

THE MEXICAN MAQUILADORA INDUSTRY LEGAL FRAMEWORK

GENERAL CONCEPT

Investors from around the world have taken advantage of the benefits of Mexico's in-bond industry, otherwise known as the Manufacturing, Maquiladora and Export Service Industry Program ("IMMEX").

An IMMEX is granted to a legal entity that is formed in Mexico with the purpose of manufacturing, assembling, repairing, servicing, or other processing of goods that are destined mainly for the export market.

In order to apply for and obtain an IMMEX the applicant must have a Mexican legal entity.

CORPORATE VEHICLE

A corporate vehicle is to be used as the IMMEX applicant. The most recommended (and most used) types of Mexican corporations are the Sociedad de Responsabilidad Limitada (S. de R.L.) and the Sociedad Anonima (S.A.).

The S. de R.L., is a closely held type of corporation. It is required to have at least 2 and up to 50 partners and a minimum of \$3,000.00 pesos capital stock, divided into partnership quotas that may not be represented by negotiable instruments such as stock shares. For U.S. tax purposes the S. de R.L. is eligible to "check the box" and consider the corporation as a pass through entity.

The S.A., is a public corporation. It is required to have a minimum of 2 shareholders and \$50,000.00 pesos of capital stock, with an unlimited maximum. The capital stock of an S.A. is represented by negotiable stock share certificates.

The capital stock of a Maquiladora company may be 100% foreign owned.

The S. de R.L. and the S.A. can be managed by one or more persons. If the S. de R.L. is managed by one person, he or she is to be General Manager. If, on the other hand, it is managed by several persons, they form a Management Board.

If the S.A. is managed by one person, he or she is the Sole Administrator. If it is managed by several persons, they form the Board of Directors.

Incorporation of all commercial associations, such as the S. de R.L. and the S.A., is carried out before a Mexican notary public or commercial broker. The time frame for incorporation is generally between 2 to 5 days, provided that all necessary information and documents are received on a timely manner, such as names and addresses of incorporating agents, proxies, names and addresses of partners or shareholders, as well as filing of registration before tax authorities.

Capital Variable (Variable Capital) or “C.V.” modality.

Legal entities with the Variable Capital (C.V.) modality are susceptible of further capital increases by shareholders contributions or admission of new shareholders, and of reduction of capital by total or partial withdrawal of the contributions of the shareholder, without the need to amend the incorporation charter of the legal entity.

Both the S.A. and the S. de R.L. can be incorporated with the C.V. modality, becoming an S.A. de C.V. or a S. de R.L. de C.V.

THE IMMEX

Once incorporated under any of the above referred types of Mexican corporations, the company must file an application requesting authorization of its Decree for the Promotion of the Manufacturing and Exportation Services Industry (IMMEX) before the Ministry of Economy, under any of the modalities foreseen in the IMMEX Decree, such as Industrial Maquiladora, Holding Maquiladora, Service Maquiladora, Third Party Outsourcing (Certified Companies) and/or a Maquiladora that carries out Shelter programs.

The Decree establishes a time frame of 15 working days for the process of analysis and approval of an IMMEX, and any Program Extension will be granted in 10 working days. Depending on some delegations of the Ministry of Economy, and provided that all necessary information is furnished accurately and in a timely manner, said Ministry may take less time to review and authorize the IMMEX. However, if the Ministry shall not grant any answer to those procedures regarding the IMMEX or extensions, in the periods of time herein mentioned, the procedure applications will be considered approved.

The Ministry of Economy, after authorizing the IMMEX, will notify this to the Treasury Department, in order for the company to be registered in the Importers Registry (Padrón de Importadores). Consequently, the company may start to carry out the importations of the merchandises under the IMMEX.

The Decree establishes that the procedures related to the Program should be carried out through electronic means.

As for extension for the IMMEX, as of April of 2008, they are no longer required, except for textile corporations, corporations importing raw material considered by the Ministry as sensible and services provider maquiladoras, which are still subject to this obligation.

Keep in mind that any extension will be granted in 10 working days if all the necessary information is provided to the Ministry of Economy in a timely manner.

RATES AND DUTIES ON RAW MATERIALS AND CAPITAL GOODS

When assessing the feasibility of a Maquiladora operation, it is advisable to investigate whether or not duties will have to be paid on the raw materials upon their time of exportation from Mexico, as well as

consider the duty rates on capital goods when imported into Mexico, since the payment of duties are waived for products being imported by one of the countries, with which Mexico has celebrated a Foreign Trade Treaty.

