

This memorandum provides a summary of basic information a foreign investor should consider when determining whether to invest in Mexico. It discusses the available alternatives for a U.S. investor interested in establishing a presence in Mexico, the formation of a Mexican company, tax ramifications for the establishment of a physical presence in Mexico and certain basic information related to the rights of Mexican employees. Please note that this memorandum is not a comprehensive review of Mexican law but only a guide for the first time investor. Further analysis will be required once a company decides to conduct business in Mexico.

I. Foreign Investments in Mexico.

According to the Mexican Foreign Investment Law (“LIE”), a foreign investor can actively participate without limitations in the capital ownership of Mexican companies in most sectors of the economy. Foreign ownership, however, is prohibited or limited in certain strategic industries, such as oil, transportation, credit unions, mining, and banking.

Mexican law recognizes three different methods of direct foreign investment in Mexico:

- a) Through the establishment of an office of a foreign company in Mexico, which office may take two different forms:
 - (1) As a branch or representation office with earnings. These are business entities legally recognized in Mexico. A foreign company doing business in Mexico in this manner will not be authorized to conduct activities or acquisitions reserved under or subject to specific regulation under the LIE.
 - (2) As a representation office without earnings. These business entities do not participate in commercial enterprises. Their only purpose is to provide informational and consulting services concerning the activities, products or services provided by the company outside of Mexico.
- b) Through the formation of a Mexican company, of which foreign investors may contribute up to one hundred percent (100%) of the company’s capital. The available types of business entities are discussed below.

- c) Through a Mexican company subject to specific regulation.

For an investor interested in conducting full-scale business operations in Mexico, the best alternative is to form a Mexican company. The following section discusses the requirements for establishing a Mexican company and the different alternatives available to a foreign investor.

II. Establishing a Mexican Company.

In order to establish a Mexican company, the foreign investor must determine what type of business entity is appropriate to achieve its business objective, file the required documents and obtain the necessary permits. The following sections of this memorandum provide some basic information concerning these matters.

A. Selecting a Type of Business Entity.

Mexico's General Law on Business Entities¹ recognizes six different types of business entities:

- a) *sociedad anónima* (including the *sociedad anónima de capital variable*);
- b) *sociedad de responsabilidad limitada*;
- c) *sociedad en nombre colectivo*;
- d) *sociedad en comandita*;
- e) *sociedad en comandita por acciones*; and
- f) *sociedad cooperativa*.²

All of the business entities listed above, with the exception of the *sociedad cooperativa*, may be established with fixed capital or variable capital. Usually, Mexican companies are established with fixed capital. Mexico's corporate law establishes a specific amount of capital that must be invested at all times in a company with fixed capital. Business entities with variable capital must comply with the fixed capital requirements.³ However, they may also have variable capital allowing additional investments to be made by the existing shareholders, the addition of new shareholders or the reduction of

¹ *Ley General de Sociedades Mercantiles*.

² *Ley General de Sociedades Mercantiles*, D.O., Aug. 4 1934, as amended December 28, 1933, Art. 1.

³ *Id.* at Art. 217.

capital investment.⁴ A company using the variable capital structure must include the words “capital variable” or the abbreviation “C.V.” after its name.

B. Typical Business Entities Used by Foreign Investors.

The *sociedad de responsabilidad limitada* and the *sociedad anónima* are the entities usually favored by foreign companies and individuals interested in investing in Mexico. The following is a brief description of each of these business entities.

1. Sociedad Anónima.

The *sociedad anónima* is similar to a corporation in the United States. It is the only available form of business entity for publicly held companies. In order to incorporate a *sociedad anónima*, the following requirements must be met:

- a) The *sociedad anónima* must have at least two shareholders, and each shareholder must hold at least one share of stock;
- b) The fixed capital must consist of at least M\$50,000,000 old Mexican pesos⁵, or approximately U.S.\$4,640 at the current exchange rate, fully subscribed.
- c) If the value of the stock is being paid in cash, then at least twenty percent (20%) of the value of each share of stock must be paid up front; and
- d) If the value of the stock is being paid, partially or totally, in property, then such amount must be fully paid into the company.⁶

The name of the business entity must be followed by the words “Sociedad Anónima” or its abbreviation “S.A.”⁷

A *sociedad anónima* may be incorporated either by the appearance before a public notary of the individuals incorporating the company or through the equivalent of a public offering.⁸ In addition to the

⁴ *Id.* at Art. 213.

