entry for up to six months.
9. Local visitors: foreigners visiting maritime ports and border cities will be granted permits for a period not to exceed three days.
10. Provisional visitors: foreigners landing in international airports without the required immigration documentation who may be allowed up to thirty days to obtain such proper documentation; such foreigners must make a deposit or obtain a bond to guarantee their return to their country of origin.
11. Correspondents: foreigners engaged in the activity of journalism, either to report a special event or to temporarily carry out journalistic activities. They will be granted up to a one-year stay, with extensions as long as they continue performing their journalistic activities.

In 1990, the Interior Ministry, in collaboration with the Ministry of Foreign Relations, issued Joint Instructions authorizing the Mexican Foreign Service (embassies and consulates) to issue non-immigrant immigration permits without prior authorization from the Interior Ministry for citizens of most countries in the following cases: tourists, travelers in transit, visitors (including businesspeople, technicians, retirees and members of boards of directors).

Foreigners entering the country with immigrant or non-immigrant status, in the latter case as religious ministers or members of religious associations, refugees, students, political asylum grantees, scientific visitors, technicians and confidential employees, are required to register at the Domestic Foreigners Registry within 30 days of the date of entry. Also, notice of any change in their immigration status or characteristics (such as a change of address) shall be given to the Registry within 30 days of such change. Fines are levied for late notifications.

All visitors entering Mexico as non-immigrants under the following visa categories: tourist, business visitor (FMN), board members and traveler in transit will be subject to a \$170.00 pesos immigration documentation fees (about US\$17.00.)

If the visitors enter Mexico under the above mentioned categories, they will be issued the application form (FMT, FM6, FMN or FMVC) through the Mexican Consulates, airlines, travel agency and immigration personnel at the ports of entry, according to the activities they will be conducting while visiting Mexico.

The payment of the immigration documentation fees may be made at any bank branch with form SHCP-5. Sometimes the airlines will absorb the cost of the visa fee and will issue the visa application at the time the airline ticket is purchased.

B. IMMIGRANT

Immigrants are foreigners authorized to enter the country with the purpose of establishing permanent residency. Immigrants will be allowed to remain in the country upon satisfying various requisites and will be granted an immigrant ("inmigrante") permit for up to one year annually renewable for up to five years, provided they comply with the proper requisites established by the Ministry of the Interior. Upon completion of the five-year period, the foreigner will be granted permanent resident ("inmigrado") status. Immigrants staying out of the country more than 18 months in a continuous or non-continuous manner during the five year annually renewable period will not be granted the permanent resident status until a new five-year period has elapsed thereafter. When such absences total more than 2 years, foreigners will lose their immigrant status.

Immigrant categories include the following:

1. **Retirees:** foreigners over 50 years of age engaging in non-remunerative activities but receiving from abroad funds such as interest or any other fixed income coming from abroad, provided they can prove the receipt of a monthly income equivalent to 400 times the daily minimum wage in force in the Federal District (approximately US\$1,600.00) and an additional monthly income of 200 times the daily minimum wage (approximately US\$800.00) per family dependent who accompanies them. There are restrictions regarding residence in certain cities of Mexico in which there are already a high number of foreign residents.
2. **Investors:** foreigners entering the country to invest their capital in industry, commerce or services. The minimum investment shall be the equivalent of 40,000 times the daily minimum wage in force for the Federal District (approximately US\$160,000.00).
3. **Professionals:** foreigners entering the country to exercise a profession. Educational requirements must have been fulfilled and must be revalidated by the Mexican authorities to exercise the corresponding profession.
4. **Scientists:** foreigners who enter Mexico to perform scientific, training or educational activities. The Ministry of the Interior may require that foreigners entering Mexico under this category be invited by an institution active in the area of specialization of the foreigner, and that the foreigner work in the institution to instruct Mexicans through conferences, courses, lectures or other methods.

