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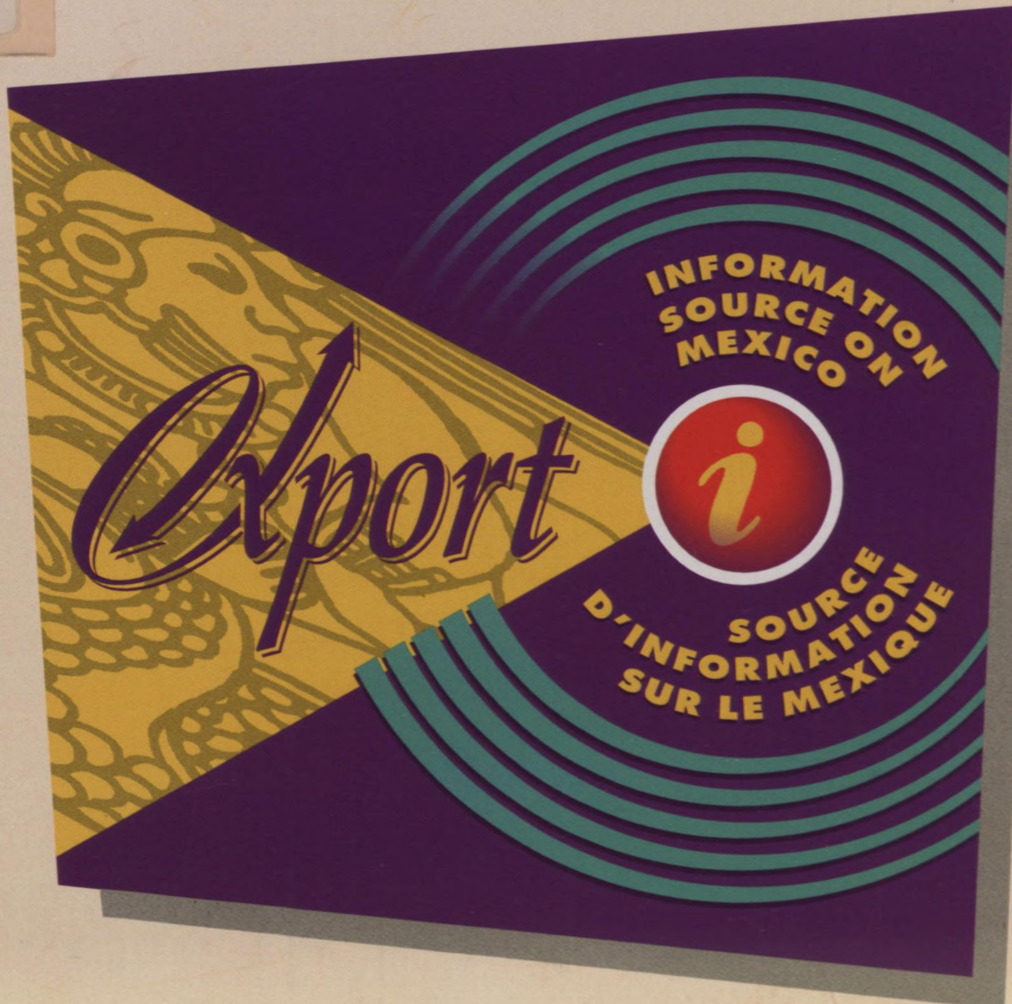

OPPORTUNITIES IN MEXICO: KEY LEGAL ASPECTS OF DOING BUSINESS IN MEXICO

REFERENCE MATERIALS - MEXICO

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Department of Foreign Affairs and International Trade
Ministère des Affaires étrangères et du Commerce international
Latin America & Caribbean Branch

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Opportunities in Mexico

Key Legal Aspects of Doing Business in Mexico

March, 1996

 Although the foregoing memorandum provides an introductory overview of Mexican law, it is not intended to constitute legal advice or to serve as a substitute for the assistance of qualified legal counsel in a specific case or transaction.

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Reference Materials — Mexico

Key Legal Issues of Doing Business in Mexico was contributed to the Mexican Knowledge Base by the Chicago Office of Baker & McKenzie. This market profile was made possible through the support of the Toronto office of Baker & McKenzie.

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Catalogue No. E74-72/3-1995E
ISBN 0-662-23825

Published by Prospectus Inc.
Printed in Canada.

Disponible en français.

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Introduction

Overview

This document provides a general summary of certain aspects of Mexican law of interest to foreign companies considering doing business in Mexico. The areas of law summarized in this include:

1. Foreign Investment Law
2. Competition Law
3. *Maquiladora* Operations
4. Company Law
5. Taxes
6. International Trade
7. Labour Law
8. Environment
9. Intellectual Property

The foregoing areas of Mexican law, as they affect investors from certain countries, are modified by treaties to which Mexico is a party, including in particular the North American Free Trade Agreement (NAFTA) among Canada, Mexico and the United States. Although this memorandum makes numerous references to NAFTA and other treaties, it does not comprehensively address all instances in which Mexican law is modified or complemented thereby.

Political structure and legal system

The United Mexican States is a federal republic composed of 31 states and a federal district. As in the United States of America, the federal government is comprised of three branches: executive, legislative and judicial. The head of the executive branch is the President who is elected by popular vote for a six-year term. Legislative power is vested in the Chamber of Deputies and the Senate, whose members are elected for three-year and six-year terms, respectively. The judicial branch consists of a Supreme Court of Justice, Circuit Courts and District Courts.

Each of the 31 states has its own constitution, civil code and other local laws and regulations, as well as its own executive, legislative and judicial authorities. The head of the state executive branch is the governor. The legislative branch consists of the Chamber of Deputies; the judicial power is exercised by the local courts.

Mexico has a civil law system, which is based on the Continental European legal tradition stemming from Roman law and Napoleonic principles. Under this system, basic legal principles are largely codified in civil, commercial, criminal, judicial and procedural codes. Judicial precedents are not binding except for Supreme Court decisions under certain circumstances.

1. Foreign Investment Law

Mexico enacted a new Foreign Investment Law (FIL), effective December 28, 1993. The FIL repealed the old foreign investment law of 1973 and dramatically changed the regulatory framework of foreign investments in Mexico. The reforms embodied in the FIL largely follow those imposed by the NAFTA, although the NAFTA affords greater benefits in certain areas to American and Canadian investors.

1.1 No restrictions on most investments

As a general rule, the FIL allows foreign investors and Mexican companies controlled by foreign investors, without prior approval, to:

- own up to 100 percent of the equity of Mexican companies;
- purchase fixed assets from Mexican persons;
- engage in new activities or produce new products;
- open and operate establishments; and
- expand or relocate existing establishments.

