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ENTITY OF CHOICE FOR DOING BUSINESS IN MEXICO

(General Guidelines)

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INTRO

International companies frequently ask which is the best corporate vehicle to establish their operations in Mexico. Their main objective is to have a direct handle of the Mexican Market.

These guidelines are for general information, based on 30 years of experience and do not constitute specific business, legal or tax advice. Once the decision to invest in Mexico is taken we recommend verify with local counsel and tax advisor.

COMMON INITIAL OBJECTIVES FOR ESTABLISHING IN MEXICO

International companies with experience in selling their products or providing their services through local commission agents or reseller-distributors have the question as to "how" they enter into such market.

There are common denominators and similarities in the objectives of international companies that want to establish in Mexico, which generally can be described as follows.

1. Initially establish in Mexico with a light structure to develop the Mexican market;
2. The Headquarters are abroad and wish to keep the main management and control of the local entity. This management group will not reside in Mexico.
3. Keep a legal representative for Mexican matters, who will be residing in Mexico with certain managerial activities and limited powers of attorney, including signing of contracts, hire and fire personnel, and opening and closing bank accounts.
4. The Mexican Entity will also have local agents with powers of attorney for specific matters such as obtaining the tax ID, file tax reports, act before government agencies, file claims and perform collections. Normally these powers are given to local accountants and lawyers.
5. To ensure technical and commercial and follow-up the International Company can enter with the Mexican Entity into sales promotion and commission agreements, and/or into technical assistance and management agreements; and
6. Foreign Headquarters employees can come and reside in Mexico for periods of time. For them business visas can be obtained. Visas can be sponsored by the International Parent Company or by Mexican Entity, and are usually for 6 months and renewable.

To achieve these objectives, the International Companies usually face the following options to establish in Mexico, and they need to determine which the best one is:

BRANCH;
REP. OFFICE;
SUBSIDIARY; or
JOINT VENTURE.

BRANCH:

A branch in Mexico known as a “sucursal”.

foreign commercial companies in general look to have a “Sucursal con Ingresos”, that is, a branch that will yield and produce income.

A branch will be a new location, division, department, office, or extension of the International Company. A branch will not be a separate legal entity from the Headquarters of abroad.

A branch will not have its own capital equity or its own board of directors, and it will be totally controlled by the International Company abroad.

A branch will have to use in Mexico the International Company’s name the since the branch is a part of such International Company.

Also a branch will not be considered as an independent employer for Mexican labor purposes. The Foreign Headquarters will be considered the employer of record for Mexican law.

REPRESENTATIVE OFFICE

Foreign companies whose intentions are just to promote their products or services without closing sales in Mexico, or charity institutions or foundations, will look to have a “Sucursal sin Ingresos” also known as Representative Offices or “Oficina de Representación sin Ingresos”. These are branches with no income.

SUBSIDIARY:

A subsidiary will be an independent legal entity incorporated in Mexico. It will be Mexican Company.

Note that Mexico has the requirement to have at least 2 shareholders/partners for each legal entity.

Usually foreign companies become the parent of the Mexican subsidiary, owning or controlling most of the equity of the subsidiary; the minority may be owned by another equity holder from its same group, or even from Mexico. This is situation is commonly known as “wholly owned subsidiary”.

No need to have a mayoralty Mexican equity in any company except for strategic trade areas reserved to the Mexican Government or to Mexicans.

The Subsidiary will be defined by its own By-Laws, and will be a stand alone company, and will have its own (i) capital structure, (ii) scope of business, (iii) administration, and (iv) agents, with powers on behalf of the subsidiary.

The subsidiary's accounting and tax treatment will be totally independent from any other entity abroad (contrary to a branch).

The subsidiary will be considered as an independent employer for labor purposes.

JOINT VENTURE:

A joint venture is normally achieved by entering into an association agreement with a local Mexican Partner. Joint Ventures translate into an agreement

A Joint Venture Agreement (also "JVA") is a private agreement which can take any form or name, but is one where two or more individuals or legal entities jointly undertake a business venture for a period of time.

Even though verbal/oral agreements are valid in Mexico, a written JVA is recommended.

