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Selling Products and Securing Sales in Mexico

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These Guidelines are based on 30 years of experience in this field. They provide general information and selected comments on legal issues of interest to our Clients. The following contents are not a comprehensive treatment of the subject matter covered and is not intended to provide specific legal or tax advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein

I. AGENCY, COMMISSION AGENCY, AND DISTRIBUTION

A foreign company that is testing the Mexican market for its products or services has traditionally used four basic commercial vehicles: (1) appoint a sales agent in Mexico; (2) appoint a commission (sales) agent (commercial intermediary); (3) enter into an agreement with an independent distributor in Mexico; or (4) license technology (for example in a franchise operation).

If the market is ripe foreign companies decide establish a subsidiary in Mexico to have a "hands on" control on the market.

1. DIRECT SALES AGENT.

Is an agent of a foreign company performing business acts in Mexico in the name and on behalf of the foreign company.

Even though this scheme has the appearance of doing business from abroad, it actually is doing business in Mexico and creates a branch operation for tax purposes ("permanent establishment"), as explained below.

A. IMMIGRATION REQUIREMENTS.

The Immigration Act (*Ley General de Población*) is Mexico's current Immigration Act and provides for the terms and conditions upon which foreigners may enter into and conduct business in Mexico.

Typically, a sales agent is classified as either (i) "business visitor", and can stay in Mexico for up to 180 days; or as (ii) a "Temporary Resident" from 1 (one) to 4 (four) years.

A sales agent should not enter Mexican Territory as a tourist when the underlying purpose of his/her trip is to do business in Mexico (i.e. visit customers, take orders, engage in contract negotiations connected with the principal's business activities in Mexico). Failure to comply with immigration provisions carries penalties ranging from a fine or deportation to a felony charge.

B. APPLICATION OF THE MEXICAN LABOR LAW TO SALES AGENTS.

The Mexican labor legislation (the "Labor Law") applies to all labor relations performed within the Mexican Republic.

The Labor Law applies to any employer, within Mexico or abroad, that has a subordinate in Mexico performing services for the employer in Mexico. In such case, the legal effects of acts and contracts will be governed by the Labor Law.

C. CONSEQUENCES OF THE APPLICATION OF THE LABOR LAW.

In Mexico, the Labor Law and other laws derived from it, such as the Social Security Law (*Ley del Seguro Social*) and the Workers Housing Fund Institute Law (*Ley del Instituto del Fondo Nacional para la Vivienda de los Trabajadores*) are applicable to both foreign Company and sales agent located in Mexico. These regulations cannot be waived. (For a detailed explanation on this, see below.).

The employee will have to declare its labor related taxes and pay its Social security and related quotas. The Foreign employer is exempted from that.

D. TAX CONSEQUENCES - PERMANENT ESTABLISHMENT.

Foreign companies performing business operations in Mexico, are deemed to be doing business in Mexico and creating a local branch operation for tax purposes ("permanent establishment").

There are several ways of creating permanent establishments in Mexico, but among typical ones are having:

- (i) Employees in Mexico with the power to execute contracts on behalf of the foreign company to fulfill its business activities;
- (ii) Goods and merchandise in Mexico delivered on its behalf; or
- (iii) An individual assuming business risks on behalf of the foreign company.

E. WHAT IS NOT CONSIDERED PERMANENT ESTABLISHMENT.

The following cases in which the law does not apply the concept of permanent establishment:

- (i) The use of an independent agent whose relationship with the foreign resident is arms-length;
- (ii) The maintenance of premises or installations for the sole purpose of storing, displaying or delivery of goods or merchandise;
- (iii) The keeping of goods or merchandise for a foreign resident, for the sole purpose of storing or displaying it or for being transformed by a third party (e.g. for "*maquila*" operations);
- (iv) Having a business place with the sole purpose of buying goods or merchandise or for obtaining information for the resident abroad;
- (v) Having a business place with the only purpose of performing "preparatory or auxiliary" activities for the foreign resident. These activities should consist of something similar to those of promotion, supply of information, scientific research, preparations to grant loans, or other similar activities; or
- (vi) Deposit of goods or merchandise of a foreign resident in a general deposit bonded tax warehouse, or their delivery for further importation into Mexico.