The only exceptions to that general rule are those expressly established in the FIL itself (discussed in 1.2 below) or, in the case of the financial sector, in the legislation covering that sector. This new regulatory framework replaces the restrictions of the old foreign investment law, which generally limited foreign investment in Mexican companies to 49 percent or less.

1.2 Restricted activities under the FIL

The FIL lists certain economic activities that are:

- reserved to the Mexican State;
- reserved to Mexican nationals or Mexican companies without foreign equity participation;
- subject to quantitative foreign investment limitations; and
- subject to prior approval if the foreign investor wishes to own more than 49 percent of a company engaged in those activities.

1.2.1 Activities reserved to the Mexican state

In compliance with the Mexican Constitution and as a reflection of historical concerns regarding private investment, the FIL reserves certain strategic areas to the Mexican State. Neither Mexican nor foreign investors may engage in these areas of economic activity. These areas include:

- petroleum and other hydrocarbons;
- basic petrochemicals;
- electricity;
- generation of nuclear energy;
- radioactive minerals;
- satellite communications;[1]
- telegraphs;
- radio telegraphy;
- mail service;
- issuance of money;
- control, supervision and security of ports, airports and heliports; and
- certain others expressly indicated in the relevant legislation.

1.2.2 Activities reserved to Mexican investors

The activities reserved by the FIL to Mexican nationals and to Mexican companies without foreign equity participation include:

- domestic and international[2] land transportation of passengers, tourism and cargo, excluding messenger and courier services;
- retail trade of gasoline and L.P. gas;

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[1] Under a constitutional amendment effective as of March 3, 1995, satellite communications are no longer reserved to the Mexican State. It is expected that the participation of private investment in this area will soon be specifically regulated. Hence, the FIL should be amended soon to reflect the above. This Constitutional amendment also liberalized restrictions in the railroad sector.

[2] Under Transitory Article Sixth of the FIL, as of December 18, 1995, foreigners may own up to 49 percent of the capital of Mexican entities engaged in international land transportation of passengers, tourism and cargo within Mexico and in administrative services for bus stations and related services; they may own up to 51 percent of such enterprises as of January 1, 2001; and 100 percent as of January 1, 2004. This liberalization schedule follows the NAFTA's phase-out schedule for land transportation. Foreign investment in domestic land transportation will continue to be prohibited.

- radio and television, excluding cable;
- credit unions;
- development banks; and
- professional and technical services reserved to Mexicans in the relevant legislation.

Under the FIL, foreign investors may not engage in any of the foregoing activities, directly or indirectly, through any agreement or corporate structure or scheme, except through special approved "neutral" shares without voting rights or with limited corporate rights, or as otherwise approved by the National Commission of Foreign Investments (NCFI).

1.2.3 Activities with foreign investment equity limitations

The FIL establishes foreign ownership limits in certain companies, activities and types of shares, as set forth below:

- up to 10 percent: production cooperatives;
- up to 25 percent: domestic and specialized air transport and aerotaxi transport;
- up to 30 percent: financial holding companies, commercial banks, securities firms and securities specialists[3]; and
- up to 49 percent: autoparts industry, as defined in the applicable legal provisions[4]; insurance and bonding companies; exchange houses; general deposit warehouses; financial leasing and factoring companies; authorized companies that loan funds raised in the capital markets; investment advisors and companies that manage investment companies; shares in the fixed capital of investment companies and companies that manage investment companies; production and sale of explosives, firearms, cartridges, munitions, fireworks, excluding the purchase and use of explosives for industrial and extractive purposes, and the preparation of explosive mixtures for use in said activities; printing and publication of periodicals for exclusive distribution within Mexico; Series "T" shares of companies owning agricultural, cattle-raising and forest lands; cable television; basic telephone service and videotext and packet switching services[5]; fresh-water and

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[3] Under an amendment to various Mexican financial laws effective as of February 16, 1995, foreign investors generally may own up to 49 percent in these companies. These new provisions prevail over the FIL.

[4] Under Transitory Article Seventh of the FIL, as of January 1, 1999, foreigners may own up to 100 percent of the capital of Mexican entities engaged in the autoparts industry.

[5] Under Transitory Article Eighth of the FIL, as of July 1, 1995, foreigners may own up to 100 percent of the capital of Mexican entities engaged in videotext and packet switching services.

coastal fishing, and fishing in the exclusive economic zone, excluding aquaculture; comprehensive port management; pilotage services to vessels engaged in interior navigation; shipping companies that operate commercial vessels for navigation in interior waterways and between domestic ports, excluding tourist ferries and the exploitation of dredges and naval devices for port construction, maintenance and operation; and supply of fuel and lubricants for ships, airplanes and railroad equipment.

Unless a treaty otherwise provides (e.g., the NAFTA in the case of financial services), a foreign investor may not own more than the permitted percentage of equity in a Mexican company engaged in any of the above activities. These limits may not be surpassed either directly or through any type of agreement or corporate structure or scheme, except through the "neutral" shares mentioned in 1.2.2 above.

1.2.4 Activities where foreign investors require prior approval to own more than 49 percent

Under the FIL, prior approval is required for foreign investors to own more than 49 percent of a company engaged in any of the following activities:

- port services to vessels engaged in interior navigations, such as towing and mooring;
- overseas shipping;
- management of air terminals;
- private schools, at preschool, primary, secondary, preparatory and higher education levels;
- legal services;
- credit bureaus;
- securities rating institutions;
- insurance agents;
- cellular telephone services;
- construction of petroleum and petroleum derivatives pipelines;
- drilling of petroleum and gas wells; and
- erection, construction and installation works[6].

[6] Under Transitory Article Nine of the FIL, as of January 1, 1999, foreigners may own up to 100 percent of the capital of Mexican entities engaged in these activities.

Foreign investors required to obtain prior approval to own more than 49 percent of a new or existing Mexican company must file an application, therefore, with the NCFI. Pursuant to the 1989 Foreign Investment Regulations[7], the NCFI has 45 business days to issue its ruling from the day it deems the application file to be complete. If the NCFI does not rule within this 45-day period, the application will be deemed approved.

1.3 Acquisition of existing Mexican-owned companies

Under the FIL, a foreign investor may acquire more than 49 percent of the equity of an existing company owned more than 49 percent by Mexican investors, provided that the target company is not engaged in a restricted activity and the total value of the assets of such a company does not exceed certain monetary thresholds established annually by the NCFI. Transitory Article Ten of the FIL established the first annual threshold at N $85,000,000 pesos (approximately US $25,000,000). This amount is roughly the threshold that the NAFTA establishes for the acquisition of existing companies in 1994. Under the NAFTA, this threshold, subject to inflationary adjustments, will be increased to US $50,000,000 in 1997, US $75,000,000 in 2000 and US $150,000,000 in 2003. It is expected that the NCFI's annual monetary thresholds for foreign non-NAFTA investors wishing to acquire a Mexican company will follow the general parameters of the NAFTA.

