



MEXICO UPDATE



Message from the Co-Chairs

At the International Law Section's August 2011 Leadership Retreat, held on a perfect summer day at the Royal Canadian Yacht Club's island in Lake Ontario a short water taxi ride from Toronto's financial district, our Mexico Committee received the Section's award for "Most Improved Committee".

This recognition reflects a multi-year trajectory of increasing vibrancy, launched under leadership of our past chair, **Alejandro Suárez**. It likewise reflects our Members' investments in making our Committee a premiere place to find personal and professional growth, extend business development networks, and contribute to improving the legal systems in which we work.

This newsletter celebrates the diversity and quality of our membership's interests in our Committee. In addition to features of broad interest on Mexican constitutional law, cross border tax analysis, dispute resolution, and trade law, it includes reviews of a film and a novel, each authored by Mexican lawyers who have chosen to exercise their advocacy skills through arts accessible to broader culture. Read, learn about our work, and volunteer!

Patrick Del Duca and Juan Carlos Velázquez de Leon,
Mexico Committee Co-chairs

A Note from the Editors

This issue of MEXICO UPDATE addresses important challenges that Mexico now faces. Such challenges draw international attention whenever Mexico might seem unable to pace the harmonization of its legal institutions and practices with those of the rest of the world. For instance, the article of **Aline Cardenas** (p. 4) addresses a promising constitutional amendment in the area of human rights, that nonetheless to be effective requires a profound cultural shift in Mexico. As the change begins with those who claim to defend human rights in Mexico, the change may permeate on to those indifferent to them.

The contribution of **Patrick del Duca** (p. 17) about an upcoming program sponsored by our committee for the 2012 International Law Section Spring Meeting discusses a crucial concern of foreign investors in Mexico: the protection of collateral. The challenge for Mexico is not only to reform the law to provide better and safer mechanisms to create and enforce security interests in Mexico, but, again, to change a culture--in this case, the culture of respect and observance in the part of debtors, attorneys and judges to validly created collateral obligations.

Finally, what is likely the greatest ongoing challenge of the Mexican legal system is discussed by **Lorena Martínez** on her article about Mexico's criminal law and criminal procedure (p. 27). Lorena addresses the well-known true-story presented in the film PRESUNTO CULPABLE that exposes "the many contradictions of the Mexican judicial system that presumes suspects guilty until proven innocent."

Alejandro Suárez (asuarez@suarezintl.com), **Ana Patricia Esquer Machado**
and **Rodrigo Soto Morales**, Editors

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Contents

Mexico Committee Leadership Update	3
Constitutional Reform on Human Rights	4
Mexico's <i>Impuesto Empresarial a Tasa Única</i>	7
Cross-border secured lending: the collateral package	17
Review of LA CONJURA, CON O SIN LA CIA, Mexico Committee member Ernesto Velarde Danache's first novel	18
El Paso Brown Bag—Border Environmental Cooperation Commission	19
Los Angeles Chamber of Commerce—CHOOSING THE LANGUAGE	19
January 2011 Amendment to Mexican Law on Judicial Control and Cooperation in Mexican Arbitration	20
Mexico Committee Member Swims English Channel	22
-Knock knock. -Who's there? -It's the NAFTA auditors. -The NAFTA what?	23
PRESUMED GUILTY: A glimpse at Mexico's penal system and criminal procedure laws	27
Highlights of Symposium <i>US-Mexico Relations Today--Law, Society & Business</i> , Seattle, July 19, 2011	28



About the Mexico Law Committee

Anchored by coordinators in nine cities in Mexico and the United States, the Mexico Committee seeks to grow its members' involvement in dialog on current and potential developments of Mexican, United States and other law relevant to their practice of law and to the establishment of sound policy. Current substantive focuses of the committee's work include arbitration, antitrust law, criminal procedure reform, data privacy, environmental law, legal education, secured lending, and trade law. The Committee contributes to the annual *Year in Review* publication, is developing its newsletter in partnership with a leading Mexican law faculty, maintains its website, and actively organizes programs at the spring and fall meetings of the International Law Section.

The Mexico Committee's membership is its most important asset. We encourage all Committee members to be involved in Committee activities and to communicate freely their suggestions and ideas.

Upcoming Events — Save the Date

Dublin Fall 2011 Meeting

October 11-15

Mexico Committee sponsors the panel *Guidelines for Understanding, Adjudicating, and Resolving Disputes in Elections, featuring Gerardo de Icaza Hernández*, Chief of International Relations of Mexico's *Tribunal Electoral del Poder Judicial de la Federación*, plus **Pablo Hooper Ramirez** of Gonzalez Calvillo SC, speaks on *Global Overview of Current Developments in the Regulation of Offer and Sale of Franchises*, each Wednesday, October 12, at 2:30 PM, plus a **Committee Dinner** Wednesday evening (ticketed event), **book signing** by Section author Patrick Del Duca of CHOOSING THE LANGUAGE OF TRANSNATIONAL DEALS, at 4:00 PM Thursday, October 13, and an **in-person Mexico Committee Business Meeting**, Friday, October 14 at 5 pm Dublin time, with conference telephone availability to Mexico Committee members not in Dublin [**a special time for our October Monthly Mexico Committee Call**]

October 24, Antitrust in Latin America - What's Going On?

Join experts from Argentina, Brazil, Chile, Colombia, and Mexico to hear about key antitrust developments in merger control, cartel enforcement and other anticompetitive conduct issues. The panel will discuss recent cases, changes in practice and agency advocacy efforts in each of these areas.

The Mexico Committee is pleased to support the program in cooperation with the International Antitrust Committee, especially in view of the participation of **Francisco**

Fuentes Ostos, convenor of the Mexico Committee's working group on antitrust issues.

Moderator: Alfredo M. O'Farrell / Miguel del Pino, Marval, O'Farrell & Mairal, Argentina

Speakers:

Mexico: **Francisco Fuentes Ostos**, Mijares, Angoitia, Cortés y Fuentes, S.C.

Brazil: Bruno Peixoto, Lanna Peixoto Advogados

Colombia: Mauricio Jaramillo Campuzano, Gómez Pinzón Linares Samper Suárez Villamil & Asociados

Chile: Gerardo Varela, Cariola Diez Perez-Cotapos & Cia Ltda.

New York Spring 2012 Meeting

April 17 - 21

Mexico Committee sponsors the panels,

Cross-border secured lending: challenges of structuring the collateral package, chaired by Mexico Committee Co-chair **Patrick Del Duca** and Lucila Escriña

How Many Ways Can North American Importers Get Certificates of Origin Wrong? Stories From the Attorneys With Battle Scars, chaired by Mexico Committee member **Luis F. Martinez**

Save the date for a proposed **Mexico Committee standalone program** in Mexico City, June 6-7, 2012—more news to come next issue!

ALSO, join our **monthly Mexico Committee calls**, announced through our listserve!

Committee Leadership 2011-2012

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MEXICO UPDATE



Mexico Committee Leadership Update

Patrick Del Duca and Juan Carlos Velázquez de León

In this, our first Mexico Committee newsletter of the 2011-2012 bar year, we celebrate the renewed commitment of our committee's leaders and active members in carrying forward the committee's work.

Committee Co-Chairs **Patrick Del Duca** and **Juan Carlos Velázquez de León Obregón** benefit from both an active committee membership and the support of our Section's leaders in recognizing the importance of the issues and activities targeted in the Committee's business plan. In particular, they coach Committee members in the proposal of programs for the Section's spring and fall meetings, an effort that is yielding consistent results, with the presentation of high quality programs, they serve *ex officio* on the various working groups that carry forward the Committee's activities, and they nurture the involvement of each of the Committee's members in its work.