5. Confidential employees: foreigners entering the country to perform activities as sole administrators or any other managerial positions at the discretion of the Ministry of the Interior, in a business established in Mexico.
6. Technicians: foreigners entering Mexico to render technical assistance and services for resident companies. The Ministry of the Interior may require that foreigners entering Mexico under this category be invited to conduct instructive conferences, courses or lectures, just as in the case of scientists described in section 4 above.
7. Relatives: dependent spouses or blood relatives provided they are minors, full-time students in Mexico, or handicapped children, of an immigrant or permanent resident.

Family members of permanent residents may obtain authorization from the Interior Ministry to engage in other activities.

Children and siblings of immigrants, permanent residents or Mexican citizens may only be admitted into Mexico under this category if they are minors, unless they are students or can demonstrate an incapacity to work.

If the marriage ends or the foreigner does not comply with the obligations imposed by civil law, such as alimony, the foreigner may lose this immigration status unless the foreigner already has permanent resident status. Immigration authorities, at their discretion, may confirm the foreigner's current residency status or authorize a change of immigration classification.

8. Artists and sportsmen: at the Ministry's discretion.
9. Assimilated: foreigners assimilated to the Mexican milieu, having a Mexican spouse or child, and not included in any of the above categories.

C. PERMANENT RESIDENT

Immigrants residing in the country for five years may acquire permanent resident status ("inmigrado") if they have complied with the respective legal immigration provisions. Permanent resident status must be requested within six months following expiration of the fourth renewal of their immigrant status.

Under the permanent residency classification (inmigrado), the foreigner's periods of permitted absences from Mexico become more liberal, and the foreigner may leave and enter the country freely.

If, however, the permanent resident foreigner remains outside Mexico for more than three consecutive years or for more than five years in a 10-year period, the foreigner will lose permanent residency status. The 10-year periods are computed from the date the foreigner becomes a permanent resident.

D. GENERAL COMMENTS

Foreigners entering the country as non-immigrants may import a vehicle during the term of their status complying with certain requisites, such as periodic renewals and posting bonds. Immigrants may not import a vehicle, except for immigrants in the retiree ("rentista") classification. Non-immigrants and immigrants may import household belongings with certain restrictions. Among the various requirements that may apply to obtain immigrant status are possession of a valid passport, demonstration of economic solvency, and presentation of a certificate from the police authorities in the last place of residency indicating there have been no criminal violations, payment of fees and a personal appearance before the granting authority.

The Labor Law may be applicable to foreigners entering under the various categories referred to above, and for Tax Law applicability.

E. TEMPORARY ENTRY OF VISITORS AND MEMBERS OF A BOARD THROUGH THE "FMVC"

The FMVC immigration form went into effect on August 15, 1995, in order to facilitate foreigners entering Mexico as Visitors or as Members of a Board covered by categories listed below, and has been replaced by a combined form that also includes tourists and travelers in transit.

The combined form is available at the consular offices of Mexico, airlines, travel agencies and immigration staff at the ports and the points of entry to the country and are valid for a maximum period of time of thirty (30) days, in any of the following modalities:

1. Business Visitor: foreigner who intends to realize any business activity related with trading or signing of commercial agreements, or the search for alternatives to invest in the country.
2. Members of Board: foreigners entering the country to attend meetings or board of directors meetings of enterprises which is legally established in Mexico.
3. Technicians: foreigners entering the country to render specialized services, previously stipulated, on the transfer of technology, patents and trademarks, transfer of machinery and equipment, technical qualifying of staff agreements; or any other similar activity related to the production process of any enterprise which is legally established in the country.
4. Transfer of Staff: those parties who are employed by an enterprise and who discharge management or executive duties or who which assist with specialized knowledge in said enterprise or in one of its subsidiaries or affiliates which are legally established in Mexico.