⁵ 1 Mexican peso equals 1,000 old Mexican pesos.

⁶ *Id.* at Art. 89.

⁷ *Id.* at Art. 88.

⁸ *Id.* at Art. 90.

information required to be included in the articles of association⁹ of all Mexican companies, which articles are discussed below, the articles of association of a *sociedad anónima* must include the following:

- a) A statement of the paid up portion of the outstanding capital;
- b) The number, par value and nature of the shares that constitute the outstanding capital of the *sociedad anónima*, unless otherwise required by law;
- c) The terms and form in which any unpaid portion of the shares is to be paid;
- d) The participation in profits granted to the founders;
- e) The appointment of one or several shareholder's representatives; and
- f) The powers of the general assembly of shareholders and the conditions for the validity of its deliberations, and its exercise of voting rights; all insofar as legal dispositions can be changed at the volition of the shareholders.¹⁰

If the *sociedad anónima* is organized through a public subscription, the founders must prepare and file in the Public Register of Commerce a prospectus containing the proposed articles of association conforming to the established legal requirements.¹¹ Only after filing of the prospectus may the company accept subscriptions. All subscriptions must be completed within a year unless a shorter term is established.¹² If all shares are not subscribed within the designated time period, then existing shareholders may withdraw their respective contributions.¹³

The formation of the *sociedad anónima* and the adoption of the articles of association must be pursuant to a general meeting of shareholders. Within fifteen (15) days of approval, the minutes of the

⁹ The articles of association of a Mexican commercial company, known as *estatutos* or *acta constitutiva*, are the combined equivalent of the articles of incorporation and bylaws in a U.S. corporation.

¹⁰ *Id.* at Art. 91.

¹¹ *Id.* at Art. 92.

¹² *Id.* at Art. 97.

¹³ *Id.* at Art. 98. Please note that there is an exception from the fully subscribed shares requirement for companies with variable capital.

meeting and the articles of association must be notarized and filed.¹⁴

Shares of stock represent the company's capital.¹⁵ Common stock represents the residual ownership of the company and has no preferential rights. Preferred stock can also be issued if authorized by the articles of association.¹⁶

The ultimate authority in the company vests in the shareholders.¹⁷ The shareholders can hold general or special meetings. A general meeting must be held at least once a year within four (4) months of the end of the company's fiscal year. During the general meeting, the shareholders will review the company's financial information for the previous year, appoint the sole director or the board of directors and the *comisarios*,¹⁸ and determine the salary of the directors.¹⁹ Shareholders may be represented at the meeting by proxy, if allowed under the articles of association.²⁰

The holders of at least thirty-three percent (33%) of the outstanding shares of a *sociedad anónima* may at any time present a written request to the board of directors or the sole director that a general meeting be held. The request must indicate the reasons for the proposed meeting.²¹

Special meetings may be held to deal with a number of issues, including but not limited to, the early dissolution of the company, the increase or reduction of the company's capital, mergers, payment of bonuses, amendment of the articles of association, or extension of the duration of the company. Special meetings may be held at any time.²²

If there are different classes of shares, the special meetings will concern matters affecting a particular class.²³ General meetings will be held to deal with matters affecting all classes of shares.

The business and affairs of a *sociedad anónima* are managed by or under the direction one or more directors. Directors need not be

¹⁴ *Id.* at Arts. 99, 101.

¹⁵ *Id.* at Art. 111.

¹⁶ *Id.* at Art. 114.

¹⁷ *Id.* at Art. 178.

¹⁸ *Comisarios* are individuals appointed by the shareholders to exercise unlimited surveillance of the business of the company, including the actions of directors and managers. *Id.* at Art. 166(IX).

¹⁹ *Id.* at Art. 181.

²⁰ *Id.* at Art. 192.

²¹ *Id.* at Art. 184.

²² *Id.* at Art. 182.