Each of the Committee's Vice-Chairs has stepped forward to commit to leadership of an aspect of the Committee's work. Vice-Chair **Juliana Victoria Campagna** of Hofstra Law School is serving as the Committee's Communications Officer, and exploring as part of the Committee's City Coordinator Initiative, with New York-based Committee Members **John Rogers** and **Stuart Shroff**, the prospect of a New York City event modeled on the successful event this summer in Seattle, also within the Committee's City Coordinator Initiative, under the leadership of Committee members **Ben Rosen** and **David Spencer**. Vice-Chair **Francisco Cortina** continues as the Committee's (and the Section's) liaison to the *Barra Mexicana*, with an active role in the Committee working group exploring a stand-alone program in Mexico City in June 2012. Committee Vice-Chair **Leslie Alan Glick** is co-chairing the Committee working group on the proposed Mexico City stand-alone program, together with Mexico Committee member **Joaquín Gustavo Rodríguez Zarza**, also the Section's membership ambassador for Mexico, and active contributions of many of the Committee members here mentioned. Committee Vice-Chair **Ana Patricia Esquer Machado** of the law faculty of the Universidad Panamericana, Guadalajara Campus, is a leader of the Committee's collaboration with her law faculty on this MEXICO UPDATE, the Committee's newsletter, now published quarterly.

Committee Vice-Chair **Carlos A. Sugich**, based in Phoenix, leads the Committee's increasingly active City Coordinator Initiative, benefiting from the commitment of members in nine cities to organize events to highlight visitors of interest and to enable members to deepen their appreciation of their respective practices and complementary interests. Committee Vice-Chair **Eddie J. Varón Levy**, with the experience of having served as a member of Mexico's Congress, has committed to lead the Committee's governmental relations.

The Committee's active steering group also includes a strong and diverse roster of additional Committee members.

Committee member **Stuart Shroff** coordinates the Committee's monthly working calls (generally the second Friday of each month, but modified to reflect the opportunity for in-person business meetings, also with conference call participation, on the occasion of the Section's seasonal meetings). Reflecting the deepening trade and investment relations between Brazil and Mexico, the Committee's membership initiatives are led by the team of **Joaquín Rodríguez** and Brazilian lawyer **Ana Luisa Derenusson**. The Mexico Committee's Liaison to the ABA Science and Technology Section is Committee Member **Isabel Davara F. de Marcos**. Mexico City lawyer **Andrés Nieto** has stepped forward to lead the administration of the Mexico Committee's initiative to activate fully its policy function. He benefits from the existence of the Committee's Competition Law Working group, convened under the leadership of Committee member **Francisco Fuentes Ostos**, and the exploration in course under the leadership of Committee Member **Sergio Bustamante** for the establishment of an environmental law working group. Our Committee's Immediate Past Chair and Senior Advisor **Alejandro Suárez** leads the Committee's publication activities, including this MEXICO UPDATE newsletter. Committee Member **Jay Stein** returns to coordinate the Committee's contribution to the *Year in Review* issue of THE INTERNATIONAL LAWYER. Committee members **Marco Montañés-Rumayor** and **Nadia González Elizondo** have committed to lead special projects for the committee. Committee member **Jorge E. Frago** is our webmaster.

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MEXICO UPDATE



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Constitutional Reform on Human Rights

by *Aline Cárdenas*

“The evolution of the Human Rights movement clearly illustrates humanity’s ongoing struggle toward creating a better world.”

Robert Alan.

Article 2.1 of the International Covenant on Civil and Political Rights, and Article 2 of the American Convention of Human Rights, declare the duty of States to adopt the laws necessary to enforce human rights. However, the existence of such rights does not depend on the adoption of domestic rules by any State, because such rights derive neither from the will of a State, nor by virtue of the international community’s attribution of them to any person. Rather, because human rights derive from human nature, they are inherent in every person.⁽¹⁾

Mexico, following the presentation of some thirty-three reform initiatives to the Mexican Congress in just two years, has adopted a *Constitutional Reform on Human Rights*, effective March 2011. This reform modifies Chapter I of Title I of the Mexican Constitution, plus a further eleven articles of the Constitution. The reform reflects a desire to strengthen Mexico’s system to assure respect of human rights. The adoption of the constitutional reform is a major step forward in Mexico’s broad progress on the incorporation of international human rights law into its domestic legal system. In particular, it represents a major step towards full harmonization of Mexico’s national policy with the highest international human rights standards. It also promotes the observation of various commitments that Mexico has made to the international community and the implementation of recommendations delivered by international organizations.

The adoption of the constitutional reform is a major step forward in Mexico’s broad progress on the incorporation of international human rights law into its domestic legal system.

The *Constitutional Reform on Human Rights* clarifies that any person can demand the respect, and exercise, of human rights. Although such rights have been protected in Mexico prior to the reform, the reform ameliorates some details that detracted from the effectiveness of the protection of these rights. Both the Chamber of Deputies and the Senate have affirmed that this reform must not be diluted or delayed, but instead should be effective promptly and expeditiously, in benefit of the Mexican people.

This reform was undertaken at the initiative of the Executive Power, and ultimately involved an extensive process of consultation among various social and political groups.

After considering the claims of various human rights organizations, and the arguments advanced in both legislative houses during the constitutional amendment process, the Congress approved the reform. The following are the reform’s principal modifications of the Constitution:

- 1) Article 1 replaces constitutional references to the term “individual”, with the more accurate “person”. Further, it now refers expressly to the enjoyment and effective fulfillment of human rights and the guarantees for their protection.
- 2) Express contemplation is made that Mexican authorities must respect the human rights recognized in the Constitution and also those in international treaties to which Mexico is a party.
- 3) The Mexican State is obligated to prevent, investigate, punish and remedy human rights

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MEXICO UPDATE



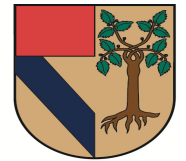
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- violations in the terms established by Mexican law.
- 4) Each authority of the State must respond to the recommendations of Mexican human rights bodies. Should such recommendations not be accepted or implemented, the authority must establish the reasons, and publicly acknowledge its failure to comply.
 - 5) Each of the Mexican states and the Federal District must guarantee the autonomy of bodies that protect human rights.
 - 6) The designation of the presidents of the National Human Rights Commission and of its advisory council in each of Mexico's states, will be accomplished through a procedure that involves public consultation.
 - 7) Mexico's Human Rights Commission may investigate *ex officio* or *ex parte* facts that may constitute grave violations of human rights.
 - 8) The Mexican Constitution now newly contains an express prohibition on discrimination against a person for that person's sexual preferences. It maintains the prohibition against discrimination based on ethnic or national origin, gender, age, disability, social status, health status, religion, opinions, marital status or any other reason in violation of human dignity or any discrimination that negates or impairs individual rights and freedoms.
 - 9) The Mexican State is now obliged to encourage respect for human rights through education.
 - 10) Article 11 of the Constitution, concerning the right to enter and leave the country, travel through Mexican territory and change residence without a security card, passport, safe-conduct or other similar requirements, now employs the term "person" rather than "man" and allows anyone persecuted to seek and enjoy asylum.
 - 11) The prison system is to be organized on the basis of respect for human rights. This mandate reaffirms that this system must be based on work, training, education, health and sport as means to achieve the reintegration of the sentenced person to society.
 - 12) Any restriction or suspension of rights and constitutional guarantees may be undertaken only in accord with specific law issued to that effect, and at all times observing the principles of legality, rationality, proclamation, publicity and non-discrimination. Such measures may not refer to an individual person, and the following rights may not be suspended: nondiscrimination, recognition of legal personality, life, personal integrity, protection of family, name, nationality, rights of children, political rights, freedoms of thought, conscience and religion, non-retroactivity of law, the prohibition of the death penalty, prohibition of slavery and servitude, prohibition of forced disappearance and torture, and the judicial guarantees essential to protect such rights. Any decree of restriction or suspension issued by the Executive is to be immediately reviewed by the Supreme Court of Justice, which will rule on its constitutionality and validity. Such measures are allowed only in the context of serious disturbance of public peace or invasion, thus providing a legal and constitutional, rather than arbitrary, basis for necessary action by the Executive Power.
 - 13) The President's constitutional power to expel a non-citizen from the national territory, formerly a discretionary attribution bound only in its restriction to use in the cases established in the Constitution, is now expressly further limited by a guarantee of due process of law.

The Mexican Constitution now newly contains an express prohibition on discrimination against a person for that person's sexual preferences.



MEXICO UPDATE



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14) Within a year after the amendments come into force, Congress is required to adopt federal legislation regulating compensation for damages, the suspension of the exercise of the rights and guarantees, and the expulsion of non-citizens.