1.4 Branches

Under the FIL, a foreign company must obtain a permit from the *Secretaría de Relaciones Exteriores (SRE),* Secretariat of Foreign Relations, and approval from the *Secretaría de Comercio y Fomento Industrial (SECOFI),* Secretariat of Commerce and Industrial Development, to establish and register a branch in Mexico. *SECOFI* must rule on the branch application within 15 business days from the date the complete application is filed. To obtain the permit from the *SRE*, the foreign investor must agree to be deemed a Mexican national with regard to the investment in question. Moreover, the foreign investor agrees not to seek the protection of its government in the event of dispute under penalty of forfeiting its interests in favour of the Mexican nation if it seeks such protection.

1.5 Foreign investors with investment commitments

Pursuant to the prior foreign investment law and its regulations, under certain circumstances foreign investors could own more than 49 percent of a Mexican company, provided that they committed to comply with certain performance requirements. The most common requirements are related to foreign currency balances and job creation. Those performance requirements have proved onerous for many foreign investors.

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[7] Transitory Article Four of the FIL provides that the 1989 Foreign Investment Regulations will continue to apply, to the extent they do not contravene the FIL, until new regulations are issued.

Under Transitory Article Fifth of the FIL, foreign investors may petition the foreign investment authorities to release them from their investment commitments. The authorities have 45 business days to respond to the foreign investor's petition. Because the NAFTA does not, in general, allow Mexico to impose or enforce a series of performance requirements against any foreign investors, (including export, foreign currency and job requirements) the Mexican foreign investment authorities should release foreign investors from these types of requirements upon request.

1.6 Registration requirements

Under the FIL, all foreign investments, whether subject to prior approval or not, must be registered with the Foreign Investment Registry within 40 business days from the date of the respective incorporation, branch registration, acquisition or execution of the relevant trust agreement. Foreign investors who do not register their investment with the Foreign Investment Registry are subject to administrative fines.

1.7 Repatriation and remittance rights

Mexican law does not impose any general restrictions or limitations on the remittance of dividends or repatriation of capital.

1.8 Real estate

Mexican law establishes certain restrictions on land ownership by foreign investors in Mexico.

1.8.1 Restricted zone

Under the Mexican Constitution, foreign individuals and entities may not hold legal title to real estate in Mexico located within 100 kilometers from the border or 50 kilometers from the coastline (the Restricted Zone). However, such individuals and entities may hold the beneficial interest in such real estate under a Mexican trust. Real estate trusts in Mexico have a maximum duration of 50 years and the trustee thereof must be a Mexican bank.

Under the FIL, Mexican companies with foreign equity participation may hold direct title to real estate located in the Restricted Zone if they engage in non-residential activities. If they engage in residential activities, they may hold the real estate in trust, that is, they may not hold direct title thereto.

1.8.2 Foreign corporate ownership of land

Although the FIL and the relevant constitutional provisions are not entirely clear, it appears that foreign companies still may not hold direct title to real estate located in Mexico. They may, however, hold the beneficial interest in such real estate under a Mexican trust.

1.8.3 Non-rural land outside the Restricted Zone

Under Mexican law, foreign individuals and Mexican companies with foreign equity participation may hold legal and beneficial title to non-rural land located outside the Restricted Zone.

1.8.4 Rural land outside the Restricted Zone

Foreign individuals and Mexican companies with minority foreign equity participation may hold legal and beneficial title to rural land located outside the Restricted Zone. Mexican companies with majority foreign equity participation may hold legal title to rural land, provided the ownership of such land is represented by special Series "T" shares. Foreign investors may not own more than 49 percent of the Series "T" shares issued by the respective company.

1.8.5 Quantitative restriction of land ownership

The Mexican constitution and regulatory agrarian legislation establish limitations on the amount of rural land a person may own and protect against expropriation for communal use. For example, generally the maximum area of irrigated land which may be protected from expropriation is 100 hectares per person. For lands subject to seasonal use and unirrigated pastures subject to agricultural harvest, the maximum protection area is 200 hectares. Under the constitution, a Mexican corporation may own and protect up to 25 times the land area one individual is permitted to protect.

Under certain circumstances and if certain requirements are met, a landowner may protect an area which exceeds the above limitations, e.g., if he or she improves the quality of the land by installing irrigation or drainage systems.

2. Competition Law

On December 22, 1992, Mexico published in the Official Gazette a new competition law, entitled the *Ley Federal de Competencia Económica*, Federal Law of Economic Competition, hereinafter called the "Competition Law". The law became effective on June 22, 1993.

The Competition Law:

- restricts and regulates monopolistic practices and economic concentrations;
- creates a *Comisión Federal de Competencia*, Federal Competition Commission, hereinafter called the "Commission" with broad investigative and enforcement powers;
- sets forth the basic procedure for actions by and before the Commission; and
- creates a limited private right of action for damages.

2.1 Regulated practices

The Competition Law prohibits in broad terms those monopolies and practices which "diminish, damage or impede free competition in the production, processing, distribution and marketing of goods and services". Monopolistic practices are divided into "absolute" and "relative" monopolistic practices.

Absolute monopolistic practices are defined as agreements or arrangements among competitors which have the purpose or effect of:

- fixing prices;
- limiting production or distribution;
- dividing markets; or
- "rigging" public bids.

The Competition Law provides that, apart from the civil and criminal sanctions that may be applicable to the parties involved, such agreements and arrangements are null and void.

The definition of relative monopolistic practices encompasses certain specific practices, which are prohibited only if the actor has "substantial power" over the "relevant market". The latter terms are defined by reference to the presence of certain factors detailed in the Law. This includes substitutability of goods, distribution and input costs, market share of the actor and its competitors, and existence of market barriers.

The practices which may be deemed relative monopolistic practices are agreements or combinations that unduly impede market access to third parties, or which give exclusive advantages to certain persons, in the following cases:

- between non-competitors:
  - the establishment of exclusive distribution arrangements, whether based on subject matter, geographic territories or time periods, including the allocation of customers or suppliers; and
  - the imposition of obligations not to compete;
- the imposition of price or other conditions which distributors or suppliers must observe upon re-sale of goods or provision of services;
- tying arrangements;
- the conditioning of sales or other transactions on obligations not to deal with certain third parties;
- the refusal to deal with certain parties; and
- concerted action to pressure or retaliate against third parties.

2.2 Restricted economic concentrations: prior approval

Restricted economic concentrations are defined as those between any persons or enterprises, whether competitors or not, having the purpose or effect of diminishing, damaging or impeding competition in identical, similar or substantially related goods or services. The Competition Law identifies certain factors that the Commission must consider in determining whether a concentration violates this prohibition, such as the likely market power or price-fixing abilities of the resulting concentration. The Commission has the power to condition its approval of a proposed concentration on the restructuring of the transaction to avoid anti-competitive consequences. It is also empowered to order that prohibited concentrations be undone.