²³ *Id.* at Art. 195.

shareholders of the company.²⁴ If the company has more than a sole director, the directors will constitute the board of directors. The board of directors, the sole director or the shareholders may appoint one or more managers to conduct the day-to-day business of the company. The appointment of a manager is revocable at any time. A manager need not be a shareholder of the company.²⁵ A manager will have the duties, rights and obligations expressly granted and will not need a special authorization of the sole director or the board of director to perform acts within the sphere of its duties.²⁶ Managers are normally granted a power of attorney which sets forth the nature and limits of the duties and obligations of the manager to act on behalf of the company.

The duties of the directors and managers are personal and cannot be delegated to any other person.²⁷ The termination of the appointment of a director or a manager does not extinguish the powers and responsibilities held during their appointment. The articles of association or the shareholders may require payment of a bond by the directors and/or managers to ensure the performance of their duties.²⁸

The directors are jointly liable to the company for (1) the contributions made by the shareholders; (2) the lawfulness of the benefits paid; (3) the proper maintenance and legality of the company's books and records; and (4) for exact compliance with shareholders resolutions.²⁹ This liability is technically the equivalent of a director's fiduciary duties under U.S. corporate law. A director, who is without fault, would not be liable if he opposed the resolution approving an event being questioned.³⁰ A director will be jointly and severally liable for the actions of a predecessor in the event he discovered the violation and failed to report it with a *comisario*.³¹

2. Sociedad de Responsabilidad Limitada.

A *sociedad de responsabilidad limitada* is similar to the limited liability company in the United States. The members' obligations are limited to the extent of their respective contributions, such contributions to be represented by membership interests and not by shares of stock or

²⁴ *Id.* at Art. 142.

²⁵ *Id.* at Art. 145.

²⁶ *Id.* at Art. 146.

²⁷ *Id.* at Art. 147.

²⁸ *Id.* at Art. 152.

²⁹ *Id.* at Art. 158.

³⁰ *Id.* at Art. 159.

³¹ *Id.* at Art. 160.

any similar negotiable instrument. The name of the company must include the name of one or more of the members followed by the words “*Sociedad de Responsabilidad Limitada*” or the abbreviation “*S. de R.L.*”³² Failure to comply with this requirement would make the member liable for the obligations of the company. The number of members cannot exceed fifty (50) at any time.³³

The minimum capital needed to form a *sociedad de responsabilidad limitada* is M\$3,000,000 old Mexican pesos, or approximately US\$280 at the current exchange rate. Although different types and categories of interests may be created, the stated value of each member’s contribution must be M\$1,000 old Mexican pesos (approximately less than US\$1 at the current rate) or a multiple thereof.³⁴ The entity cannot be formed nor the capital increased through a public offering. At the time of formation, the capital of the company must be fully subscribed and at least fifty percent (50%) of the capital contributions must have been paid.

Transfer of membership interests will be allowed with the approval of a majority of the members, unless the articles of association require a greater percentage.³⁵ In the event of a capital increase, the existing members have a preferential right to acquire the membership interests in proportion to their existing ownership. In addition, the articles of association may require members to make pro-rata supplementary contributions to the company according with their original contribution.³⁶

Existing members will also have a preferential right to acquire shares if membership interests are offered to an outsider. The interested member will have fifteen (15) days to exercise such preferential right when an existing membership interest is offered to an outsider.³⁷

One or more managers, who need not be members of the company, are to be appointed to manage the business and affairs of the company. The members of the company will name the managers, and unless otherwise agreed by the membership, the members also have the right to remove the managers at any time.³⁸ Unless the articles of association require a unanimous vote, the managers usually act by

³² *Id.* at Art. 59.

³³ *Id.* at Art. 61.

³⁴ *Id.* at Art. 62.

³⁵ *Id.* at Art. 65.

³⁶ *Id.* at Art. 70.

³⁷ *Id.* at Art. 66.