The constitutional reform has two principal kinds of features: it broadens the list of fundamental rights, and it strengthens the institutions responsible for preventing and reporting human rights violations, including by clarifying their duty to rectify such breaches. This reform is accordingly the most important of the ongoing developments on human rights in Mexico.

It would be wrong to think, as some have asserted, that this reform will affect separation of powers, checks and balances among the branches of government, and the federal system, or that various issues will newly become the object of dispute in international courts. On the contrary, the reform is a constitutional recognition of existing international obligations. Indeed, Constitution Article 133 has previously provided that international treaties are national law and a source of obligations for both the Nation and its states, as does the Vienna Convention on the Law of Treaties, ratified by Mexico on March 10, 1988.

Moreover, the expansion and strengthening of the constitutional recognition of universal human rights is in line with the rich Mexican constitutional tradition, democratic in nature, committed to respect the rights and freedoms of all. Also, the democratic rule of law and the federal Constitution are reinforced by the reform, as it responds to a logic of complementarities

between international and domestic law, as well as between federal and local norms.

For these and other considerations, the *Constitutional Reform on Human Rights* has been recognized as significant normative progress by the OAS's Inter-American Human Rights Commission, the United Nations High Commissioner for Human Rights, and more importantly by a broad group of civil society representatives, academic experts and specialists in the subject.

(1) Ortiz Ahlf, Loretta, *Derecho Internacional Público*, ed. Oxford, México, 2008, p. 414.

The constitutional reform has two principal kinds of features: it broadens the list of fundamental rights, and it strengthens the institutions responsible for preventing and reporting human rights violations, including by clarifying their duty to rectify such breaches.

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MEXICO UPDATE



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Mexico's *Impuesto Empresarial a Tasa Única* Is Not a Significant Concern for a Capital Intensive U.S. Venture in Mexico by *Christopher Hanfling**

In 2008, Mexico imposed a new tax, the *Impuesto Empresarial a Tasa Única* ("IETU"), to replace a previous asset tax with one that would more effectively encourage investment while increasing tax collections. (1) The IETU is a separate tax imposed on a business in Mexico only if the IETU surpasses the businesses liability under the standard income tax for the year.(2) However, the IETU is not a significant concern for a U.S. investor launching a capital intensive start-up venture in Mexico such as a telecommunications company or a power plant, because IETU liabilities can be minimized through careful structuring of the venture, IETU payments are creditable for the foreseeable future for purposes of U.S. taxes, and the incurrence of debt financing reduces the potential tax savings provided by the IETU.

The IETU can be significantly minimized through judicious structuring of the venture. Through manipulating cash flows, the venture can ensure that IETU liabilities rarely if ever surpass income tax liabilities, potentially eliminating any incurrence of the IETU. Similarly, the base upon which the IETU is imposed can be decreased by reducing non-deductible expenses via alternative financing, outsourcing labor, and limiting related party interactions.

Additionally, the United States Internal Revenue Service ("IRS") currently allows the U.S. Foreign Tax Credit for the IETU, even though the tax technically does not qualify for this treatment. This allowance is unlikely to change for the foreseeable future and thus, any IETU liabilities incurred by a U.S. venture in Mexico will not likely be subject to a second layer of taxation in the U.S.

The IETU allows a current deduction for capital expenses, which provides significant opportunities for minimizing both income tax and IETU liabilities early

in the venture. Although these tax savings can be extensive, they result in an increased tax burden later in the life of the venture, which is worsened by extensive interest expenses. Thus, in a debt-financed venture, these potential savings are quite limited.

Because the IETU can be mostly avoided, does not cause double taxation, and has limited use for tax avoidance, it is not a particularly significant concern for a debt-financed, capital intensive start-up U.S. venture in Mexico.

I. IETU liabilities can be avoided through tax planning

Although the IETU was intended to raise revenues generally, any business in Mexico not attempting to engage in aggressive tax avoidance is able to mostly eliminate any IETU liabilities. A taxpayer aggressively reducing income taxes owed will have fewer income taxes paid credits with which to offset its IETU liabilities. In this way, the IETU prevents extreme forms of tax evasion and thereby increases revenues. The actions to minimize IETU liabilities can be done through a variety of techniques that are mostly formal or structural rather than substantive.

A. The architecture of the IETU

The IETU was adopted in 2008 in order to replace the previous asset tax in a way that would both encourage investment and increase revenues.(3) Although it may at first have been intended to follow the model of the Alternative Minimum Tax ("AMT") for individuals in the U.S. or other similar taxes in other countries that assure a minimum level of tax, it ended up being something quite different.(4) Like the AMT, the IETU is imposed at a significantly lower rate on a significantly larger base than the Mexican corporate income tax.(5) However, this larger tax base for the IETU than the income tax is calculated with a

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MEXICO UPDATE



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qualitatively larger margin of difference than that distinguishing the bases on which the AMT and the U.S. individual income tax are calculated. Additionally, the IETU is calculated using the cash method of accounting, rather than the accrual method that is permitted in most income and minimum tax regimes, including the Mexican corporate income tax.(6)

Like most income taxes, the IETU is calculated by totaling gross receipts, deducting the cost of earning those receipts, and multiplying the result by the tax rate of 17.5%.(7) Gross receipts are calculated by summing the revenues from sales, services, and some leases.(8) Deductions are allowed for a variety of expenses including capital expenditures, royalties and rents paid to unrelated parties, other state and federal taxes, and inventory expenses.(9)

This total is not necessarily imposed on the business, however, because each year a credit is allowed against it for income taxes paid that year.(10) Thus, only if IETU liability exceeds income tax liability for the year will there be any IETU imposed, and then only to the extent it exceeded the income tax. Additionally, if in a given year deductions exceed the gross receipts in calculating the IETU, an excess deductions credit is created that can be applied against future IETU liabilities.(11) This excess deductions credit lasts for up to ten years or until offsetting IETU liabilities are consumed.(12) This credit can also be used to offset traditional income tax liability, but only within the year in which it is created.(13)

Unlike most income taxes, the cost of capital assets such as machinery or equipment is currently deductible from the base on which the IETU is imposed. It need not be amortized over its useful life through deduction expenses.(14) This deduction is a very large incentive for capital investments.(15) However, because the assets are currently deductible, taxpayers will not hold them with a tax basis under the IETU. This means that there are no depreciation deductions and that when capital assets are resold there will be gain recognized in the amount of the full resale value for purposes of

calculating the IETU.

Due to the current deduction for capital expenses, a new capital intensive venture in Mexico will accrue an extensive account of excess deductions credits as it makes its initial capital investments. As the venture becomes more profitable and the purchase of capital assets slows down, this account will gradually be used up in any year that IETU liabilities exceed income tax liabilities. Only once the entire account is emptied, will IETU liabilities actually be owed. This may not take very long, due to the different methods of calculating income tax and IETU. In the early years of a capital intensive start-up, the depreciation deductions for the recently purchased capital assets and costs of debt servicing can frequently cause the venture to not show any profits despite large cash receipts. Under the IETU, these two deductions are disallowed, and so the cash receipts may cause significant IETU liabilities without leading to income tax liabilities. Thus, it is important to structure the venture to minimize the extent to which IETU liabilities exceed income tax liabilities.

B. Manipulating timing to limit IETU liabilities

Every year, IETU liabilities are credited for any income taxes paid.(16) Thus, if the taxpayer can ensure that in no given year does the IETU liability exceed income taxes owed, the taxpayer will never have to pay any IETU. Due to the different bases on which the IETU and the corporate income tax are imposed, there could easily be years in which this does not occur naturally, such as years with extensive asset depreciation.

Because the IETU is imposed on a cash, rather than accrual, basis,(17) the taxpayer avail itself of these timing mechanisms to prevent IETU liabilities from exceeding income tax liabilities. Through use of prepayment and debt, the taxpayer can cause expenses to be recognized under the cash method of accounting in different years than they are under the accrual method. Combined with careful timing of capital investments and their associated deductions, the



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

taxpayer can ensure that IETU liabilities regularly match income tax liabilities, maximizing the value of the income taxes paid credit.⁽¹⁸⁾

Using the income taxes paid credit as much as possible to offset IETU liabilities will reduce the total amount of IETU liabilities that must either be offset by the excess deductions credit or actually paid. Thus the use of these timing techniques will reduce total IETU liabilities owed throughout the life of the venture.