Proposed concentrations meeting the following monetary thresholds must be notified to the Commission prior to their consummation:

- transactions having a value in excess of twelve million times the daily minimum wage (DMW) for the Federal District (N $18.30 pesos as of April 1, 1995) or approximately US $35.4 million (at N $6.20 pesos per US dollar);
- transactions involving the accumulation of more than 35 percent of the assets or shares of a person or enterprise with assets or sales exceeding 12 million times the DMW (approximately US $35.4 million);
- transactions involving:
  - persons or enterprises whose combined assets or yearly sales exceed 48 million DMW (approximately US $141.7 million) and
  - an accumulation of assets or capital exceeding 4.8 million DMW (approximately US $14.2 million).

The Commission has a period of 45 calendar days from the date of the notice, or from such later date on which any additional requested information was received, in which to respond. If the Commission does not respond during this 45-day period the transaction will be deemed approved.

2.3 Federal Competition Commission

As the agency responsible for enforcing the Competition Law, the Commission has broad investigative and enforcement powers. It may institute administrative proceedings on its own initiative and at the request of third parties, investigate and resolve such cases and enforce its orders through administrative penalties. It may also bring cases of a criminal nature to the attention of the public prosecutor. The Commission may also issue advisory opinions.

2.4 Penalties

The Commission is empowered to levy fines of up to 1,500 daily minimum wage (DMW), or approximately US $4,427 (at N $6.20 pesos per US dollar) per day, for non-compliance with the Commission's orders. In addition to being obligated to cease the prohibited practices or divest prohibited concentrations, violators may be subject to civil and criminal penalties, including fines in the following amounts:

- up to 375,000 DMW (approximately US $1,106,855) for absolute monopolistic practices;
- up to 225,000 DMW (approximately US $664,113) for prohibited relative monopolistic practices or prohibited economic concentrations;
- up to 100,000 DMW (approximately US $295,161) for failure to provide the Commission with prior notice of economic concentrations, in the cases required by the Competition Law;
- up to 7,500 DMW (approximately US $22,137) for individuals directly participating in prohibited monopolistic practices or concentrations, in their capacity as representatives of legal entities; and
- in serious cases of any of the above violations, the higher of 10 percent of the violator's annual sales or 10 percent of its assets.

2.5 Private right of action

The Competition Law also gives private parties an express right of action to bring ordinary civil suits for damages. In order to be able to bring such an action, however, the plaintiff must have previously given evidence of its alleged damages in administrative proceedings before the Commission. The judge is allowed to consider the Commission's estimation of the plaintiff's alleged damages. The Competition Law expressly denies any private right to bring a judicial or administrative action based on the Law (e.g., alleging damages due to violations thereof), except for the foregoing right of action established by the Law.

3. Maquiladora *Operations*

The Mexican *maquiladora* program was introduced over 25 years ago by the Mexican government in response to a private sector initiative designed to alleviate a high unemployment problem along the border with the United States. The *maquiladora* industry in Mexico is governed by the Decree for the Promotion and Operation of the Export Maquiladora Industry of December 22, 1989 (the *Maquiladora* Decree), as amended December 24, 1993. The latter amendment took effect on January 1, 1994.

3.1 Corporate presence in Mexico

Under the *Maquiladora* Decree, a foreign investor may qualify to operate under *maquiladora* status only if it has a corporate presence in Mexico. A Mexican corporation that qualifies for *maquiladora* status may have up to 100 percent foreign ownership. The great majority of *maquiladoras* are wholly-owned subsidiaries of foreign (especially American) corporations.

3.2 Operation and import permits

Once a company has been incorporated, in order to qualify to operate under *maquiladora* status it must receive approval from the *Secretaría de Comercio y Fomento Industrial (SECOFI),* Secretariat of Commerce and Industrial Development, for its *maquila* program. For such approval to be obtained, the company must submit information with regard to the project, including the following:

- the product(s) to be assembled and/or manufactured in Mexico and their intended use;
- a brief description of the manufacturing process and the duration thereof;
- a breakdown of investment in fixed assets, whether owned by the parent or by the subsidiary, and projections on operating expenses for a two-year term;
- a projection of the number of jobs to be created during the first two years of operations;
- a list of machinery, equipment, tools and auxiliary items to be imported into Mexico for the manufacturing process (including fair market value of each item); and
- a list of components, raw materials and auxiliary supplies to be processed, manufactured and/or assembled in Mexico (including unitary weight and value of each item).

Once *SECOFI* approves the *maquila* program, permits will be issued for the importation of machinery, equipment, components, raw materials and supplies. The *maquila* program approval is valid for an indefinite period and is not subject to any renewal requirements.

3.3 Duty-free imports

The Mexican Customs Law allows goods to be imported without the payment of import duties, provided the goods are eventually exported from Mexico. Such method of importation is only available under special circumstances and for specific purposes. One of those special circumstances is a *maquila* operation.

A company that has qualified to operate under a *maquila* program approved by *SECOFI* automatically qualifies to import, on a temporary basis, certain items listed in the *Maquiladora* Decree, such as raw materials, components, equipment or tools. Upon approval of the *maquila* program or any time thereafter, *SECOFI* may issue the import permits for the specific items required to be imported by the *maquiladora.*

A temporary importation entails certain record-keeping obligations listed in the *Maquiladora* Decree. If such obligations are not fulfilled, the importer may be subject to the payment of duties and penalties.

Inasmuch as the NAFTA eliminates Mexican customs duties on imports from the U.S. and Canada either immediately or over a period of years depending on the goods in question, it significantly reduces the attractiveness of the *maquiladora* program for U.S. and Canadian investors. As a corollary to the latter point, after January 1, 2001, the NAFTA prohibits Mexico from allowing import duty exemptions to *maquiladoras* or any other importers in respect of goods to be re-exported to the U.S. and Canada.

3.4 Sales into the Mexican Market

Pursuant to the December 24, 1993 amendments to the *Maquiladora* Decree and under the NAFTA, a *maquiladora* may sell a portion of its output into the domestic Mexican market. Beginning in 1994 a *maquila* company will be able to sell to the domestic market up to 55 percent of the total value of its annual exports in the previous year. Each year thereafter this percentage will be increased by 5 percent. As of January 1, 2001, *maquiladoras* will not be subject to any percentage limitation on sales to the domestic market. In any event, duties must be paid on all imported materials or components contained in the finished product to be sold into the domestic market of Mexico.