The IMMEX approval entitles a company to temporarily import Value Added Tax (IVA) free into Mexico, all machinery and equipment, and raw materials required for its manufacturing, assembly or repair process, as specified in the IMMEX.

The machinery and equipment imported into Mexico may remain in the country for as long as the IMMEX is in force, and the raw materials may remain in Mexico for up to eighteen months, except when said materials are considered as sensible, the period being calculated as of the day such are imported.

Raw Materials:

All raw materials imported into Mexico by a Maquiladora, originated from a NAFTA country in terms of NAFTA'S chapter IV (Rules of Origin), are exempt from import duties.

Raw materials imported into Mexico by a Maquiladora, from a Non-NAFTA country and exported to a Non-NAFTA country or a NAFTA country, are exempt from import duties, provided such raw materials are from a country with which Mexico has a Foreign Trade Treaty.

Capital Equipment:

In accordance with the IMMEX Decree, imports of capital equipment by Maquiladora operations will be subject to the payment of import duties.

Capital equipment imported before January 1, 2001, may remain in Mexico under the provisions established in the Mexican Customs Law, without the application of import duties. The IVA exemption will still be granted.

Sectorial Program:

In 1998 the Ministry of Economy created the Sectorial Promotion Program, currently known as "Prosec" (Programa Sectorial).

The IMMEX Decree from November, 2006, now allows the Ministry of Economy to authorize simultaneously a Prosec Program, together with the authorization of an IMMEX Program. The Prosec Program is authorized as long as the goods assembled are within the range of industries authorized.

This program allows for the elimination or reduction of duty rates for certain industries, with duties averaging between 0% and 5%.

This program was created in order to offset the impact of NAFTA's Article 303, for key industries. The Prosec started with two industries, electronic and electric. It currently contains 22 different industry sections, such as furniture, automotive, textile and medical equipment, and new industries are continuously being considered to be added to the program.

SALES IN MEXICO

As of November, 2006, the Maquiladoras, under any of the modalities, can carry out sales in the Mexican market. However, they have the commitment of making annual sales outside the country for a value greater than US\$500,000.00, or its equivalent in pesos, Mexican Currency, or invoice exportations, of at least 10% of their total invoicing.

Transfer pricing considerations, value added tax and duties, must be verified before these sales take place.

TRANSFERS AND SUB-MANUFACTURING

It is common that Maquiladora companies manufacture products that will not be exported directly by them, but rather be sold to other manufacturing companies in Mexico, which in turn incorporate those products to their own, and thereafter, become the final exporters.

Another common variation of the Maquiladora activity is to engage in sub-contracting, “submaquila”, in order to receive products, sub-products, sub-assemblies or raw materials from other Maquiladoras to be processed and returned to the original importers for subsequent exportation.

The Maquiladora and submaquila activities are permitted under current legislation and are regulated by it. However, prior authorization must be applied for and obtained from the Ministry of Economy before starting such activities.

The submaquila operation may be carried out between Maquiladoras with an authorized program, or a company that does not have any exportation program, but is registered in the IMMEX Program of the company which is contracting the submaquila program, and such operation will be an industrial complementary process of the merchandise that is prepared by the title holder of the IMMEX Program.

A certified company can perform manufacturing operations through third parties, if such certified company does not have its own facilities to carry out the production process.

Under no other circumstance may a company that does not have an export program claim the benefits of the IMMEX Decree.

ENVIRONMENTAL REGULATION

An important part of the authorization process of a Maquiladora operation that could be requested, is the authorization of the corresponding environmental authorities. In most cases, the authorization must be obtained from the State Ministry of Ecology. In some exceptional situations, the authorization must come from the Federal Ministry of the Environment and Natural Resources (SEMARNAT).

In all cases, the authorization of SEMARNAT will be required if hazardous materials or waste will be produced by the Maquiladora operation.

LABOR

According to Mexican labor law, 9 out of 10 workers hired by an employer must be Mexican nationals. However, Maquiladora companies have enjoyed a flexible enforcement of this rule with regard to management and technical personnel. Furthermore, this rule does not apply to foreign workers who are not employed by the Mexican Maquiladora company but rather by a foreign company while rendering

their services in Mexico. Foreign employees must request an entry visa, called FM-3, for which purposes the Maquiladora company must first request Mexican immigration authorities to open a so called "basic file" of the company. Please refer to "Highlights of the Mexican Labor Legislation", for further details.