C. Limiting expenses not deductible under the IETU

The mechanism through which the IETU is imposed on a broader base than the Mexican corporate income tax is the disallowance of deductions for certain expenses. The most important of these disallowances pertain to interest, wages, and related party rents and royalties. Through judicious structuring of a venture, these expenses can be minimized relative to expenses deductible for purposes of the IETU. This would cause the base upon which the IETU is calculated to shrink, leading to reduced IETU liabilities and increased excess deduction credits. Although many of these structuring techniques do not eliminate the non-deductible expense entirely, the more the expenses are reduced, the longer the excess deductions credit will last to offset what IETU liabilities remain.

In calculating the IETU base, rents and royalties paid to related parties are not allowed as deductions.⁽¹⁹⁾ It is through manipulating these payments that much international tax evasion takes place,⁽²⁰⁾ and this disallowance significantly hampers the effectiveness of those evasive techniques. While this limits both the availability of aggressive tax planning and the value of corporate integration, any venture willing to pay fair market value can simply enter into similar arrangements with non-related parties and avoid these non-deductible expenses.

In some situations it may be impossible to find a third-party alternative, and non-deductible rents or royalties may be paid; a related party may be the only owner of

certain intellectual property or the cost savings from corporate integration may be worth increased tax liabilities. However, altering the structure of these related party arrangements to minimize the amount actually paid as rents or royalties will reduce the amount of non-deductible expenses under the IETU.

The IETU also does not allow a deduction for wage expenses.⁽²¹⁾ Thus, while payroll taxes are deductible, payroll itself is not.⁽²²⁾ This is ameliorated somewhat by a credit the IETU allows after it has been calculated.⁽²³⁾ This credit is for the sum of the taxable wages paid multiplied by the IETU rate.⁽²⁴⁾ At first glance, this credit would seem to mirror a deduction for wage expenses; however there are two significant gaps.⁽²⁵⁾ First, any untaxed wages, such as fringe benefits or wages excluded from the employee's tax return, are not included within this credit.⁽²⁶⁾ Thus, in the case of businesses that hire large numbers of low-wage employees who pay minimal taxes such as many maquiladora factories, the disallowance of a deduction for the untaxed wages is quite significant.⁽²⁷⁾ Second, because this credit is imposed after the IETU liability has been calculated, it is only applied in years where IETU liability is positive. In years where deductions exceed gross receipts, all wage expenses will decrease the available excess deductions credit.⁽²⁸⁾ Thus, this credit only partially accounts for wage expenses, and only then in years where IETU liability is positive.⁽²⁹⁾

In order to reduce non-creditable wage expenses, a start-up venture in Mexico should structure itself to minimize payroll generally, and particularly minimize the use of non-taxable fringe benefits and low-cost labor. This can be accomplished through contracting outside the venture for services, rather than hiring a staff to perform them. Additionally, employment arrangements for essential personnel can be designed so as to minimize tax-exempt benefits in favor of higher salaries, for the bulk of compensation to be paid in years where the IETU liability is already positive, or for compensation to be in the form of stock options or some other form that does not affect



MEXICO UPDATE



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PANAMERICANA

cash flows. In a capital intensive start-up, almost all of the labor can potentially be performed by non-related parties; independent specialty firms and Mexican companies particularly designed to provide labor services under the new IETU regime can be utilized to greatly reduce the venture's payroll.

Except for certain banks and financial institutions, interest expenses are not allowable deductions in calculating the IETU.⁽³⁰⁾ Thus, while the purchase of a capital asset is currently deductible, the cost of financing that purchase with debt is not.⁽³¹⁾ Disallowing a deduction for interest expense removes the tax preference for debt over equity financing; the interest is now subject to two layers of taxation, first due to the IETU liability imposed on the debtor, and then through the income tax imposed on the creditor. This mirrors the tax usually imposed on dividends at both the corporate and shareholder levels. However, where the shareholder can exclude dividends received from income, the IETU favors equity financing by only subjecting it to the first layer of taxation.

In order to reduce the amount of interest expense, alternative forms of financing should be considered. Vendor financing where a lower interest rate is provided in exchange for a higher overall price, for instance, would lead to a higher percentage of total acquisition cost being deductible under the IETU. Similarly, equity financing, even if structured through preferred classes of stock that closely resemble debt instruments, is now a more attractive method of raising capital for purposes of the IETU. For a capital-intensive venture, third-party debt financing may still be necessary and thus avoiding interest expenses altogether may be impossible. In that case, debt structures that minimize the total interest cost can be used to minimize the amount of non-deductible expenses under the IETU. These structures could include lower interest rates in exchange for less favorable terms, or shorter maturities generally.

In a new capital intensive venture, financing is one of the most crucial concerns. Limiting the use of debt

financing may be virtually impossible, and many institutional lenders may not be willing to alter their terms in order to minimize IETU liability. However, with an IETU rate of 17.5%, the venture can have significant non-deductible interest expenses before the IETU liabilities exceed income tax liabilities if there are minimal other non-deductible expenses and capital investment is being carefully timed. Thus, even if the venture is entirely financed through high interest debt, IETU liabilities can be minimized or even avoided through careful monitoring of the other non-deductible expenses and maximizing the use of the income taxes paid credit.

II. The IETU is a creditable foreign tax for purposes of U.S. tax

One of the most important questions for American investors in Mexico is to what extent their Mexican earnings will be taxed by the United States. Because the United States taxes its residents and non-resident citizens on their global income,⁽³²⁾ there is a large opportunity for double taxation.⁽³³⁾ Double taxation can cause a venture that otherwise would be quite profitable not to be cost effective for the U.S. investor. Therefore, U.S. investment in Mexico depends in large part on whether or not the IETU qualifies for the Foreign Tax Credit either under the tax treaty between Mexico and the U.S. or the U.S. tax code generally.⁽³⁴⁾

A. The U.S. credit for foreign income taxes

The Foreign Tax Credit ("FTC") pursuant to §901 of the Internal Revenue Code⁽³⁵⁾ is a rule designed to minimize double taxation.⁽³⁶⁾ It provides U.S. residents and non-resident citizens a dollar-for-dollar credit for all income taxed paid to other nations up to the amount the United States would tax.⁽³⁷⁾ If the other nation has a lower tax rate, the IRS will demand the difference between the two taxes, and if the other nation has a higher tax rate, the excess income taxes paid do not provide further credits.⁽³⁸⁾

However, through the past century there have been a



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

variety of situations in which something that was formally an income tax actually served some other purpose.(39) Perhaps the most important were the various tariffs imposed by oil-rich nations in exchange for exploiting their oil reserves.(40) These levies were in substance payments for the economic benefits of oil rights rather than a tax on income.(41) The U.S. did not want to subsidize the oil industries of foreign nations, and so it had to determine which foreign taxes to credit and which not.

When the IETU was first imposed, the IRS issued a notice that it required time to determine if the IETU was eligible for the FTC.(42) In the meantime, the IRS has allowed taxpayers to take the credit for IETU liabilities paid, and has declared that any decision to the contrary will not be enforced retroactively.(43) In 2008, one Treasury representative said that the determination would take “years.”(44) The IRS has since provided no further guidance regarding creditability of the IETU.