Citizens from the following countries are eligible applicants under the above categories:

Argentina		Holland		Portugal	
Australia		Hungary		San	Marino
Austria		Iceland		Singapore	
Belgium		Ireland		Slovak	Republic
Bermuda		Israel		Slovenia	
Brazil		Italy		South	Africa
Czech	Republic	Japan		South	Korea
Chile		Liechtenstein		Spain	
Denmark		Luxembourg		Sweden	
Finland		Monaco		Switzerland	
France		New	Zealand	United	Kingdom
Germany		Norway		Uruguay	
Greece		Poland			

In the cases of Brazil and South Africa no consular visas suppression agreements exist with Mexico. Therefore, it would be necessary for applicants from those countries have a Mexican Consular visa stamped in their passports in order to request the FMVC immigration form.

The combined form must be completed by the interested party, who must be prepared to demonstrate the following at the Mexican point of entry or at a Mexican consular office abroad:

- a. Proof of citizenship.
- b. Mexican immigration policy grants this status to residents of the United States and Canada; U.S. and Canadian citizens are covered under NAFTA categories. (See G. below.)
- c. Letter issued by the interested enterprise, association, Mexican or foreign chamber, binational, foreign or Mexican councils that are accredited in the country, which should describe the applicant's proposed activities and qualifications, express the necessity of the applicant's presence in Mexico to carry out the activity, and evidence economic payment sufficient to cover his stay in the country.
- d. In the event of "transfer of staff," the foreigner must present a letter in Spanish issued by the enterprise, its subsidiary or affiliate stating that the applicant is an employee, and that the corresponding payment of salary for the activities and services of the foreigner will be paid by the enterprise.

A foreigner entering the country as "technician," "business visitor," or "transfer of staff," who desires to extend his stay in the country for a term exceeding thirty (30) days; must appear at the nearest office of the National Immigration Institute to apply for an FM3 as a Non-immigrant visitor with authorization to perform said activities in the country, for a period not to exceed a year.

F. NATURALIZATION

The granting of nationality status to foreigners is exercised in a very selective manner. The requirements include five years residency with immigrant status, which could be reduced to two years

under certain circumstances. The granting of nationality is exercised in a discretionary manner and often depends on economic, business and social considerations.

Persons with relationships defined in the law to Mexican nationals could be granted nationality without fulfilling certain requisites such as residency. Along with Mexico's entrance into various multilateral and regional organizations, considerations are being made regarding liberalization of policies toward naturalization.

The new Nationality Law became effective on March 20, 1998, and waives the traditional one nationality principle. It now grants permanent nationality to Mexicans by birth.

Such nationality is granted to Mexican-born individuals under the norm of *jus soli* (place of birth regardless of the parents' citizenship) or *jus sanguine* (if one of the parents is Mexican-born or naturalized). In both cases, this right may only be transferred to the first generation.

Dual citizenship, accepted as a corollary of permanent citizenship pursuant to the above reform principal, only benefits Mexican-born citizens. Subsequently, several ancillary laws were modified in order to avoid dual-citizenship conflicts. For instance, public posts and functions may be held only by Mexican-born citizens who have not acquired any other nationality, for which reason such citizens shall comply with the provisions of Constitutional Article 32 by stating the waivers specified in Articles 15, 16 and 17 of the Nationality Law.

When the Naturalization Law went into effect (as reported in the Official Daily Gazette of March 20, 1998) the Legal Department of the Foreign Relations Ministry prepared new forms according to the various assumptions foreseen by said Nationality Law, specifying the requirements to be fulfilled in each of the cases stated hereunder:

1. Application for Mexican nationality by birth. Form DNN2.
2. Application for Mexican naturalization through standard procedure. Form DNN3. Minimum residence: 5 years.
3. Application for Mexican naturalization by Privilege. Form DNN4. Minimum residence: 2 years; for
 - a) Children of a Mexican-born national.
 - b) Parent(s) of Mexican-born children.
 - c) Native of a Latin American country or Spain or Portugal.
 - d) Having rendered distinguished services or made significant cultural, scientific, technical, artistic, sports, or corporate contributions to Mexico.
4. Application for Mexican naturalization by marriage. Form DNN5. Minimum residence: 2 years and having lived by mutual consent with the Mexican spouse.