F. TAX BASE OF PERMANENT ESTABLISHMENTS.

In general terms, any foreign company with a permanent establishment in Mexico will be treated like a branch and taxed as a Mexican company.

The tax base for a permanent establishment will be all income derived from such establishment's business activities in Mexico.

This tax base includes income derived from the selling of goods or providing services in Mexico out by the permanent establishment.

The permanent establishment will be allowed deductions for expenses incurred in the particular operation in Mexico which may be prorated with the head office or other offices located outside Mexico as long as those expenses relate to the Mexican operations.

Remittances to such offices in payment of royalties, fees, commissions, etc. are not deductible.

G. INCOME TAX ON PERMANENT ESTABLISHMENTS.

A permanent establishment is subject to the corporate tax rate of 30% applicable to the tax base as described above.

Such permanent establishment must appoint a representative in Mexico who will be personally responsible before Tax Authorities for the corresponding tax filings.

H. PERMANENT ESTABLISHMENT AS A REGULATED INVESTMENT.

The existence of the foregoing permanent establishment tax treatment refers to a situation in which the foreign entity establishes a presence in Mexico.

A permanent establishment results in the foreign company doing business **"in"** Mexico for tax purposes. Therefore the foreign company may require a prior authorization or at least registration with Foreign Investments Authorities.

Such authorization will depend on the interpretation given by the authorities to the concept of "doing business **in** Mexico" for commercial purposes.

The test of what constitutes **"doing business in Mexico"** is twofold, that the foreign company:

- (i) Engages in commercial activities in Mexico; and if so,
- (ii) Does it conduct such activities regularly or continuously (a test of habit). This is a fact specific investigation and is decided on a case by case basis.

Conservatively speaking, it might be that Authorities will consider that the foreigner is regularly engaging in commercial activities in Mexico when performing two or more operations through a permanent establishment in a reasonably short period of time.

An agent in Mexico performing any of the foregoing activities will result in a "permanent establishment". Therefore, the agent will probably be deemed to be "doing business in Mexico" and therefore subject to authorization under the Foreign Investments Legislation.

2. COMMISSION AGENT (COMMERCIAL INTERMEDIARY).

There are no specific rules or legislation for commission agency agreements. The basic rules of contracts and the free will of the parties will apply to these agreements.

The appointment of a commercial intermediary implies the existence of a foreign contractor appointing an agent with limited powers.

The extent of these powers should not include activities that make the foreigner have a permanent establishment in Mexico.

A foreign company usually appoints a commission agent, usually agreeing on a pre-determined territory to win new business and increase the goodwill of the foreign company's products.

The commission agent is usually an individual or a company in a specific area where they have an excellent understanding of the market in order to generate sales for and raise the profile of the business.

A commission agent typically conducts market research, and promotes, solicits, and negotiates the sale of the contractor's products.

The agent will only be furnishing the prospective Mexican clients with information such as pricing and payment policies. The agent can also process and forward orders, and can even accept payments on behalf of the foreign resident. Hence, the agent performs "preparatory or auxiliary" services for the contractor.

The contractor abroad maintains authority to accept the purchase orders made by the Mexican customer, and in general determines the policy to be followed in the acceptance of the different offers.

The legislation in Mexico allows for arms-length negotiations among both contractor and the commission agent including compensation or the termination of an agency relationship.

The typical fee for an agent may consist of a straight commission on orders accepted, or a monthly retainer plus commission.

If it is an independent contractor is hired in Mexico for such purposes, it is customary to advise the agent to refrain from using the name and logo of contractor in his/her offices, business cards, or letterhead. This will avoid the appearance of having an establishment in Mexico and insure that the intermediary agreement is not a sham transaction.

A foreign company having a significant export volume or an extensive product range most commonly takes this route. It is probably best to contract with a company rather than hire an individual for these activities due to the fact that Mexican labor law favors the dismissed.

The final customer in Mexico is the one that acquires title of the product abroad and imports them into Mexico.

3. DISTRIBUTOR.

As a third alternative is a distributorship agreement.