B. The IETU does not meet the requirements for the Foreign Tax Credit as it is not an income tax

Although for the foreseeable future, the IETU is eligible for the FTC, this is due to IRS fiat and not any substantive tax rule. According to U.S. Treasury regulations and their surrounding case law, the IETU is in fact not eligible for the FTC. This is because under both the U.S. FTC regulations and the U.S. – Mexico Tax Treaty, only income taxes are creditable. The IETU is not an income tax according to either Mexican or U.S. law, and therefore is not creditable.

i. Mexico’s Supreme Court declared the IETU is not an income tax

Once it was adopted, the IETU came under extensive constitutional challenges.(45) Significantly, the lack of many of the traditional income tax deductions for wage, interest, and related party rents and royalties was challenged.(46) These disallowances were cited as leading to unfair, disproportional taxation by not properly calculating net income.(47) This was said to violate the constitutional guarantees of fairness.(48)

When the Mexican Supreme Court heard the cases, it declared that the IETU was a tax on gross, rather than net, income.(49) As such, any deductions allowed were at the discretion of the legislature, and not an attempt to calculate net income.(50) Thus, because the calculations were not unfair, the IETU did not violate the constitution.(51)

By labeling the IETU as not a tax on net income, Mexico’s Supreme Court may have diminished any chance of the IETU qualifying for the FTC. However, because application of the FTC is a purely U.S. legal question, a Mexico court decision is not binding for this purpose. Thus, a U.S. court could determine that the IETU is an income tax for purposes of U.S. law without regard to analysis of the nature of the tax by a Mexican authority, even one with the high standing and reputation of the Mexican Supreme Court.

ii. The U.S. – Mexico tax treaty does not provide a credit for the IETU

The tax treaty between Mexico and the U.S. declares that a tax credit shall be provided for income taxes.(52) However, it does not further define income taxes, and because the treaty was written before the IETU was adopted, it does not provide guidance regarding the treatment of the IETU.(53) In order to qualify under the treaty, the IETU must be substantially similar to a tax that qualified for the credit when the treaty was signed.(54) The IETU is qualitatively and quantitatively different than either the asset tax which it replaced, or any other tax Mexico has imposed. Thus, due to the fact that the IETU is so unique and the fact that the Mexican government has taken the position that it is not in fact an income tax, the tax treaty almost certainly does not make the IETU creditable for U.S. taxpayers.

iii. The IETU is not an income tax under U.S. law

In order to qualify for the FTC, a foreign levy must have the predominant character of an income tax in the U.S. sense.(55) An income tax in the U.S. sense is one which meets the realization, gross receipts, and



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

net income requirements of Treasury Regulation 1.901-2.(56) The IETU does not meet the net income requirement of this test.

The realization requirement is that the tax be imposed subsequent to an event that would be considered a realization event under the United States tax code.(57) Given that the IETU is imposed on cash receipts for goods or services, it clearly meets this definition.(58) Similarly, the regulations require that the tax be imposed on the basis of gross receipts.(59) By including the broad categories of sales, service, and rental incomes, this is most likely met.(60)

The net income element requires that gross receipts be reduced by the significant costs and expenses attributable to them.(61) The regulations further allow that, where a deduction is not allowed, the tax does not fail to reach net income if the tax provides allowances that effectively compensate for the non-recovery.(62) Due to the insufficient compensation for wage expense and the lack of compensation entirely for the interest and related party rents and royalties disallowances, the IETU clearly does not allow recovery of the costs of doing business and therefore is not an income tax.

The disallowance for depreciation deductions does not prevent the IETU from reaching net income. Depreciation deductions exist to recover the cost of capital assets through the reduction of the taxpayer's basis in them. Under the IETU, all of these capital assets lead to a deduction in the year at which they are purchased, so there is no basis in them to be reduced by depreciation deductions. Thus, by allowing the current deduction for these purchases, the IETU essentially permits depreciation at the most accelerated rate possible. Through this very taxpayer friendly cost-recovery method, the IETU is overestimating the expense of the wear and tear on capital assets, and thus more than effectively compensating for the disallowed depreciation deductions.

The disallowance for wage expenses, however, is not effectively compensated. Wages traditionally are one of

the central costs of earning profits and almost always deductible.(63) Without compensating for this disallowance, the IETU cannot be an income tax under the U.S. regulations. The credit provided by the IETU for wages paid is insufficient compensation. Because the credit only applies to taxable wages as opposed to all wages, and because it is only usable in years with a positive IETU liability, the credit will almost always underestimate wage expenses, and never overestimates them.(64) The regulations, however, require that the recovery of costs be calculated in a way that equals or exceeds those costs.(65) By systematically undervaluing the wage expenses of a business, the IETU does not allow sufficient recovery for them.

The disallowances of interest expenses and related party rents and royalties are even more clearly uncompensated. Interest, rents, and royalties, even if paid to related parties, are significant costs of doing business. Without a related credit or additional deduction as in the wage and depreciation disallowances respectively, there clearly is no compensation for these instances of non-recovery in the IETU. In fact, the lack of an interest expense deduction alone has been grounds for challenging the creditability of a foreign tax.(66) Thus, the lack of compensation for the disallowance of deductions for both related party rents and royalties and interest clearly prevents the IETU from reaching net income.

Credits or deductions based on the specific cost disallowed are not the only way to effectively compensate for disallowed costs; a tax can be judged in its totality to determine if there is effective compensation for a disallowance. In *Exxon Corp. v. Commissioner*(67) a tax was imposed on oil production that did not allow a deduction for interest expenses. However, various exclusions and allowances in the tax based on volume produced effectively compensated for the disallowance.(68) Similarly, in *Texasgulf Inc., & Subs. v. Commissioner*(69) a mining tax did not allow deductions for interest or depletion, but a processing



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

allowance based on volume mined was deemed to be effective compensation.⁽⁷⁰⁾ Unlike *Exxon* or *Texasgulf*, the IETU does not include an additional exclusion, deduction, or allowance based on volume. Thus, without an additional method of compensating for the disallowed deductions, the IETU is not an income tax under the relevant case law.

If the IRS decides to stop allowing the FTC for IETU paid, taxpayers will probably argue that, as in *Exxon* and *Texasgulf*, the IETU effectively compensates for the disallowed deductions. They will point to the current deduction for capital assets, the credit for traditional income tax paid, and the long life of excess deductions credits to show that the IETU does not fall on more than net income. As in *Exxon*, where the court examined records from over thirty companies liable for the tax in question,⁽⁷¹⁾ this argument will require evidence of the IETU's actual financial impact. This evidence must include numerous years of data, both to see the long-term effects of the carry-forward credit and to see the application of the IETU without any confusion from the transitional rules put in place when it was adopted.⁽⁷²⁾ However, even if the plaintiffs can find many instances where the current deduction for capital expenses provided tax savings compensatory with the tax cost of all the disallowances, instantaneous depreciation deductions are not an additional allowance or exclusion as were found in *Exxon* and *Texasgulf*. Thus, if the IRS ever decides to disallow the FTC for the IETU, the decision will most likely be upheld.

C. The IRS is unlikely to disallow the foreign tax credit for the IETU

Although the IETU does not meet the statutory requirements for the FTC, is not creditable under the US-Mexico tax treaty, and is not even considered a tax on net income by the Mexico's Supreme Court, the IRS is still unlikely to make a determination regarding the IETU's creditability. Instead, the IRS will likely continue indefinitely to provide the FTC for the IETU

on a temporary basis.

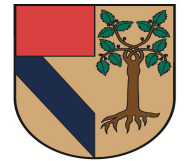
The IRS is unlikely to determine that the IETU is not a creditable income tax because such a determination would have significant political and economic consequences. By disallowing the FTC for the IETU, the IRS would be unilaterally changing the status quo of the U.S. – Mexico tax treaty. Without guidance from other governmental agencies regarding possible foreign relations concerns, the IRS is unlikely to want to alter U.S. – Mexico relations. Similarly, by disallowing the FTC for the IETU, the IRS would be placing U.S. investors in Mexico at a competitive disadvantage to other investors. This would chill U.S. investing in Mexico, which would have ramifications within the political and business sectors of both Mexico and the U.S.

A determination that the IETU is not creditable would be challenged in court by U.S. owned businesses paying IETU liabilities. Although the court would likely come out in favor of the IRS, the expense and uncertainty involved in civil litigation, specifically collecting all the data regarding the real world impact of the IETU, would be significant. The IRS has limited resources, and spending them defending a minor determination such as this would be inefficient. Additionally, the very structure of international taxation, particularly the FTC, is currently under significant scrutiny and debate in the U.S. government.⁽⁷³⁾ Thus, even if the IETU becomes a significant source of tax avoidance, the IRS may decide to wait until the current political debates are resolved before making such a determination.