5. Application for Mexican naturalization through parental rights and duties. Minimum residence: 1 year for adopted and minor children up to second-degree lineage, subjected to the Mexican adoptive parents' rights and duties. Should parents not take this step, the adopted children may take it during the year following their majority (18 years).

Mexican-born individuals, who waived their Mexican nationality and wish to recover it, shall submit a written request therefor to the Foreign Relations Ministry or to the respective Mexican embassies or consulates within five years after this Law goes into effect. To this end, they must submit full evidence of their identity and fill in form DNN2.

In cases of naturalization, the applicant must prove by examination his knowledge of Spanish, Mexican history and his integration into the Mexican culture.

G. TEMPORARY ENTRY OF BUSINESS PERSONS UNDER NAFTA

Chapter XVI of NAFTA states the general principles under which a NAFTA Party may authorize temporary entrance of businesspersons of another NAFTA Party, without the need for an employment permit.

The term businessperson under NAFTA includes the following categories: business visitor, traders-investors, intra-company transferees, and professionals.

1. Business visitors: performing activities related to, among others, research and design; agriculture; manufacturing and production; marketing; sales; distribution; after-sales services and general services.

2. Traders-investors:

- a) Traders: of goods or services principally among NAFTA Parties.

- b) Investors: establishing, developing, administering or providing advice or key technical services to the operation of an investment.

3. Intra-company transferee: businesspersons employed by an enterprise to render services to that enterprise, or a subsidiary or affiliate thereof, to fulfill management or executive functions, or functions involving specialized knowledge.

4. Professionals: businesspersons seeking to perform a business activity professionally in one of several permitted areas. The exercise of a profession is permitted only after compliance with the educational revalidation requirements established in Article Five of the Mexican Constitution and other related regulations, including NAFTA measures.

Businesspersons entering as professionals are expressly prohibited from performing any activity that involves a professional practice, without previously obtaining a professional license from the Ministry of Education.

All the above authorizations shall be temporary, and thus visitors shall be classified as non-immigrants. NAFTA creates the "FMN", a special immigration document, currently included in a combined immigration form covering tourists, travelers in transit and non-immigrant businesspersons, as well as the FMVC category mentioned in E. above, issued by the consular offices or at the airlines, to businesspersons crossing the border to develop a non-Mexican remunerative activity for a maximum of 30 days. Upon expiration, a businessperson shall apply for an FM3 as a non-immigrant businessperson performing non-profitable activities.

The provisions of NAFTA Chapter XX shall govern dispute resolution when authorization for temporary entry is denied as a pattern of practice and all other administrative remedies have been exhausted

IX- MONETARY AND FINANCIAL SYSTEM

A. NORMATIVE FRAMEWORK.

Money, foreign exchange and financial services are regulated by a series of laws, regulations and circular letters from the Ministry of Finance, the Bank of Mexico, National Banking and Securities Commission (NBSC) and the National Insurance and Bonding Commission (NIBC).

B. Currency.

The unit of currency is the peso. The only legal currency circulating are paper bills issued by the central bank, and coins of various values and characteristics. Foreign money is not legal currency in Mexico. Obligations denominated in foreign currency for payment in Mexico may be paid by delivery of the equivalent amount in pesos at the exchange rate in effect on the date of payment, as established in the Monetary Law. The Official Daily Gazette publishes the U.S. dollar exchange rate determined by the central bank for payment of obligations. The parties may agree to make payment in foreign currency outside of Mexico, in which case the Monetary Law would not be applicable. The exchange rates for other foreign currencies is calculated according to the exchange rates of those currencies with the U.S. dollar in international markets. The rates of exchange of most foreign currencies are available at banks in Mexico.

Mexican monetary law provisions may not be waived and any contractual stipulation to the contrary is null.