4. Company Law

4.1 Forms of business organization

Mexican law contemplates several forms of business organization, including:

- corporations (*sociedades anonimas (S.A.)*, or *sociedades anonimas de capital variable (S.A. de C.V.)*; hereinafter collectively referred to as "corporation(s)");
- limited liability companies (*sociedades de responsabilidad limitada (S.R.L.)*, or *sociedades de responsabilidad limitada de capital variable (S.R.L. de C.V.)*; and
- partnerships (*sociedades en nombre colectivo*).

Partnerships are not generally used by foreign investors because they do not provide limitation of liability to the partners. U.S. investors sometimes use an *S.R.L.* (which does provide limited liability) for U.S. tax purposes. The corporation, however, is by far the most common form of organization used by foreign investors in Mexico. The balance of the discussion in this section is limited to corporations.

4.2 Capital

Upon incorporation, a corporation must have fully subscribed capital of at least N $50,000 pesos and all in-kind contributions. Furthermore, at least 20 percent of cash contributions must be paid-in.

The *S.A.* and *S.A. de C.V.* differ in at least one significant respect. A maximum amount of capital for an *S.A.* is fixed and specified in its charter and by-laws; any subsequent increase or decrease in the corporate capital requires amending the corporate charter and by-laws. Conversely, the charter and by-laws of an *S.A. de C.V.* fix the amount of minimum capital and an amount of "variable" capital in excess of the minimum capital. The variable capital may be unlimited and may be increased or decreased without amending the corporate charter and by-laws. For this reason, foreign investors, particularly those with wholly-owned subsidiaries that want the flexibility of increasing or decreasing the corporate capital without amending the corporate charter and by-laws, ordinarily organize their business activities in the form of an *S.A. de C.V.* rather than an *S.A.*

4.3 Management structure

The management of a corporation may be vested in one or more directors. Whenever two or more directors are entrusted with the management of a corporation, they must act as a board of directors. If the board is composed of three or more directors, a shareholder owning 25 percent or more of the shares representing the corporate capital has the right to appoint one director. The board of directors may appoint one or more general or special managers. Such appointment is revocable at any time by the board of directors or by the shareholders.

4.4 Minimum number of shareholders

There must be at least two shareholders to organize a corporation. The Mexican Companies Law does not require a specific number of the shareholders to be Mexican individuals or entities other than as required under the FIL. Consequently, all of the shareholders of corporations that qualify to be wholly foreign-owned may be foreigners.

5. Taxes

5.1 Treaties

Mexico has executed treaties for the avoidance of double taxation with various countries, including the U.S., Canada, and several Organization for Economic and Community Development (OECD) countries. Those treaties establish different rules for taxation of Mexican source income (e.g., withholding rates on dividends, royalties and interest) derived by residents of the signatory countries. The relevant tax treaty must be reviewed to determine the applicable rates. If such a treaty is not in place, the rules of the Mexican Income Tax Law (ITL) will govern, as discussed below.

5.2 Corporate income tax

Under the ITL, a company resident in Mexico is subject to income tax on its worldwide net income at the rate of 34 percent.

5.3 Dividend withholding tax

Dividends distributed by a Mexican company are not subject to withholding tax if distributed from the company's "net after-tax profit account". The "net after-tax profit account" is comprised of the company's net after-tax profit for each fiscal year, plus the dividends received by the company from other companies resident in Mexico, minus the dividends distributed in cash or in kind from that account. The net after-tax profit for a fiscal year is the amount that results from subtracting from the company's taxable income for the year:

- the workers' mandatory participation in the profits of the company (see Section 7.1.1 below);
- the company's income tax liability; and
- its non-deductible expenses.

If a dividend to a foreign corporate shareholder is distributed from a source other than the "net after-tax profit account", the withholding tax rate will be 34 percent multiplied by a factor of 1.515.

5.4 Other withholding taxes

Royalties, license fees or other compensation paid by a Mexican licensee to a nonresident for unpatented technology, software or technical assistance are subject to withholding tax at the rate of 15 percent. Royalties paid to a nonresident for patented technology or trademarks are subject to withholding tax at the rate of 35 percent. When royalties arising under the same contract are paid for both patented and unpatented technology, the withholding tax rate is 15 percent.

Interest payments to nonresidents are subject to withholding tax at the rates of 4.9 percent, 10 percent or 35 percent, depending on the type of payee. In general, if the payee is a foreign bank or other financial institution registered with the *Secretaría de Hacienda y Crédito Público (SHCP),* Secretariat of Finance and Public Credit, (other than payees domiciled in tax haven jurisdictions), the interest payments will be subject to withholding tax at the rate of 4.9 percent. If the payee is:

- a credit institution other than a bank or financial institution registered with *SHCP*;
- either a foreign supplier of machinery and equipment or a foreign financing entity that finances the purchase of such machinery and equipment or generally provides working capital financing, pursuant to an agreement that sets forth these circumstances and, if the entity is registered with *SHCP*, the interest payments will be subject to withholding at the rate of 10 percent. (The 4.9 percent and 10 percent rates are effective until December 31, 1995, at which time they will increase to 15 percent and 21 percent, respectively.) In all other cases, interest is subject to withholding tax at the rate of 35 percent.

5.5 Tax on the sale of shares

The sale of shares of a Mexican company is subject to Mexican income tax, regardless of where the sale takes place. Foreign residents who sell shares of Mexican companies are subject to a 20 percent tax on the gross proceeds from the sale, or, at the option of the foreign resident if it has a local representative in Mexico, to a 30 percent tax on the net gain derived from the sale. This option is not available to foreign sellers domiciled in a tax haven jurisdiction. The net gain, in the latter case, is determined by subtracting from the gross sale proceeds the seller's tax basis in the shares sold, adjusted for inflation and other factors as determined in the ITL.

5.6 Asset tax

The Mexican Asset Tax Law subjects Mexican business taxpayers (i.e., individuals or companies resident in Mexico engaged in business activities, individuals or companies resident abroad with permanent establishments in Mexico, and other foreign persons which own "Mexican-situs" assets used in another's business activities) to a tax on business assets at a flat rate of 1.8 percent per annum of the value of such assets. Taxpayers subject to the asset tax may credit Mexican income tax payments against their asset tax liability for the current year. If the income tax payments exceed the asset tax liability in a given year, the taxpayer may request a refund of asset taxes paid during the ten prior fiscal years in the amount of the excess.

6. International Trade

6.1 Imports in general

Mexican import controls have been significantly liberalized in recent years. Most products no longer require prior import permits. Import duties have also been reduced. Duties are generally assessed against the transaction value of the products imported into Mexico.

6.2 NAFTA and other regional trade agreements

Mexico has negotiated and continues to negotiate trade agreements with other countries. Mexico is a party to the General Agreement on Tariffs and Trade (GATT), the NAFTA and free trade agreements with, among others, Chile, Venezuela, Colombia and Costa Rica. These agreements, among other things, will reduce import duties on products imported into Mexico originating from any of the signatory countries. Under the NAFTA, for example, duties on many American and Canadian products imported into Mexico have been eliminated as of January 1, 1994, and duties on the remaining products will be phased out on a five- ten- or fifteen-year schedule.