Under This agreement a foreign company further develops its sales and offers adequate servicing through an independent Mexican company or individual, who acquires the products outside of Mexico from the foreign company and resells them in Mexico.

The distributor acquires title of the product abroad, imports them into Mexico, and resells them in Mexico.

The distributor may not appear as an attorney-in-fact of the foreign seller, but shall only purchase and further wholesaler/retailer the merchandise to its customers in Mexico.

It will not have authority to bind the foreign company and therefore being able to avoid the "permanent establishment" issue.

A. U.N. CONVENTION ON THE INTERNATIONAL SALE OF GOODS.

Mexico is a party to the U.N. Convention on the International Sale of Goods (1980), which has rules on the creation, development, enforcement and termination of the sale of goods among parties from Member States of such Convention. Parties in an international operation for sale of goods can waive the application of the provisions of the Convention.

B. DEALERS ACTS.

Mexico has not enacted a Dealers Act like many other Latin American jurisdictions. Such Acts regulate all distribution agreements in the host country, stating limitations as to the execution, performance and the causes of termination.

In Mexico There are no specific rules or legislation for distribution agreements. Any distribution agreement will be governed by the general contract provisions of the Civil and Commercial Codes which are very similar to the ones found in Civil and Commercial Code and Status worldwide. The basic rules of contracts and the free will of the parties will apply to these agreements.

II. TRANSACTION TERMS AND SECURING PAYMENT WHEN SELLING GOODS IN MEXICO

1. WRITTEN AGREEMENTS AND DOCUMENTS

Although a written agreements are not necessary in Mexico to consider an international commercial transaction valid and enforceable in court, documentary evidence substantially helps to bring a stronger case upon collection and make for shorter proceeding.

International companies should to support the sale of goods with a formal written contract.

2. DOCUMENTS IN LIEU OF CONTRACTS

In lieu of such a contract they should try to have hard evidence on every detail about the transaction with the use of relevant information in signed documents, and with exchange of faxes and/or mails. Such relevant information is:

- (i) Statement from the debtor on its identity and location;
- (ii) Terms of sale;
- (iii) Parties' obligations, the
- (iv) Status of the amount in debt.

Such conditions can be achieved by implementing the following documents:

A. CREDIT APPLICATION BY THE BUYER

This represents an essential document to support a claim. It will be important to include, among others, the terms of sale, the debtor's identity, the authorized personnel to make purchase orders, and personal guarantees by key shareholders.

An original signed copy of such application must be requested at some point during the initial stages of the transaction.

B. PURCHASE ORDERS (PO's)

Equally important is to have documents that prove that certain goods were requested (thoroughly specified), that buyer promised to pay on certain terms, and to receive such goods on a specific location.

Such PO's are only to be considered if submitted and signed by appropriate personnel. The carrier can also help request the original signed PO.

C. RECEIPT OF GOODS SOLD

This is fulfilled by handling and obtaining a proper bill of lading by the carrier. The carrier must be instructed to specify the date of delivery, and obtain the full name of the person receiving the goods and obtain its acknowledging receipt signature.

If there is no carrier because buyer is taking care of freight or transportation, a receipt for such goods must still be obtained by the buyer.

III. MEANS OF SECURING PAYMENTS AVAILABLE IN MEXICO

As follows are the most common and helpful legal instruments for securing payments in financed sales in Mexico:

1. COMMERCIAL PLEDGE.

This pledge is a device that creates a security interest on debtor's personal or "movable" property, such as goods recently acquired out of an international sale.

For years, Mexican law required that goods securing a credit be delivered to the creditor (supplier-seller). Now, recent amendments to the Negotiable Instruments and Credit Transactions Law (May, 2000) allow creditors to retain an interest in the pledged property while debtors retain possession.

Another feature of this new pledge is the possibility of creating a security interest in present and future collateral, as well as to secure present and future obligations. Future collateral include after-acquired property, proceeds, account receivables, etc.

2. MORTGAGE.

The mortgage agreement allows a creditor to establish a security interest in the debtor's real estate property to secure payment of any credit with priority over other creditors.