D. Investment Units (UDIs).

To offset inflationary pressures, the Mexican government has created the Unit of Investment (UDI) which is a unit of account that may be used to express the value of investments, credits or commercial transactions. The value of the UDI is calculated daily by the Bank of Mexico based on the National Consumer Price Index.

UDIs may be used to denominate the value of obligations in credit instruments, except checks. They are voluntary and when due, payment must be made in pesos by multiplying the peso value of the UDIs on the payment date by the number of UDIs owed.

Relatively few private investments or commercial transactions are denominated in UDIs, principally because of the relative stability of the exchange rate of the peso and attractive interest rates in pesos.

E. The Central Bank and foreign exchange.

The Bank of Mexico operates as the country's central bank. The purpose of the Bank of Mexico is to provide legal currency for the economy, and its goals include achieving stability in the purchasing power of the peso, as well as promoting the healthy development of the financial system and providing an effective payment system.

The Bank of Mexico is well respected both inside Mexico and in international financial circles.

Mexico uses a floating exchange rate system. Foreign currency may be sold or purchased in authorized currency exchange houses and in commercial banks. Furthermore, peso futures markets operate in Chicago, U.S.A., and in Mexico City. Although there is no exchange control, bank accounts may not be denominated in foreign currency, with few exceptions for maquiladoras and individuals. There are some discussions to allow dollar bank accounts more generally; this being related to monetary policy.

F. EXCHANGE CONTROLS

1. REPATRIATION AND EXCHANGE CONTROLS.

Repatriation is not restricted in Mexico nor was it ever controlled except for a relatively short period, and does not require any special tax or exchange rate. No requirements exist for registering direct foreign investment made in foreign currency or to pay dividends or to repatriate capital investments or loans and interest.

2. CAPITALIZATION AND PAYMENT OF DIVIDENDS.

Apart from the general capitalization requirements discussed in Section XIII.A.3 and A.4.b), no capitalization requirements apply before a dividend may be repatriated.

Dividends to foreign shareholders are not generally taxed when distributed, if they are paid from a net taxed profit account. (See Section XV.C.4.I.)

There are no imposed limitations on capital remittances when operations are terminated.

X.- INTELLECTUAL PROPERTY. LICENSING

The Industrial Property Law as amended on August 2, 1994, was the last of a series of amended laws that ameliorated obstacles to foreign investment in earlier versions.

The Industrial Property Law created the Mexican Institute of Industrial Property, an independent entity dedicated to the enforcement of intellectual property rights. The content of the Law may be summarized as follows:

A. PATENTS

A patent is a right granted to an individual or to an assignee 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:

1. it must be novel, not be comprised in the state of the art, which is defined as the technical information generally available to the public through a written or oral description, through working or through any publication in Mexico or abroad; there is no loss of novelty if an invention is exhibited in a nationally or internationally recognized industrial or trade show;
2. 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;
3. it must be capable of industrial application, that is, must be useful to manufacture a product or to use a process in any type of economic activity; and
4. 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.

The following inventions are not patentable:

- 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. (These are protected by the Vegetal Variety Law discussed below.)

Patent Law incorporates the first-to-file principle. Mexico is a party of, among others, the Paris Convention, the Patent Cooperation Treaty, UPOV and others, thus the date of filing a patent application in another member country 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 the longer of three years following issuance of the patent application or four years following the filing of the application, provided the applicant or patentee has no valid reason for the failure to work the invention.

B. 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 with the Institute of Industrial Property if they are absolutely new and capable of industrial application. Protection is granted for a non-renewable term of 10 years from the date of filing.

C. INDUSTRIAL DESIGNS

Industrial designs include industrial drawings and industrial 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 tridimensional 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 with the Institute if they are new and are used as a type or mold to make industrial products and are granted protection for a non-renewable term of 15 years.

D. 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 confidentiality of which the owner has taken measures to preserve by labeling information as "confidential," "secret," or in another similar manner. An industrial secret must necessarily relate to the nature, characteristics or purposes of products, to production methods or processes, or to the means or forms of distribution or marketing of products, or the rendering of services.