6.3 Foreign trade law

Mexico has enacted a new Foreign Trade Law (FTL), effective July 28, 1993. The FTL regulates international trade and prohibits unfair trade practices such as dumping and trade subsidies. The FTL generally follows the principles estiblished in the GATT and conforms to the requirements of the NAFTA.

7. Labour law

The Mexican Federal Labour Law (FLL) regulates employment relationships in Mexico. The FLL applies to all employees in Mexico regardless of nationality or place of entering into the employment agreement.

7.1 Mandatory employee benefits

7.1.1 Profit sharing

As of the second year of operations, all employers must distribute among their employees an amount equal to 10 percent of the employer's pre-tax profit within 60 days after the employer is required to file its year-end income tax return. Fifty percent of such amount is to be distributed in proportion to the number of days worked by each employee during the year, and the remainder according to the wages of each employee. Certain managerial employees are not entitled to profit sharing.

7.1.2 Christmas bonus

All employers must pay their employees a year-end bonus equal to at least fifteen days' wages, payable before December 20th of every year.

7.1.3 Paid holidays

The following are the legal paid holidays which must be observed. An employee required to work on any of these holidays must be paid overtime at the rate of at least three times his normal wages:

- January 1 (New Years Day);
- February 5 (Constitution Day);
- March 21 (Benito Juárez Day);
- May 1 (Labour Day);
- September 16 (Independence Day);
- November 20 (Revolution Day);
- December 1 (every six years upon inauguration of a new President);
- December 25 (Christmas Day); and
- Special dates designated by the electoral laws.

7.1.4 Vacation premium

All employers must pay vacation days at a rate of at least 125 percent of the employee's wages. Employees with more than one year of seniority are entitled to six days of paid vacation. Such a six-day period is increased by two days per subsequent year of seniority up to twelve days. After the fourth year, minimum paid vacation is increased by two days every five years thereafter.

7.1.5 Training

Employers are obligated by law to provide training to their employees. The employer must have a training program approved by the *Secretaría del Trabajo y Previsión Social (STPS),* Secretariat of Labour and Social Welfare. The program must be implemented by a Mixed Commission for Training and Instruction, comprised of an equal number of representatives of the employees and of the employer.

7.1.6 Employer housing contributions

The FLL requires employers to pay an amount equal to 5 percent of each employee's wages to the *Instituto del Fondo Nacional para la Vivienda de los Trabajadores (INFONAVIT),* Housing Pension Fund for Private Sector Employees. Employers must deposit these contributions in a special account at a local bank.

7.1.7 Minimum wage

The FLL establishes a minimum amount which must be paid to all employees in cash, without deductions or withholdings, on a weekly basis. The minimum wage is determined from time to time by the National Minimum Wage Commission. The minimum wage varies for each of three economic regions into which the country is divided. A general minimum wage applies to all employees within each economic region, except those that fall within a series of specific job categories. The general minimum wage for the three regions effective April 1, 1995 was as follows:

Zone A (including Mexico City):	N$ 18.30 per day
Zone B:	N$ 17.50 per day
Zone C:	N$ 15.44 per day

7.1.8 Maximum hours/overtime pay

The maximum number of hours which an employer may require its employees to work, without having to pay overtime, is 48 hours per week. The employer must pay the first nine hours of overtime at 200 percent, and overtime exceeding nine hours at 300 percent of standard pay. An employer may not require its employees to work more than nine hours of overtime per week. The normal work hours may be distributed throughout the week as necessary: most employers now distribute them in five days (9.5 hours per day). At least one paid full day of rest per week must be observed. Sunday work is subject to a 25 percent premium, independent of any overtime premium that may apply. If an employee works in excess of 57 hours a week or 11 hours a day, the employer may be penalized by the labour authorities.

7.1.9 Health and safety

The employer is obligated to provide a safe and sanitary environment for the workers to render their services. A Mixed Commission for Health and Safety must be created to investigate the causes of illness and accidents and to propose means to avoid them.

7.1.10 Paid maternity leave

All employers must provide their female employees with a fully paid maternity leave of six weeks prior to the approximate delivery date and six weeks thereafter. After this twelve-week period, employers must offer such employees their former positions back, including any accrued rights thereunder such as accrued seniority and vacation pay.

7.1.11 Employer social security contributions

See 7.3 below.

7.1.12 Additional benefits

Employers may voluntarily enhance the minimum benefits established by law. Benefits such as savings funds, punctuality and attendance bonuses, cafeteria and transportation subsidies, productivity bonuses, and so on are provided by many Mexican employers.

7.2 Severance payments

7.2.1 Occasion and basis of the payment: reinstatement

Mexican employers may not freely dismiss employees without cause. To dismiss an employee without being liable for the severance pay described below, a Mexican employer must:

- be able to prove, in labour court if necessary, that the dismissal was for a statutorily-defined "just cause"; and
- give the employee prompt written notice of the dismissal and the "just cause" therefore.

If the employer fails to prove "just cause" as explained in 7.2.2. below, the employer is obligated to make the following severance payments:

- three months of salary;

- a seniority premium, equal to the 12 days of salary per each year of services rendered (subject to salary limitation up to twice the minimum wage);
- back-salary from the date of the dismissal through the date of payment; and
- accrued benefits.

If the employee ends the individual employment relationship for a "just cause", the employer is required to pay, in addition to the foregoing, 20 days of salary per each year of services rendered.

An employee dismissed without "just cause" has the option to be reinstated to his or her former job instead of receiving the severance payment. In some cases, for example, dismissal of an employee of "trust" as described in 7.2.5 below, the employer may avoid having to reinstate the employee to his former job by making the payments mentioned in the two preceding paragraphs.

7.2.2 Just cause for dismissal

The FLL lists the specific causes for which an employer may dismiss an employee without being liable for severance pay. These causes include, for example, immoral conduct, repeated absenteeism, unauthorized disclosure of trade secrets and unreasonable refusal to follow directions.

7.2.3 Employee's just cause for resigning

An employee may resign and be entitled to severance pay if his or her employer commits specified acts against him or her that are listed in the FLL. Such acts include, for example, reduction of salary, failure to pay salary when due, and causing or allowing unsafe working conditions.

7.2.4 Termination of the individual labour relationship

The FLL provides that a labour relationship may be terminated without either party being liable under certain circumstances, including:

- mutual agreement of the parties;
- death of the employee;
- under limited circumstances, the conclusion of a specific job; and
- the physical or mental incapacity or disability of the employee.