A JVA is recommended before establishing a company or performing any deal with local associates in Mexico. Joint Venture Agreements are usually entered with local Mexican Partners because they already know the Mexican market and can provide the International Company with easier accesses to the market.

International Investors frequently wish to enter into Joint Venture Agreements with their local commission agents, or reseller-distributors.

The JVA can take any form that the parties decide. The exact type of business venture determines the liability and tax treatment.

Sometimes a JVA takes the form of an "association in participation agreement" with an active partner (in Mexico) and a silent partner (abroad).

In a JVA, the Parties agree on how they will provide their respective contributions, share risks and divide profits. It defines the "business equation" among the parties.

However, most of the time a JVA results in further establishing a Mexican company, whose By-Laws become public and are registered at the Registry of Commerce.

We recommend that the "business terms" be only included in the JVA, but not in the By-Laws of the Mexican company, since third parties will have access to privileged commercial information and the "business equation" among the parties.

The reason for this is that the By-Laws of a Mexican company are registered before the Public Registry of Commerce, and the terms of the JVA are not.

Both, the terms of the JVA and the provisions of the By-Laws, have the same validity among the parties. Nevertheless, the By-Laws will also have effects before third parties.

The By-Laws typically refer only to the (i) capital structure, (ii) scope of business, (iii) administration, and (iv) powers of attorney of agents of the company.

The sole existence of the By-Laws of a company without a previous JVA among the parties could lead to misunderstandings.

Additional Agreements:

Aside from the creation of a Mexican Company, the JVA usually results into additional agreements among the Parties, to be carried through the Mexican Company, such as: financing; technical assistance; management consulting; sale of assets; marketing services; distribution; labor support; supply; etc.

The parties individually can enter into agreements in all these areas.

TWO BASIC OPTIONS FOR DOING BUSINESS: (I) BRANCH, OR (II) SUBSIDIARY

Considering the above explanations and from experience, we can basically divide the options for legal entity in Mexico in 2 (two): (i) a branch, or (ii) a Mexican subsidiary or local company.

GENERAL OPINION

From experience, and considering the typical business objectives of international companies doing business in Mexico, and how to best protect the international investors under Mexican legislation, in our opinion is preferable to establish a COMPANY in Mexico (subsidiary), rather than a BRANCH.

Note however that for business reasons some clients are required by their customers to establish branches rather than subsidiaries. For example that happens when the customers are government agencies.

REASONS FOR CHOOSING A LEGAL ENTITY

The decision of establishing a BRANCH or a MEXICAN COMPANY is usually related to:

- (i) Difficulties and timing in setting up in Mexico,
- (ii) Corporate, accounting and tax control, and
- (iii) Liabilities from the corporate, labor and tax perspectives.

From experience, sales promotion offices, that will always be promoting sales without engaging into trade, tend to be established as branches in the form of representative offices with no income.

The same is true for international charity institutions or foundations that give grants and economic assistance to groups in peril or under health risks ("sucursal sin ingresos").

However if the International Company wishes to get involved into the local market for selling products or servicing to clients and generating income, the best vehicle will be to establish a Mexican company.

Locally incorporated Mexican commercial companies have no obligation to yield profits, nor obligated to generate any sales. Tax reports can be declared in zeros ("0") until profits start to appear.

I. STEPS AND TIMING IN SETTING UP A COMPANY AND A BRANCH:

In practice the steps to incorporate a Mexican Company and to register a Branch in Mexico are very similar.

However, the time frames and costs of incorporating a Mexican Subsidiary are less for than registering a Branch.

To establish a Branch in Mexico, the International Company will have to take a corporate resolution abroad resolving on establishing the Branch in Mexico. The International Company will also need to grant special powers of attorney a local agent (our Firm) to establish the Branch in Mexico.

Said corporate resolutions and POA will have to be notarized abroad and legalized abroad ("Apostille" or "consularization" at the Mexican Consulate abroad).

Legalization, through an Apostille, means that the foreign country in question is part (together with Mexico) of the Hague Convention on the Legalization for Foreign Public Documents, for validating documents of the Member Countries. You can information on the Apostille legalization process in many Web Pages.