Although the IRS is heavily incentivized against not crediting the IETU, the IRS is similarly unlikely to issue a determination that the IETU is creditable because such a determination would go against the regulations and case law regarding creditable foreign taxes. In order to allow the credit, the IRS would either have to alter the pertinent regulations to include taxes such as the IETU, or simply provide a more relaxed interpretation of the regulations than was



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

espoused in *Exxon* or *Texasgulf*. Either of these mechanisms would change the status quo regarding creditable taxes, which would lead to extensive litigation as taxpayers attempted to apply the changes to other foreign taxes that currently are denied the FTC.

Finally, although the IETU is does not meet the requirements for a creditable tax under the Treasury regulations and case law, allowing the credit in this instance obeys the spirit, if not the letter, of the tax laws. Unlike the majority of levies that the Treasury regulations were designed to prevent from being credited, the IETU is not a payment to the Mexican government for some economic benefit such as oil rights. Rather, the IETU is imposed across industries on the basis of gross receipts and allows for recovery of many of the costs of doing business, much like a true income tax. Thus, although it is contrary to the current regulations and case law, allowing the FTC for the IETU is consistent with the U.S. international tax regime currently in place.

With such strong incentives against a determination one way or another, maintaining the current arrangement set forth in Notice 2008-3 allows the IRS to provide the FTC for the IETU without changing the status of the current regulations. Because the IRS does not want to make a determination for the reasons set forth above, and making no determination is favorable to the taxpayers, there is very little motivation to make the determination at all. This impasse may not last forever, especially if the U.S. legislature makes significant changes to the U.S. international tax system, and thus there is a modest risk that a U.S. venture in Mexico could be exposed to double taxation due to the IETU at that time. However, for the foreseeable future, the IETU remains creditable.

III. The capital expenses deduction has limited value as a tax avoidance mechanism for a debt financed venture

The current deduction for capital expenses, when

combined with the excess deductions credit, is a powerful tool for tax planning, because the purchase of capital assets causes a current reduction in overall tax liabilities. However, this reduces the excess deductions credits available to offset the disallowance for interest expense deductions. Thus, in a heavily debt-financed venture, using the capital expenses deduction to reduce income tax liabilities will simply increase IETU liabilities. Although the value of earlier deductions is greater than the cost of an equal later increase in tax liabilities, the value of the capital expenses deduction as a tax avoidance mechanism is limited for a heavily debt-financed venture.

In order to take advantage of the capital expenses deduction, the purchase of the initial capital investments should be delayed as much as possible. By spreading out initial capital investments through the years in which a venture begins incurring income taxes, the excess deductions credit can be applied to decrease or even eliminate income taxes entirely in the early years of the venture. Alternatively, the start-up can be combined with a pre-existing, profitable venture to offset the income taxes due by the older venture. In a start-up with sufficiently expensive capital asset requirements, these tax savings could be very substantial.

However, this aggressive use of the capital expense deduction would increase the likelihood that the IETU would exceed income taxes in later years and could even lead to an increase in the venture's net tax burden. The excess deductions credits would be used up offsetting income tax liabilities, and they would no longer be available to offset the various deduction disallowances. Simultaneously, the offset income taxes would no longer be generating income taxes paid deductions, and thus the total tax liabilities over the life of the venture will increase. Thus, there would be a tax cost for these savings at a later date in the form of high IETU liabilities, which would increase with the amount of non-deductible expenses the venture incurs. These costs, if sufficiently extensive, could



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

outweigh the benefits of deferral, causing a net increase in the tax burden of the venture. Additionally, although it is unlikely, the IETU may at some point no longer be eligible for the U.S. FTC, and in that situation the increased IETU liabilities could lead to significant double taxation and therefore an even larger net tax burden.

Because a heavily debt-financed venture will have extensive non-deductible interest expenses, the tax cost of these potential tax savings would be increased significantly, and thus they are not as valuable as they may at first appear. In a venture with enough debt, these tax avoidance opportunities may be nonexistent because the increase in subsequent IETU owed would exceed the value of the early tax savings enough to make them unprofitable. In a venture where there is minimal or no debt financing, however, these techniques could be very valuable.

IV. The IETU is not a significant concern for a capital intensive, debt financed, U.S. venture in Mexico

With proper planning, a capital intensive U.S. venture in Mexico can minimize if not eliminate any IETU liabilities. However, doing so requires minimizing interest expenses through reduced or alternative debt financing, limited in-house employment, and few transactions with related parties. None of these changes are themselves essential, and all of them are more structural than substantive.

For the U.S. investor, any IETU liabilities are eligible for the FTC, and thus do not lead to extra layers of taxation. Although the IETU does not meet the requirements for the FTC, it continues to be creditable, and this is unlikely to change. Thus, even if IETU liabilities are incurred, they will not lead to double taxation.

The excess deductions credit can even be used to reduce traditional income taxes owed during the early profitable years of the venture. However, in a venture that requires extensive debt financing, this may not be

cost effective.

Because the costs the IETU will impose are minor and the possible tax avoidance strategies it permits are limited by the use of debt financing, the overall affect of the IETU on a U.S. capital intensive venture in Mexico is fairly minimal.

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(1) Caren S. Shein & Jose Manuel Ramirez, *Mexican Tax Reform 2008: Is the IETU a Creditable Foreign Tax for U.S. Purposes?*, 59 TAX EXECUTIVE 498, 498 (2007).

(2) Enrique Hernandez-Pulido, *Mexico's Flat Tax (IETU) and How It Affects Investors in Mexican Real Estate Projects*, (Procopio, Cory, Hargreaves & Savitch LLP, San Diego, Cal.) at 1, available at <http://www.procopio.com/userfiles/file/global/5203.pdf>.

(3) Shein & Ramirez, *supra* note 1, at 498.

(4) Hernandez-Pulido, *supra* note 2, at 1.

(5) Omar Zuniga, *Chasing the Goal of a Reformed Mexican Tax System*, 19 INT'L TAX REV 74, 75 (2008).

(6) Hernandez-Pulido, *supra* note 2, at 1.

(7) Impuesto Empresarial a Tasa Única [IETU] [Corporate Flat Tax], Diario Oficial de la Federación, [D.O.], 1 de Octubre de 2007 (Mex.) ch. 1, art 1.

(8) *Id.*

(9) *Id.* ch. II, art. 5.

(10) *Id.* ch. III, art. 7.

(11) *Id.* ch. III, art. 11.

(12) *Id.*

(13) *Id.*

(14) *Id.* ch. II, art. 5.

(15) *See* Hernandez-Pulido, *supra* note 2, at 1.

(16) *See* IETU *supra* note 7, ch. III, art. 7.

(17) Hernandez-Pulido, *supra* note 2, at 1

(18) Unlike the excess deductions credit, the income taxes paid credit does not carry forward or back to any other years.

(19) IETU *supra* note 7, ch. II. Art 5.

(20) Martin A. Sullivan, *International Tax Planning: A Guide for Journalists*, Tax Notes, Oct. 4, 2004; JOSEPH ISENBERGH, INTERNATIONAL TAXATION 67 (3rd ed. 2010)

(21) IETU *supra* note 7, ch. II, art. 5.

(22) Shein & Ramirez, *supra* note 1, at 498.

(23) *Id.*

(24) *Id.* at 3.