7.2.5 Employees of "trust"

The FLL creates a special category of employees for managers in general and other employees "*trabajadores de confianza*" who hold positions of trust. Employers are not required to reinstate those *trabajadores de* *confianza*, as mentioned in 7.2.1 above. These employees may form unions, but they must be separate from those of other employees.

The determination of whether an employee is a *trabajadores de confianza* depends not on his title but on his actual functions. Generally the FLL defines functions of "trust" as those of "*dirección, inspección, vigilancia y fiscalización*", direction, inspection, surveillance and supervision and those that involve personal matters of the owner(s) of the company.

7.2.6 Seniority premium

The seniority premium discussed in 7.2.1 above, equal to 12 days of salary (limited to twice the minimum wage) per each year of services rendered, must be paid to all employees who:

- voluntarily leave their jobs after completing 15 years of employment;
- leave their jobs for "just cause";
- are dismissed by the employer with or without "just cause"; or
- die while still employed, in which case their beneficiaries receive the seniority premium.

7.3 Employer's withholding obligations: social security and income tax

7.3.1 Social security

In accordance with the Social Security Law (the SSL), all employers must register their employees with the *Instituto Mexicano del Seguro Social (IMSS)*), Mexican Institute for Social Security. Such registration relieves the employer from any liability in connection with job-related illnesses or accidents, and provides certain benefits to the employee and his dependents, including the following:

- medical and hospitalization insurance for any illness, accident or maternity;
- insurance for disability, old age, unemployment during old age and death;
- child care; and
- retirement.

All services performed in connection with the above benefits are provided at *IMSS* facilities.

Both the employer and the employee must make contributions to the *IMSS*. The employer is obligated to withhold from the employee's salary the employee's portion of social security contributions and pay it, along with the employer's own contribution, to the *IMSS*. In the case of employees who earn minimum wage, the employer must make the entire contribution to the *IMSS*.

Employers must also pay and deposit into a special retirement savings account at a local bank an amount equal to 2 percent of each employee's salary (limited to 25 times the minimum wage for Mexico City).

7.3.2 Income tax

The ITL obligates employers to withhold personal income taxes from their employees' salaries and pay the amount withheld to the Mexican tax authorities on a monthly basis. No income taxes are withheld from the salaries of minimum wage employees. The current marginal rates applicable for withholding purposes range from 3 to 35 percent, but the Mexican peso amounts for the upper and lower limits of each tax bracket are subject to periodic indexing, based on increases in the general minimum wage for the Federal District.

Employers must submit to the federal tax authorities an annual declaration which provides all of their employees' names, tax registration numbers, past year's wages and tax withholdings and, if applicable, the calculation of their annual tax obligations for the preceding year.

7.3.3 Penalties

Any employer who fails to properly withhold and pay to the *IMSS* the corresponding social security contributions or withhold and pay to the federal tax authorities their employees' income taxes as required by law, who submit false information to *IMSS* or to the tax authorities, or who otherwise fail to fulfill the employer's obligations under the SSL or the ITL, could be subject to a range of penalties. Aside from being obligated to pay the contributions or taxes due, employers may be subject to fines for "fiscal infractions" or even harsher measures such as prison terms for "fiscal crimes".

8. Environment

Enacted in 1988, the *Ley de Equilibrio Ecológico y Protección al Medio Ambiente,* Law of Ecological Equilibrium and Environmental Protection (the Environment Law), is the primary Mexican environmental statute. It contains specific chapters concerning air, water, soil, hazardous waste, noise, vibration, thermal energy, lighting, odor and visual pollution. It also sets out enforcement procedures and other provisions concerning the respective responsibilities of the federal and state government. In addition, many of Mexico's 31 states have also promulgated environmental laws. All activities conducted in Mexico must comply with the federal and state laws.

8.1 Environmental Authorities

The *Instituto Nacional de Ecología (INECO),* the National Institute for Ecology, and the *Procuraduria Federal de Proteccion al Ambiente (PFPA),* Federal Agency for Environmental Protection, which are under the umbrella of the *Secretaría del Medio Ambiente, Recursos Naturales y Pesca (SEMARNAP),* Secretariat of Environment, Natural Resources and Fisheries (formerly *SEDESOL* and *SEDUE*), are the federal bodies which oversee the enforcement of the Environment Law. They set national policy, procedure and, through the frequent issuance of technical norms, standards for the permissible level of emission of pollutants.

The Environment Law establishes a licensing system based upon media-specific discharge limitations for air emissions and wastewater discharges and for the generation, transportation, handling and disposal of hazardous waste. All companies operating in Mexico must limit the amount of pollutants that they release or discharge within the specific ranges decreed by the *INECO*. For example, the regulations governing air pollution limit the amount of carbon dioxide which a plant may emit. In addition to establishing technical standards applicable to all wastewater discharges, the wastewater regulations specify the allowable discharge level for specific contaminants. For example, the specific industry discharge limitations apply to the glass, textile, petroleum, construction, synthetic rubber, tire, upholstery, sealant, sugar cane, carbonated beverage, lumber, meat packing, leather, fertilizer, plastic, synthetic polymer, beer, milk, metal, paper, food packing, iron and steel industries.

In addition to confining their emissions to the limits prescribed by the regulations, all companies must comply with the licensing system establishing by the Environment Law. Depending on the nature of its activities, a company may be required to: file for an operating licence; file an environmental impact statement; file for a residual water discharge licence; file for an air discharge licence; and register, file and maintain documents concerning hazardous wastes. All activities conducted in

Mexico prior to the enactment of the Environment Law were required to comply with the applicable provisions of the Environment Law by May 25, 1989.

8.2 Environmental impact statement

Environmental impact statements must be filed for a wide range of proposed activities, generally whenever the activity may cause ecological imbalance or exceed the limits and conditions provided for in the ecological technical standards and regulations issued by the federal government.

The Environment Law defines the term "ecological imbalance", as referred to above, as an "alteration of the independent relationships between natural elements which form the environment, and which negatively affects the existence, transformation and development of man and other beings".

The *INECO* has taken the informal position that the best way for a company currently operating or contemplating future operations to ensure compliance with the Environment Law is to file an environmental impact statement. Upon receipt of the statement, the government may authorize the activity, authorize the activity on the condition that changes be made, or deny a licence for the activity.

8.3 Operating licence

All "fixed sources" which emit odours, gases, solid particles or liquid particles into the air, for example all manufacturing plants, including those plants which were functioning prior to the enactment of the Environment Law, must obtain an operating licence from the *Instituto Nacional de Ecología (INECO),* the National Institute for Ecology. The *INECO* may grant or deny the licence or require modifications to be made to the plant before granting one. Plants are required to file annual reports each February with the *INECO* outlining any changes occurring during the previous year to the level of emissions made by the plant.