³⁸ *Id.* at Art. 73.

majority vote.³⁹ Unless they had no knowledge of the decision in question or if they voted against it, managers are subject to accountability for the recovery of company funds. The assembly of members and each individual member is responsible for finding the managers accountable to the company. The vote of seventy five percent (75%) of the membership is required to absolve the managers of responsibility.⁴⁰

The assembly of members is the company's highest authority. The resolutions of the assembly must be taken by a majority of the members that represent at least half of the company's outstanding capital, unless the articles of association require a higher amount of votes. If the required number of votes is not obtained during the first meeting, the members will be summoned to reconvene for a second time. During the second meeting, a resolution will be approved by a majority of the members present, regardless of the portion of outstanding capital represented.⁴¹

C. Other Types of Business Entities

The *sociedad anónima* and the *sociedad de responsabilidad limitada* are usually the favored mechanisms for foreign persons seeking to invest in Mexico. A potential investor, however, should be aware of the other forms of business entities available in Mexico. The following is a brief summary of the remaining types of business entities available in Mexico to both foreign and Mexican investors.

1. Sociedad en Nombre Colectivo.

The *sociedad en nombre colectivo* is the equivalent of a general partnership under U.S law. The partners are jointly and severally liable for the partnership debts and the liability is unlimited.⁴² The name of the company must include the name of one of the partners and if not all names are included, the words “*y compañía*” or its equivalent must be added to the name.⁴³

2. Sociedad en Comandita Simple.

The *sociedad en comandita simple* is the Mexican equivalent of a limited partnership. It has both limited and general partners. The

³⁹ *Id.* at Art. 75.

⁴⁰ *Id.* at Art. 76.

⁴¹ *Id.* at Art. 77.

⁴² *Id.* at Arts. 25-26.

⁴³ *Id.* at Art. 27.

liability of the general partner is unlimited, while the limited partners are only liable to the extent of their contribution. A limited partner, however, becomes liable for the company's debts if the name of such limited partner is used in the company's name, if the limited partner actively participates in the management of the company or if the designation "*sociedad en comandita*" or the abbreviation S. en C. is omitted from the company's name.⁴⁴

3. *Sociedad en Comandita por Acciones.*

The *sociedad en comandita por acciones* has both limited and general partners. The general partners are jointly and severally liable for the company, while the limited partners are only responsible to the extent of their contribution. The partners receive shares of stock in exchange for their contribution. The shares can only be transferred with the approval of all the general partners and of two-thirds of the limited partners. This type of entity is governed in part by the principles of partnership law and in part by the principles of corporate law.⁴⁵

4. *Sociedad Cooperativa.*

In civil law countries, a *sociedad cooperativa* is "a voluntary association of people for business purposes the profits of which are distributed in accord with the degree of the person's non-monetary participation."⁴⁶ In Mexico, the *sociedad cooperativa* is governed by special legislation.

D. Preparing Charter Documents for a Mexican Commercial Company

As part of the association process, all Mexican companies must prepare and file the company's charter documents. As noted above, except in the case of a public offering, the articles of association establishing a Mexican commercial company must be executed before a public notary. The articles of association establish the organizational and operational principles of the company, and must include the following:

- a) The name, nationality and domiciles of the individuals or entities establishing the company;
- b) The purpose of the company;
- c) The name of the company;

⁴⁴ *Id.* at Arts. 51-55.

⁴⁵ *Id.* at Arts. 207-211.

⁴⁶ BUTTENWORTHS SPANISH ENGLISH LEGAL DICTIONARY 158 (1991).

- d) The duration of the company;
- e) The amount of the company's capital;
- f) The amount of capital contributed by each investor, in cash or property; the value of such contributions and the method used for the appraisal of such contributions. If the capital is variable, the articles should state so, as well as the minimum amount of capital established;
- g) The domicile of the company;
- h) The administration procedure and the powers enjoyed by the administrators;
- i) The appointment of the company's administrators and the designation of the persons who shall be entitled to sign for the company;
- j) The method of dividing profits and losses among the investors;
- k) The amount of the reserve fund;
- l) The events which would cause the early dissolution of the company; and
- m) The procedure for winding-up the business of the company, and the method for the appointment of liquidators, if they have not been previously appointed.