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

- (25) *Id.*
- (26) *Id.*
- (27) *Id.*
- (28) *Id.*
- (29) *Id.*
- (30) See IETU *supra* note 7, ch. II, art. 5.
- (31) Shein & Ramirez, *supra* note 1, at 2.
- (32) Most other developed countries only tax income earned within, associated with, or related to them.
- (33) Isenbergh, *supra* note 20, at 137.
- (34) Kenneth Zuckerbrot & Diana S. Davis, *Creditability of Mexican IETU Tax: The IRS Addresses the Issue - Tax to be Creditable for the Time Being*, Alert (Greenberg Taurig, LLP, New York, N.Y.) Dec. 1, 2007, at 1, available at <http://www.gtlaw.com/portalsresource/lookup/wosid/contentpilot-core-401-7090/pdfCopy.name=/1200h.pdf?view=attachment>.
- (35) 26 U.S.C. §901 (2010).
- (36) Isenbergh, *supra* note 20, at 137.
- (37) *Id.*
- (38) *Id.* at 140.
- (39) *Id.* at 150.
- (40) *Id.*
- (41) *Id.*
- (42) I.R.S. Notice 2008-3, I.R.B. 2008-2 (Jan. 14, 2008).
- (43) *Id.*
- (44) Press Release, Lisa M. Nadal, *U.S. Studying Creditability of Mexico's Flat Tax*, Procopio, Cory, Hargreaves & Savitch LLP, May 12, 2008.
- (45) Manuel Carballo, *Revisa la Corte 40 mil juicios de amparo contra IETU, EL SOL DE MEXICO*, Jan. 27, 2010, available at <http://www.oem.com.mx/laprensa/notas/n1494717.htm>.
- (46) Press Release, Suprema Corta de Justicia [S.C.J.N.] [Supreme Court], *Constitucional, la Ley del Impuesto Empresarial a Tasa Unica* (Feb. 2, 2010, Mex.), available at <http://www.scjn.gob.mx/MEDIOSPUB/NOTICIAS/2010/Paginas/09-Febrero-2010.aspx>.
- (47) *Id.*
- (48) *Id.*
- (49) *Id.*; see, e.g. *Impuesta empresarial a tasa única. El artículo 3, fracción i, párrafo tercero, en relación con los diversos 1, 2 y 6, fracción i, todos de la Ley del Impuesto relativo, al excluir de las actividades gravadas a las operaciones de financiamiento o mutuo que den lugar al pago de intereses que no se consideren parte del precio y, en consecuencia, impedir le deducibilidad de los gastos por ese concepto, no violan el principio de equidad tributaria*, Pleno de la Suprema Corta de Justicia [S.C.J.N.] [Supreme Court], *Tesis Jurisprudenciales del Pleno*, Novena Epoca, Febrero de 2010, Núm. 83/2010 (Mex.), available at http://www.scjn.gob.mx/2010/pleno/SecretariaGeneralDeAcuerdos/TesisJurisprudencialesdelPleno/Documents/2010/TJ_83-2010.pdf
- (50) S.C.J.N., *supra* note 46.
- (51) *Id.*
- (52) Tax Convention, U.S.-Mex., Sep. 18, 1992, S. TREATY DOC. No. 103-7, art. 24, §1(a).
- (53) Shein & Ramirez, *supra* note 1, at 503.
- (54) *Id.*
- (55) Treas. Reg. § 1.901-2(a)(1)(ii).
- (56) Treas. Reg. § 1.901-2.
- (57) Treas. Reg. § 1.901-2(b)(2)(A).
- (58) Shein & Ramirez, *supra* note 1, at 501.
- (59) Treas. Reg. § 1.901-2(b)(3)(A).
- (60) Shein & Ramirez, *supra* note 1, at 501.
- (61) *Id.*
- (62) Treas. Reg. § 1.901-2(b)(4)(i).
- (63) Shein & Ramirez, *supra* note 1, at 501.
- (64) *Id.* at 498.
- (65) Treas. Reg. § 1.901-2(b)(4)(B).
- (66) *Exxon Corp. v. Commissioner*, 113 T.C. 338 (1999).
- (67) *Id.*
- (68) *Id.* at 359.
- (69) *Texasgulf Inc., & Subs. v. Commissioner*, 172 F.3d 209 (1999).
- (70) *Id.* at 216.
- (71) *Exxon*, *supra* note 66, at 348.
- (72) Capital assets purchased prior to 2008 are deductible to a limited extent through 2018 in order to soften the transition into the IETU for existing businesses. Hernandez-Pulido, *supra* note 2, at 3.
- (73) See, e.g. U.S. DEPARTMENT OF THE TREASURY, GENERAL EXPLANATION OF THE ADMINISTRATION'S FISCAL YEAR 2012 REVENUE PROPOSALS 42 (Feb. 2011) available at <http://www.treasury.gov/resource-center/tax-policy/Documents/Final%20Greenbook%20Feb%202012.pdf>.



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

Cross-border secured lending: challenges of structuring the collateral package

The proposal endorsed by the Mexico Committee for a program on *Cross-border secured lending: challenges of structuring the collateral package*, has been accepted for the 2012 Spring Meeting of the International Law Section in New York City. Program co-chairs are **Patrick Del Duca** and **Lucila Escriña**, respectively partners of Zuber & Taillieu LLP in Los Angeles and Negri & Teijeiro Abogados, Buenos Aires.

Seasoned cross-border lending lawyers from varied jurisdictions and multilateral institutions will debate the efficacy of currently employed security interest devices in respect of “edgy” collateral, such as satellite systems, submarine fiber optic cables, trans-border pipelines, agribusiness and hydrocarbon and other natural resources extraction, with a view to probing the limits of constraining national sovereignty through current private law instruments. The discussion will include review of the effectiveness of efforts to “off-shore” collateral packages, to work around potential assertions of national sovereignty over public utility, public service and national resource activities, and to address the tensions between “Calvo” and “ICSID” approaches to dispute resolution. The presentation will occur as a “strategy session” debate between counsel expert in the key representative jurisdictions of Argentina, Brazil, England, Mexico and the United States on the one hand, and on the other, counsel in the role of senior international and multilateral lenders.

Sponsoring Committees of the International Law Section confirmed to date include the Mexico Committee, Canada Committee, Cross-Border Real Estate Practice Committee, Europe Committee, International Commercial Transactions Committee, International Corporate Counsel Forum, International Energy & Natural Resources Committee, International Financial Products & Services Committee, International Investment and Development Committee, and Latin American and Caribbean

Committee. Anticipated speakers include: Mexico Committee member **Meaghan McGrath Sutton**, Global Lead Counsel, International Finance Corporation, Washington D.C., **Patrick Del Duca**, Partner, Zuber & Taillieu LLP, Los Angeles, **Juliana Martines**, Latin America Manager of Legal Affairs, Syngenta, Sao Paulo, **Juan Javier Negri**, Partner, Negri & Teijeiro Abogados, Buenos Aires, **Andrew Fraiser**, Partner, Allen & Overy LLP, New York, and **Spiros V. Bazinas**, Senior Legal Officer, International Trade Law Division, United Nations Office of Legal Affairs, the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL), Vienna.

The Mexico Committee’s presentation of this program in New York City is especially timely in view of a Resolution that the Mexico Committee supported and that the American Bar Association’s House of Delegates adopted at its August 2011 Annual Meeting. The Resolution adopts as official policy of the American Bar Association that its members support efforts:

“to promote the development and harmonization of international trade and commerce law and the establishment of predictable systems of secured lending in developing countries through the reform of commercial laws, including secured transactions laws”.

The full resolution is available at: http://www.americanbar.org/content/dam/aba/administrative/house_of_delegates/resolutions/2011_hod_annual_meeting_301.authcheckdam.doc. The Mexico Committee anticipates through the planned New York program and the preparations for it to explore how the Mexico Committee can further collaborate in the implementation of this policy.

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MEXICO UPDATE



UNIVERSIDAD PANAMERICANA

Review of

LA CONJURA, CON O SIN LA CIA,

Mexico Committee member Ernesto Velarde

Danache's first novel

by Patrick Del Duca

Mexico Committee member Ernesto Velarde Danache has published his first novel: LA CONJURA, CON O SIN LA CIA (Editorial Font, S.A., Monterrey, 2011, ISBN 968-6896-54-6). The novel is an action-packed, international political thriller, that offers a lawyer's vision of a path forward for Latin America, plus an exploration of personal redemption and maturation in rising from debacles of poor choices made with the best of intentions. The novel commences with the seduction of its protagonist—Franco Cannizzio, a lonesome American student in international relations at Cambridge University, to infiltrate, as an American spy, an association of well-educated, prosperous individuals concerned with international relations. Franco's discomfort with his mission and a budding romance with an Argentine graduate student, trigger conflicts that the author develops to illustrate how the growth of individuals and institutions is shaped not only by internal dynamics, but also by external influences, in ways unintended by those who exert them.