This process is usually by notarizing the document and taking it to the Apostille Agency or the Mexican Consulate abroad in which the document is issued.

All these documents, plus the Evidence of the legal existence of the Company abroad (certificate of good standing), and its By-Laws and Articles of Incorporation, have to be also legalized, and then sent to Mexico, to be translated by certified Mexican translator.

Thereafter, we will need to present those Documents to the Mexican Foreign Investment Authorities (Ministry of Economy) and file for a Permit on behalf of the International Company to establish the Branch in Mexico, and thereafter continue the fling with the Ministry of Foreign Affairs.

Once approved all Documents should be notarized in Mexico, and file for the Commercial and Tax Registrations.

Opening a branch will place the International Company within the jurisdiction of the Mexican (i) laws, (ii) authorities, and (iii) local courts.

On the other hand, establishing a Mexican Company, we will just need to get:

- (i) The approval of a corporate name for the Mexican Company, from the Ministry of Foreign Affairs;
- (ii) Get from the International Company abroad special powers of attorney in favor of our Firm to incorporate the Mexican Company (legalized-apostille);
- (iii) Draft the local By-Laws and First incorporating Meeting deciding on (a) Capital Structure, (b) Management, and (c) local special agents; and
- (iv) Get those POA notarized in Mexico.

Once that is done, the Company becomes incorporated.

Thereafter we will apply for the Commercial and Tax Registrations, and notify the Foreign Investment Registry that the Company has been incorporated.

II. CORPORATE APPOINTMENTS AND RESOLUTIONS EFFECTIVE IN MEXICO:

From the corporate point of view, it will be more burdensome to operate a Branch than a Company in Mexico because of the following.

Branches or Mexican Companies need to appoint agents with corresponding powers for carrying out several aspects of their daily businesses in Mexico.

Under Mexican commercial legislation, such appointments and powers need to be granted in writing, through a corporate resolution, or delegation from an administrator or empowered agent.

Thereafter such resolution or delegation should be formalized before a Mexican Notary Public, and many times registered at the Mexican Registry of Commerce.

These appointments and powers may fall on one or more persons. Some times these appointments and powers are needed for urgent filings or to answer litigation claims.

In the case of a Branch, any corporate resolution from the International Company, resolving on powers and appointments need to happen at the Headquarters of the International Company and then make them valid in Mexico. Therefore the stages will be:

1. The International Company should hold a Corporate Resolution abroad;
2. Obtain Notarization abroad of such Resolution;
3. Obtain Legalization (Consularization or Apostille) abroad of such Resolution;
4. Send in Original to Mexico;
5. Prepare certified translations into Spanish of such Resolution and Legalization;
6. Notarize the translated Resolution and Legalization with a Mexican Notary; and
7. Further Registration at the Tax and Commercial Registries.

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From experience, the foregoing steps will require around 3 (three) WEEKS or more, with the additional burden and cost.

The danger of time delay arises in case of emergencies to fulfill with business operations, or for government filings, claims or litigations.

In a Mexican Company, most times the corporate resolutions just require:

- (i) Preparing paper minutes (previous instructions from abroad) including the terms of corporate resolutions;
- (ii) Send those Minutes, and obtain the signed proxies from shareholders/partners abroad by e-mail;
- (iii) Take the Minutes to the Mexican Notary and,
- (iv) If necessary, send the notarized minutes and resolutions to registration.

This usually takes between 2 (two) to 3 (three) DAYS, and is less costly.

III. LIABILITIES (-CIVIL, TAX, LABOR-):

A Mexican subsidiary company will insulate (protect) the International Company, abroad, from liabilities in Mexico derived from the activities of the subsidiary that may result in civil (tort), tax, labor liability (except, possibly, for product liability).

This because a Mexican company/subsidiary will be a different entity than the International Company abroad, and therefore any liability or claim, by any third party, will remain in Mexico and will not affect the Parent Company abroad.

On the other hand, a Branch will make the International Company abroad, totally responsible for what will happen with its Branch in Mexico.

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We expect that these guides help international companies decide on the best legal vehicle to do business in Mexico.

Respectfully Submitted,

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