Information in the public domain, information which may be obvious to an expert, or information which 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 such information is disclosed to any authority for the purpose of obtaining any permits, registries, authorizations or similars.

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.

F. INTEGRATED CIRCUITS

Integrated Circuits are protected as follows:

1. Integrated circuits are products in final or intermediate form having at least an active element and one or more interconnections to form an integral part of the body or of the surface or a piece of semiconductor material destined to have an electronic function.

2. Topography or layout is the tridimensional disposition, having at least one active element with one or all of the interconnections of an integrated circuit for use in it.

3. Original topography or layout is the topography or layout of an integrated circuit that is the result of the creative effort of the inventor and which is not obvious or common among creators or among manufacturers of integrated circuits at the time of invention.

Protection is afforded to the topography and/or layout of integrated circuits which are original and have not been commercially worked anywhere in the world.

There is a two-year grace period from the date of first use. Any original combination of a previously-known layout may be protected. The term of protection is 10 years from the date of filing.

The owner of a Certificate of the Topography of an Integrated Circuit has the right to stop others from reproducing the circuit in whole or in part, and to stop the importation, sale, or distribution without authorization.

There is no infringement if the protected topography or layout of an integrated circuit is used for:

- a. evaluation, analysis, or academic purposes, not for profit;
- b. creating a different original topography or layout;
- c. a third party who, independently and prior to the publication of the registration in the Industrial Property Gazette, created an identical topography.

If a third party in good faith is importing, reproducing, distributing, or selling integrated circuits incorporating protected topography or layouts, there will be no infringement until after the infringer is notified in writing by the owner of the certificate. The infringer may finish his supplies in stock provided that a reasonable royalty is paid to the owner of the certificate.

A protected topography of integrated circuits must bear the legend "(M)" or "(T)" plus the name of the owner.

G. TRADEMARKS AND SERVICE MARKS

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.

Trademarks may be:

1. any name or visible design which is sufficiently distinctive or any other means which may identify certain products or services and distinguish them from other products of the same class;
2. tridimensional forms;
3. trade name and corporate names;
4. personal names unless there is a homonym previously registered.

Some marks are not registerable, such as:

1. words or designs that are not sufficiently distinctive;
2. 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;
3. descriptive names or designs;
4. geographic names or any name designating the place of manufacture of products or rendering of services; names of places known for the manufacturing of certain products;
5. names, figures or designs that are well known in Mexico;
6. any name, form or design confusingly similar or identical to a previously registered name, trade or service mark or design to cover the same products or services; and
7. the translation to other languages of unregisterable marks.

Trademarks and service marks must be registered in order to obtain exclusive right of use.

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.

H. 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.

I. 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 must be registered in order to obtain exclusive right of use.

J. 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 of the name on a national level.

A user may apply for publication of the trade name in the Gazette of the Institute to establish a presumption of good faith in the use of the name.

Trade names are protected for a specific class of goods or services. The publication is valid for 10 years and may be renewed.

K. 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.

L. ROYALTY PAYMENTS

Mexican law does not provide any specific rules governing minimum or maximum royalties. Tax authorities, however, have the right to adjust the taxable profit of the payer if such royalties are excessive and do not reflect "market value."

M. TRADEMARK LICENSE AGREEMENTS

Trademark license agreements must be notarized, have an apostille placed or be legalized by a Mexican consul, and translated into Spanish for registration purposes. The agreement may provide for payment of royalties in foreign currency.

Generally, licensing practices may have significant antitrust implications, i.e., including efforts by the seller or licensor to restrict by territory purchases and sales of the licensee.

N. COMPARATIVE ADVERTISING

Comparative advertising is permitted in Mexico if the comparison of products or services covered by a trademark is done for information purposes. The Institute may impose fines, close the business, or place under arrest for up to 36 hours individuals who use comparative advertising and

publicity that is misleading, false, or exaggerated, with the purpose of discrediting or trying to discredit products, services or a competitor.