Upon default of the obligation secured, the creditor has the right to request the foreclosure of the mortgaged property before a judicial court and obtain payment of its debt with the proceeds derived from the foreclosure.

3. TILE RESERVE-CONDITIONAL SALE.

Here the seller reserves title to the goods sold until buyer completes full payment. This method is effective and appropriate when the goods sold can be identified and can be recorded at the Buyer's Merchant File at the Public Registry of Commerce of the Buyer's place of business.

Proper recording allows a seller immediate repossession of the goods in case buyer defaults payment, even in bankruptcy or strike proceedings.

4. BOND.

In a bond the obligor guarantees the fulfillment of an obligation of a third party buyer-debtor. Bonds are usually granted through bond agreements.

Bonds can be granted by private individuals or companies, but are usually granted by government chartered bonding companies.

If the bond is granted by a private individual or company as obligor, the obligor is usually the main owner of the buyer-debtor company, and should pay with its personal assets in the event of default by the buyer-debtor. Bond obligors can be sued first regardless of the action against the original buyer-debtor being exhausted or not.

Private bonds are usually called internationally as guarantees.

5. GUARANTEE.

Bonds are also known internationally as a "guarantee." Guarantees are also known as a personal guarantees or unconditional endorsement guarantees.

These are usually unilateral declarations. They are often granted by individuals or companies related to the third party buyer-debtor, and guarantors are jointly and severally liable for the debt of the buyer-debtor.

Guarantors can be sued first regardless of the action against the original buyer-debtor being exhausted or not.

6. LETTER OF CREDIT.

Through a letter of credit the issuing bank commits up front to pay on behalf of buyer-debtor a specified amount of money to the seller-supplier when presented with a specified set of documents evidencing delivery of the goods: invoices, packing list, bills of lading, etc.

Although this is the safest way of securing payment, it is also the more expensive and difficult to get since the buyer will have to secure a line of credit from the issuing bank and the banks charge high commissions.

A letter of credit issued by a Mexican bank and dishonored can be enforced against the bank through summary proceedings.

7. PROMISSORY NOTE.

It is advisable to have debtors sign promissory notes (“pagarés”) for current or past due accounts. This helps by limiting defensive arguments and excuses a debtor may have in responding to a claim in court. This also enables a creditor to obtain an immediate attachment upon filing a complaint before the court. Drawing up a promissory note is fairly simple and promissory notes follow similar principles worldwide. Dishonored Promissory Notes can be enforced against the issuer through summary proceedings.

8. DEBT ACKNOWLEDGMENT.

It is advisable to have buyer-debtors sign a Debt Acknowledgment (“Reconocimiento de Adeudo”) for current or past due accounts.

These Debt Acknowledgments have to be signed before two witnesses. Debt Acknowledgments do not have to be executed before a Notary Public or registered at the Registry of Commerce to be valid; however that is advisable to have hard evidence of their existence, and to notify third parties once registered.

A dishonored Acknowledgment of Debt Agreement can be enforced against the debtor through summary proceedings.

IV. IMPORTER'S LICENSE

Any individual or legal entity, such as the Mexican Subsidiary of a foreign company, that will be bringing products into Mexico on a commercial manner, it must be registered at the Importers Registry.

This Registry depends on the Ministry of Treasury and its purpose is to have well established companies as importer and to avoid contraband.

The Importers must be duly incorporated, registered at the registry of commerce, and at the Federal Registry of Tax Payers and be current in their tax obligations.

For occasional imports you can use the services of an international courier company, or a Mexican customs broker. Customs brokers usually have importing/trading companies that can provide such service for a fee.

* * *

We hope you find this information useful for your operations in Mexico.

Respectfully Submitted,



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Legal services to international
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initial agreements to complex operations

We have being established for over 22 years, maintaining an excellent reputation.

We provide Legal Services to international and national companies in all business areas, from initial agreements to complex operations. We add value to our clients with timely and useful services.

Our Services include: company incorporation, corporate governance, contracts, mergers & acquisitions, distribution agreements, credit and secured operations, tax, labor, real estate, health, immigration, intellectual property registrations, and regulatory filings and government claims.

We keep high ethical standards, quality controls, and excellent organization systems.

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