Under the North American Free Trade Agreement, for technical and administrative personnel not hired by the Mexican Maquiladora company, but rather by its foreign counterpart and who will enter Mexico only for short periods of time, a document called FMN is a faster alternative to the FM-3. However, this applies only to citizens from Canada and the U.S.A.

A similar document called FMVC is the alternative for citizens from other countries which have trade and immigration agreements with Mexico.

TAXES

Income Tax:

Generally speaking, Mexican Maquiladora companies are treated just as any other Mexican corporation for tax purposes. The applicable annual rate of Income Tax is 30% (The tax rate of 30% will apply from the years 2010-2012, then it will start to decrease to 29% during 2013 and eventually return to 28% in 2014 as it was in 2009).

VAT:

Value Added Tax (IVA) is eleven (11%) percent in the border region areas and sixteen (16%) percent in the interior of Mexico. It is payable by the Maquiladora company on all purchases of goods and services in Mexico, as well as on all definitive imports. Temporary imports are exempt from IVA. The 0% rate is applicable on all exports of the company. The amount payable is the difference between the IVA charged to the company by its suppliers and that which it charges to customers. If the former is greater than the latter, the difference is refundable upon request.

In addition, as of January 1st, 2008 the Flat Rate Business Tax ("FRBT") was enacted, replacing the Asset Tax.

Business activities carried out by corporations of individuals regarding sales, rendering of services and leasing of goods are taxed with the 17.5% rate.

The FRBT tax applies on gross income minus business deductions, all computed on cash basis. Purchase of inventory is deductible as paid not as cost of sale. Purchase of fixed assets is also deductible instead of depreciation.

Salaries are non-deductible, instead a 17.5% credit computed on salaries is allowed, the credit applies on taxed salaries; therefore, any tax free fringe benefit will ultimately be taxed with the FRBT.

FRBT is compared with the Income Tax and the taxpayer would pay the highest (as an alternative minimum tax).

On November 5th, 2007, a Presidential Decree was issued to grant an additional tax credit to limit the liability of Maquiladoras to 17.5% of the taxable income. This credit was intended to be applicable up

to December 31st, 2011; nevertheless, on October 12, 2011 it was published in the Daily Official Gazette (D.O.F.) an amendment to said Decree which extends the credit to be effective until December 31st, 2013.

The fiscal year of all Mexican corporations must coincide with the calendar year. Companies must file Income Tax estimated prepayments after their first fiscal year. The yearly Income Tax return must be filed within the first three months of the following year. The yearly return will include Value Added Tax and Asset Tax.

Tax returns are filed via Internet and payments are electronically transferred from the bank.

Arm's length principle applies to transfer pricing arrangements between the Maquiladora and related companies abroad. Therefore, special attention should be paid to such arrangements in order to comply with said principle.

The Mexican tax authorities are empowering the application of transfer pricing and permanent establishment regulations, Maquiladoras may opt to alternative procedures for compliance. Applicable provisions must be reviewed for an overall tax planning.

REAL PROPERTY

Generally, Maquiladoras and other companies have two alternatives with regard to the use of facilities, to lease or to purchase.

If property is to be purchased, it may be acquired directly by the Mexican Maquiladora company.

Mexican companies with foreign investment may acquire direct title to real property located in Mexico's restricted zone (a strip of land of 50 km. extending throughout the country's perimeter from the coastlines and 100 km. from the borders), provided that said land is used for industrial, tourist or commercial purposes, as opposed to residential purposes.

Outside of the restricted zone, all Mexican companies and foreigners may acquire direct title to land, regardless of its usage.

Within the restricted zone, foreign companies must use a bank trust to acquire title to real property. Said trust may have a duration of up to 50 years and it is renewable. Under such trust, the trustee bank holds title to the land and in performance of the trust agreement, allowing usage of the real property to the foreign beneficiary of the trust. The trust beneficiary may instruct the bank to sell or lease the property at any time to a qualified buyer or lessor, or may likewise assign its trust beneficiary rights.

RECOMMENDATION

It is strongly suggested to consult with your legal counsel specialist, to determine the correct entry into Mexico.

Note: This is a summary covering the general aspects of the Maquiladora Legal Framework. For specific advice please consult with your legal counsel. If you require further information, please contact Pasero Abogados, S.C., by telephone at (619) 498 9282 or 52 (664) 686 5557; via facsimile 52 (664) 686 5558; by e-mail: pasero@paseroabogados.com; or by mail at P.O. Box 767, Bonita, California 91908, U.S.A.