8.4 Residual water discharge registration

No wastewater discharges containing pollutants may be discharged into any body of water or into the soil or subsoil without the prior government approval. Approval may be granted on a one-time basis or for a period of time and within certain limitations. Any proposed discharge of wastewater containing hazardous substances is subject to the filing of additional documentation and prior government approval for each such discharge.

8.5 Hazardous waste registration

The Environment Law and its regulations establish numerous licensing requirements which cover various phases of the generation, handling and storage of hazardous wastes. The regulations define "hazardous waste" in terms of certain properties they exhibit, such as corrosiveness, toxicity, reactivity, explosivity and flammability. Certain substances which are considered hazardous are listed. The regulations impose many requirements on the generators, transporters, handlers and disposers of hazardous wastes. Among the licence and document retention requirements are the following:

1. Plants that generate or handle hazardous waste must submit an environmental impact statement along with an application to obtain a generator's number from the *Instituto Nacional de Ecología (INECO),* the National Institute for Ecology. A plant may not generate hazardous waste until it receives approval from the *INECO*.

2. Ecological waybills must be obtained from the *INECO* for each importation, exportation, transportation or handling of any hazardous materials.

3. Hazardous waste generators must maintain a monthly log detailing all hazardous materials in the possession of the company and file biannual reports with the *INECO*.

8.6 Penalties

The Environment Law provides for administrative and criminal sanctions and fines for violations of the environmental laws. Several of the regulations supplement the sanctions contained in the Environment Law. The *Procuraduria Federal de Proteccion al Ambiente (PFPA)*, Federal Agency for Environmental Protection, has wide authority to select and apply the various sanctions. In the past, the *PFPA* has generally handled violations of the environmental laws by ordering violators to take corrective action and, in certain cases, to close their businesses until the violations were corrected. The *PFPA* may also order a violating business to close permanently.

Moreover, the *PFPA* has the power to impose administrative fines and to double their amounts in the case of recurrence; order administrative arrest for up to 36 hours; seek criminal fines; and seek imprisonment for one month to six years, depending on the violation.

9. Intellectual property

Intellectual property is governed in Mexico by the Industrial Property Law (IPL), of June 28, 1991, as amended, and the Copyright Law (CL). In addition, the NAFTA devotes an entire chapter to intellectual property. The NAFTA provisions establish cross-border enforcement procedures and generally serve to reinforce Mexico's recent reforms in the area of intellectual property, as embodied in the IPL.

9.1 Patent Protection

Under the IPL, patents are protected in Mexico for a period of 20 years from the date the application for registration thereof is filed. Certain products, such as pharmaceuticals, medicines, animal feed, fertilizer and pesticides which under former statutes were not patentable until 1997, are now eligible for patent registration and protection as of June 28, 1991. Also, certain products, such as vegetable variations and microbiological inventions, which in the past were not subject to patent protection, are now patentable.

Under the IPL, any patent licence or assignment of patent rights must be registered with *Secretaría de Comercio y Fomento Industrial (SECOFI),* Secretariat of Commerce and Industrial Development. If they are not registered, such licences or assignments will not be effective against third parties. Although the IPL is not totally clear on this issue, the registration procedure before *SECOFI* should not involve governmental review or approval of the corresponding patent licence or assignment.

9.2 Trademark protection

Under the IPL, trademarks are protected in Mexico for a period of ten years, which period is renewable for successive ten-year terms. Any trademark licence or assignment of trademark rights must be registered with *SECOFI.* The registration procedure is similar to the one applicable to patents.

9.3 Transfer of technology

The IPL not only introduced important reforms in the areas of patent and trademark protection, but it also repealed the Transfer of Technology Law (TTL) and its regulations. Under the TTL, all agreements which involved the transfer of technology such as patent and trademark licence agreements, know-how and technical assistance agreements had to be approved by and registered with the National Registry of Transfers of Technology (NRTT). The NRTT would not register agreements which contained "objectionable clauses", such as grant-backs, tie-ins, choice of foreign law and foreign forum clauses, and "excessive" royalties. With the abrogation of the TTL, parties may now freely negotiate technology agreements in Mexico.

9.4 Trade secrets

The IPL expressly addresses trade secrets and imposes civil and criminal sanctions against persons who, without authorization, disclose them.

9.5 Copyright

The CL recognizes copyright in "literary, scientific, technical, juridical, pedagogical, photographic, pictorial, musical, architectural [and] cinematographic [works], [and] computer programs, radio and television." It was amended in July 1991 to expressly recognize computer software as a copyrightable work. Mexico is a signatory of the Universal Copyright Convention and the Berne Convention. Accordingly, if a work first published in the United States bears the UCC copyright notice (e.g., "19__ [name of owner]"), it should be automatically susceptible of copyright in Mexico.

The CL does not require works to be registered in Mexico to secure copyright protection. It establishes an optional registration procedure. Computer software may be registered by depositing the first and last ten pages of a written version of the source or object code with the Copyright Office.

The civil remedies for copyright infringement include damages and injunctive relief. The amount of damages is not limited by statute. Copyright infringement is also a criminal offense under Mexican law.

Key Contacts

Canada

Canadian Government

Department of Foreign Affairs and International Trade (DFAIT)

DFAIT is the Canadian federal government department most directly responsible for trade development. The **InfoCentre** should be the first contact point for advice on how to start exporting. It provides information on export-related programs and services, acts as an entry point to DFAIT's trade information network, and can provide copies of specialized export publications and market information to interested companies.

InfoCentre
Tel.: 1-800-267-8376 or (613) 944-4000
Fax: (613) 996-9709
FaxLink: (613) 944-4500
InfoCentre Bulletin Board (IBB):
Tel.: 1-800-628-1581 or (613) 944-1581

Commercial Division of the Embassy of Canada in Mexico can provide vital assistance to Canadians venturing into the Mexican market. The trade commissioners are well-informed about the market and will respond in whatever measures possible to support a Canadian firm's presence in Mexico.

***Note:** to telephone Mexico City, dial: 011-52-5 before the number shown. For contacts in other cities in Mexico, consult the international code listing at the front of your local telephone directory for the appropriate regional codes.*

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Canadian Consulate
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International Trade Centres have been established across the country as a convenient point of contact to support the exporting efforts of Canadian firms. The centres operate under the guidance of DFAIT and all have resident trade commissioners. They help companies determine whether or not they are ready to export, assist firms with market research and planning, provide access to government programs designed to promote exports, and arrange for assistance from the trade commissioners in Ottawa and trade officers abroad. Contact the International Trade Centre nearest you.

World Information Network for Exports (WIN Exports) is a computer-based information system designed by DFAIT to help Canada's trade development officers abroad match foreign needs to Canadian capabilities. It provides users with information on the capabilities, experience and interests of more than 23,000 Canadian exporters. To register on WIN Exports, call (613) 996-5701, or fax 1-800-667-3802 or (613) 944-1078.

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