In addition the Consumer Protection Agency may also impose sanctions if the comparison of products is false, misleading or exaggerated, even if it does not have as a purpose to discredit or to try to discredit products, services or a competitor. The sanction in this case could be a fine up to 2,000 times the minimum daily wage in Federal District.

O. PARALLEL IMPORTS

Any person may legally import into Mexico products covered by a registered trademark, for their use, distribution or commercialization.

The legal licensee of a trademark registered in Mexico, which covers products being imported, does not have any action against the lawful importer.

P. COPYRIGHTS INCLUDING SOFTWARE.

Copyright is protected for original intellectual creations without need for registration. There are two types of rights granted to authors:

1. patrimonial rights to use or reproduce the work of the author for profit. This right is effective during the author's lifetime and 75 years after his death. The protection of posthumous works lasts 75 years counted from the day of first publication; and
2. moral rights, which include recognition of authorship and opposition to any deformation, mutilation or modification made of the copyrighted work without authorization or opposition to any action which may decrease the value or prestige of the work or the reputation of the author. This right is perpetual, non-transferable, non-waivable and does not expire when an action to enforce it is not exercised.

The protection of the author's right is granted on the following types of works: literary, scientific, technical, legal, pedagogic, didactic, musical, pictorial, design, engraving, lithographic, sculptural, plastic, architectural, photographic, cinematic, audiovisual, radio and television, titles of periodicals, computer programs and on any other work which could be considered comprised within the generic types of artistic or intellectual works mentioned above.

The Copyright Law was amended in 1996 to include computer software within the protected items against unauthorized commercial exploitation or reproduction in the same terms as the rest of the items mentioned in the paragraph above.

The author or his assignee has the right to the exclusive use of any protected work. Only the right to use or reproduce a protected work may be assigned. The author's moral rights are not assignable.

The author has the non-assignable right to be designated as such and to oppose any deformation, mutilation or change of his work. These rights pass to the author's heirs.

Copyright is protected even if it is not registered or published.

Copyright infringement is defined as any of the following actions carried out without the consent of the author or his assignees:

1. To use a protected work.
2. To use the picture of a person.
3. To manufacture, reproduce, store, distribute, market copies of phonograms, videograms, or books protected by copyright.
4. To sell, offer for sale, store or circulate protected works that have been modified, adapted or deformed.
5. To import, sell, lease, or carry on any action to deactivate electronic protection systems of software.
6. To rebroadcast, fix, reproduce or publish radio broadcasts.
7. To use, reproduce or exploit a registered work, pseudonym or character.

Copyright infringement is punishable by fine, but if the infringement is done on a commercial scale, there may be criminal penalties as well.

The Mexican Industrial Property Institute (IMPI) is in charge of prosecuting copyright as well as other intellectual property infringements.

Preliminary measures, such as the seizure of infringing material, orders to cease and desist, and orders to suspend an infringement may be issued by the IMPI.

A suit or action can be filed while a registration application is pending.

The usual defenses against copyright infringement are:

- a) That the use of the copyright is not for profit;
- b) That the reproduction of the copyrighted work is different;
- c) That there is a dispute as to who is the real author;
- d) That the copyright is not original and that it is in the public domain.

A civil action for damages also may be filed.

The author or his assignee may put a lien on the entrance fee or income derived from the performance of a copyrighted work.

The author or his assignee also may repossess electromechanical equipment, sound systems, projection systems or force commercial operations into receivership.

The judge in a civil action or in a criminal action may order the seizure of all instruments used to make unlawful copies, as well as the copies of reproductions of copyrighted works.

The judge or the public prosecutor may order the sale of all reproductions and the proceeds thereof shall be paid to the author.

If the counterfeit products may not be sold to the public because the author objects, such products shall be destroyed.

The criminal action has no effect on the civil action and vice versa.

Mexico is a party to the Universal Copyright Convention, the Interamerican Copyright Convention and the Berne Convention.