E. Obtaining the Required Permits.

In order to establish a Mexican company, the founders need to acquire a series of permits and authorizations. A permit from the Department of Foreign Relations is necessary to register the name of the Mexican company. The incorporator must submit three possible names for the company. A permit or authorization to use the name will then be issued within 24 to 48 hours. Once this permit has been obtained, the incorporator needs to develop and execute the articles of association, which document needs to be notarized by a public notary and recorded in the Public Commercial Registry.⁴⁷

Once the association process is completed, the company will need to

⁴⁷ See José Amante, *Formando una Corporación Mexicana* (visited Feb. 27, 2003) <<http://www.penasco.com/091mexcorp.html>>.

obtain additional permits required for the operation of the company. Depending on the type of business, permits may be required from a number of governmental entities, including but not limited to the Department of Commerce, the Department of State, the Chamber of Commerce and the Department of Finance. Immigration, export and import permits may also be required.⁴⁸

III. Taxes

A potential foreign investor in Mexico should consider issues related to U.S. and Mexican taxes in determining whether to conduct business in Mexico, how such business should be conducted, and which type of business entity should be selected. The foreign investor needs to consider the tax ramifications under U.S. law, Mexican law and the *Convention between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (the “Tax Treaty”). This memorandum does not attempt to discuss the specific ramifications of these tax laws and provides only a broad overview of certain aspects of the Mexican and United States tax laws.

A. U.S. Tax Considerations

Usually, the income of a Mexican company will not be subject to U.S. taxation unless such company has business in the United States.⁴⁹ If the Mexican company, however, is a wholly-owned subsidiary of a U.S. parent, the Mexican company will be classified as a Controlled Foreign Corporation under the U.S. Internal Revenue Code. As a consequence of this classification, the U.S. parent could be subject to immediate U.S. taxation on the profits of its foreign subsidiary even if the U.S. company does not receive any distributions from the foreign subsidiary.⁵⁰

The choice of entity for the Mexican company may have tax consequences under U.S. tax laws for the U.S. equity owner.⁵¹ For example, the classification of the company as a partnership has the advantage that it allows the losses of the Mexican company to be passed through to the U.S. equity owner and to be claimed as a deduction on its U.S. income tax return. Pass-through treatment can be especially advantageous for U.S. individual owners because of the workings of the U.S. foreign tax credit. On the other hand, certain expenses incurred in Mexico are subject to special limitations,

⁴⁸ *Id.*

⁴⁹ WILLIAM E. MOOZ, JR., INTRODUCTION TO DOING BUSINESS IN MEXICO 106 (1995).

⁵⁰ *Id.*

⁵¹ *Id.* at 98.

which reduce the deductions allowable for U.S. tax purposes.⁵² Mexican entities other than *sociedades anónimas* can be structured as either pass through entities or corporations for U.S. purposes; *sociedades anónimas* are automatically treated as corporations.

Once the choice of entity has been made, a U.S. investor needs to be aware of other tax consequences within the U.S. Starting up a foreign business, which involves the transfer of U.S. based assets, may result in additional tax consequences.⁵³ A U.S. tax attorney needs to be consulted to determine the applicable tax liability for the specific business in question.

B. Mexican Tax Considerations

The type of entity chosen by a foreign investor will probably not affect the tax obligations of that entity under Mexican Law. The Mexican *Ley de Impuesto Sobre la Renta* will tax the business operation as a separate enterprise subject to the current income tax rate. As of January 2002, the current income tax rate was thirty five percent (35%).⁵⁴ Mexico operates under an integrated tax system, which means that the distribution of after-tax profits to the equity owners of the Mexican company will not be subject to a second level of taxation.⁵⁵

In addition, persons conducting business in Mexico are subject to a number of other taxes. These taxes include payroll related taxes payable by Mexican employers, a value added tax, an asset tax, and taxes imposed on the initial acquisition of real estate.⁵⁶ A tax attorney needs to be contacted for a complete assessment of the tax liability of a Mexican business under Mexican law.

C. The Tax Treaty

The purpose of the Tax Treaty, which became effective as of January 1, 1994, is to “reduce and eliminate double taxation of income earned by residents of either country from sources within the other country, and to prevent income tax avoidance and evasion.”⁵⁷ The Tax Treaty has helped minimize tax consequences for persons conducting business in both Mexico

⁵² *Id.* at 99. “For example, restrictions are placed on the deductibility of intangible drilling costs, foreign mining exploration and development expenses; depreciation would be allowable over a longer recovery period; certain foreign deductions would either be subject to recapture or reclassification as U.S. source income; and, if the partner has an overall foreign loss, or is in an excess foreign tax credit position, it may not fully benefit from the pass-through of deductions.” *Id.*

⁵³ *Id.* at 100.

⁵⁴ *Id.* at 98.

⁵⁵ *Id.*

⁵⁶ *Id.* at 123.

⁵⁷ *Id.* at 96.

and the U.S.

IV. Labor Relations

The Mexican Labor Code provides that at least ninety percent (90%) of a company's employees must be Mexican nationals.⁵⁸ If the enterprise requires technical and professional expertise, foreign nationals may be employed in numbers not to exceed ten percent (10%) of the workers in a particular specialty. Foreign companies and employees are legally obligated to train Mexican nationals in such particular areas of expertise. The requirement to employ Mexican nationals does not apply to the employment of directors, administrators and general managers.⁵⁹

The labor relationship must be established in writing, either through an individual contract or through a collective bargaining agreement. The lack of a written contract, however, does not take away from the employee the rights granted by the labor laws, and the employer will be considered responsible under the law for not complying with the legal formalities.

A. Compensation and Employee Benefits

1. Minimum Wage.

The minimum wage is fixed every year by the *Comisión Nacional de Salarios Mínimos*. The amount of the minimum wage is determined according to certain geographical zones as follows:

- a) Zone A, including Mexico City, Baja California Sur, Baja California Norte, and Acapulco;
- b) Zone B, including Guadalajara and Monterrey; and
- c) Zone C, including Cancun, Quintana Roo.

2. Mandatory Benefits.

Mexican law dictates the payment of a number of employee benefits, which often amount to a large amount of an employee's compensation. The following is a brief list and description of some employee benefits dictated by Mexican law:

- a) Vacations – Workers are entitled to six (6) days of paid vacation after the first year of work. The amount of vacation days will increase by two (2) days for each subsequent year of employment until

⁵⁸ *Ley Federal del Trabajo, D.O.*, April 1, 1970, as amended January 23, 1998, Art. 7.

⁵⁹ *Id.*

it reaches twelve (12) days. After the fourth year of employment, vacation time will increase by two (2) days per each five-year term of employment.⁶⁰

- b) Sunday Bonus – Sunday is legally a day off in Mexico. Employees that work on a Sunday are entitled to receive an additional twenty five percent (25%) pay of what they would be entitled to on a normal work-day.⁶¹
- c) Days Off – An employee who works on his or her day off will be entitled to receive its regular salary plus two times the amount of its regular salary for that day.⁶²

3. Mandatory Profit Sharing.

The Mexican Labor Code provides that an employer must share ten percent (10%) of its gross profits with its workers.⁶³ This profit sharing obligation applies to all companies having employees in Mexico, including branches of U.S. companies.

Half of the amount payable under this fund is allocated based on the employee's salary and the other half is allocated by considering the number of days each employee worked during the year. Every company employee (except for directors, administrative employees and general managers) is entitled to participate in the profit sharing fund.

The following companies are exempted from the obligation to share profits with their employees:

- a) New companies, during the first year of operation;
- b) New companies dedicated to the elaboration of new products during the first two (2) years of operation;
- c) New mining companies during the exploration period;
- d) Non-profit organizations;
- e) Public assistance companies; and

⁶⁰ *Ley Federal del Trabajo, D.O.*, April 1, 1970, as amended January 23, 1998, Art. 76.

⁶¹ *Id.* at Art. 71.

⁶² *Id.* at Art. 73.

⁶³ WILLIAM E. MOOZ, JR., AN INTRODUCTION TO DOING BUSINESS IN MEXICO 222 (1995).

- f) Companies with an outstanding capital lower than the one fixed by the *Secretaria del Trabajo y Previsión Social* for a particular industry, after consulting with the *Secretaria de Industria y Comercio*.

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