An acute observer of persons, places and institutions, the author draws the novel's venues of Cambridge University, London, Tuscany, Amsterdam, Vienna and Caracas, each with its own characteristic glamour and dynamism that reflects not only intimate acquaintance, but also how an international lawyer might encounter them. The author's characters and institutions will resonate with, and often provoke a smile on the part of, members of the American Bar Association's International Law

Section. For example, an ancillary character is a high-end solo practitioner in Washington, DC, with a fondness for Latin America, who heads an international bar organization. Although thus reminiscent of some International Law Section leaders, the author also endows this character with leadership of a further international association, that in the novel's shifting illuminations might be any of a simple networking group for business generation, a study group on international relations, or a sinister,

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occult fraternity intended to subvert the domestic political sovereignty of various

countries. In another vein, the novel offers careful attention to cuisine and the accompanying beers, wines, tequilas and other spirits chosen by its lawyers, government officials, intelligence operatives and executives, an attention that lawyers who travel internationally will recognize and appreciate.

The work employs a crisp, clean Spanish that reflects the thoughtful, direct style of the seasoned lawyer that is its author. Although Spanish learners might seek recourse to a dictionary for some of the emotionally descriptive and culinary terms (corresponding to the author's parallel interests in elaborating the emotional states and gastronomic preferences of his characters), the book is an easy-to-read, "page turner" that will reward native and apprentice speakers of Spanish.

The author's work probes the role of elites in Latin America and the United States relative to popular democracy.

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MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA
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The author's work probes the role of elites in Latin America and the United States relative to popular democracy. It satirizes a provincial strain in the conduct of American foreign policy and lays out foibles of Latin American political leaders. It raises the questions of what responsibilities members of elites have to their compatriots of class and country, abundantly demonstrates that elites have no claim of anticipating what is best either for themselves or the broader society, and affirms the power of an individual to make a meaningful difference in society. The work fits within a rich tradition of detective, police and spy novels, well-developed in the Spanish-speaking world, including Mexico, to make political points.

Fans of Inspector Maigret, Miss Jane Marple and even Dirk Pitt will find intriguing the author's Franco Cannizzio. The added bonuses for such readers are not only the development of Franco's good intentions, misguided choices, and ultimate discovery of the courage to learn from his mistakes, but also the

author's elaboration of a challenging geo-political vision that ultimately becomes a call to action in the grand tradition of pamphleteers in laying the foundations of the American republic, such as Thomas Paine, or of those who provided the vision that underlies the European Union, such as Jean Monnet. The author is not shy to express his lawyer's faith that sound analysis and a well-presented argument can convince, and indeed enrich, even the most recalcitrant of adversaries. Likewise, the author's work is a clear affirmation of his belief in the value of international law and institutions, to reinforce the rule of law and social welfare at all levels. The author's work is unabashedly utopian, but thought-provoking in its transparency.

El Paso Brown Bag

The Mexico Committee will sponsor a Brown Bag lunch presentation in El Paso in late October or early November, the date to be arranged. Mexico

Committee members **Sergio Bustamante** and **Jay Stein** will host. The invited speaker is **Donald Hobbs**, General Counsel to the **Border Environmental Cooperation Commission** ("BECC"), based in Juarez. Mr. Hobbs will address water infrastructure projects and issues along the border, including environmental concerns. This will enable water and environmental professionals in Mexico, Texas, and New Mexico to interact and exchange views on issues affecting the two states and Mexico.

Meeting of the Los Angeles Chamber of Commerce Global Initiatives Council discussed Patrick Del Duca's book CHOOSING THE LANGUAGE OF TRANSNATIONAL DEALS, published by the American Bar Association.



Mexico Committee member Mauricio Leon de la Barra (left), Mexico Committee Co-Chair Patrick Del Duca and incoming president of the Los Angeles Area Chamber of Commerce Karen Hathaway, photographed at the September 21, 2011 event in Los Angeles.



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

The January 2011 Amendment to Mexican Law on Judicial Control and Cooperation in Mexican Arbitration

by *Jose Maria Abascal*

1. In January 27, 2011, a new chapter was added to the Mexican legislation governing commercial arbitration. This amendment was a follow up to Mexico's July 23, 1993 incorporation of the UNCITRAL Model Law on International Commercial Arbitration ("UMLA"). UMLA was implemented by the addition of Title Four ("Title Four") to Book Five of the Code of Commerce ("Code of Commerce"). The 2011 amendment introduced a new Chapter X titled "Court intervention in commercial settlements and arbitration". Title Four applies both to international and domestic arbitration.

2. The atmosphere was delicate when Mexico adopted the UMLA in 1993, and to introduce procedural rules that would raise debate and cause delays not a good idea. At that time it was thought that only minimal civil procedure innovations were really needed; namely, expedited proceedings for both the annulment and the recognition and enforcement of awards. Other instances of court assistance or control could be handled by the judiciary with the tools it already had at hand. Eighteen years of experience have confirmed the merit of this strategy, and yielded the experience that led to the adoption of Chapter X of Title Four.

3. Arbitration cannot function properly without the assistance and control of the judicial branch of government; it is essential that courts exercise a minimum of control over some decisions of arbitrators, thus guaranteeing the due process of law, the freedom of contract and the rule of law, and that courts assist in the enforcement of the arbitrators' decisions. However, to preserve the choice of arbitration by the parties, the Code of Commerce

provides that in matters governed by Title Four no court shall intervene, except where so provided in Title Four (Code of Commerce article 1421).

4. Title Four contemplates only nine cases of court intervention: (i) the referral to arbitration when there is an arbitration agreement (Code of Commerce article 1424), (ii) appointment of arbitrators (Code of Commerce article 1427), (iii) court assistance in the taking of evidence (Code of Commerce article 1444), (iv) consultation in respect of fees of the arbitral tribunal (Code of Commerce article 1456), (v) recognition and enforcement of interim measures (Code of Commerce articles 1479, 1480), (vi) recognition and enforcement of arbitral awards (Code of Commerce articles 1462, 1463), (vii) revision of arbitral tribunals' decisions on the challenge of arbitrators (Code of Commerce articles 1429), (viii) decisions of arbitral tribunals denying a challenge to their competence, issued in a form other than an award (Code of Commerce article 1432), and (ix) requests for the annulment of arbitral awards (Code of Commerce article 1457).

The 2011 amendment introduced a new Chapter X titled "Court intervention in commercial settlements and arbitration".

5. A recurrent issue, in Mexico and elsewhere, is the initiation of court proceedings by one of the parties to an arbitration agreement. This issue was addressed in the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention", II (3)), and later in the UMLA (UMLA, 8). It was provided that, at the request of a party that produces an arbitration agreement, the court shall refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed. Title Four has a similar article

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MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

(Code of Commerce article 1424).

6. How the requested court should enforce this provision was left to the law of the forum. Mexican law now provides for the stay of the court proceedings, allowing the arbitrators to fire the first shot, and to decide on their own jurisdiction. If the dispute is later terminated in arbitration, at the request of any of the parties, the judge shall terminate the court proceedings; if not, the judicial proceedings shall resume.

7. The party that requests the referral to arbitration shall do it in its first submission on the merits. After hearing the other parties, the judge shall stay the proceedings, unless hard evidence is provided to show the nullity of the arbitral agreement, or the inoperability or impossibility to perform it is evident. In making this determination the judge is to be rigorous. If the dispute is resolved through arbitration, then the court shall terminate its proceedings. If not, the court may resume the case and make a final decision. Against

the judge's referral to arbitration there is no recourse (Code of Commerce articles 1464, 1465). In any event, while the issue is pending before the courts, the arbitration may commence or continue and an award may be issued (Code of Commerce article 1424).

8. When there is need to appoint an arbitrator, the judge, at the request of any of the parties, shall make the appointment. This may happen when the parties fail to agree on the sole arbitrator, or when one of the parties fails to designate its arbitrator, or the two party appointed arbitrators cannot agree on the chairman, or when a party or a third party fails to perform a function entrusted to it in an agreed appointment procedure (Code of Commerce article 1427). The same rules apply to the substitution of an arbitrator

(Code of Commerce article 1431).

9. The judge shall first hear the parties and may call them to a hearing, and, also, previously consult with one or more arbitral institutions, commercial or industry chambers. Then, unless the judge considers that the list method is not convenient, the judge shall send the parties an identical list containing at least three names. Each party has ten days to return the list, after having deleted the name or names to which it objects, and numbered the remaining ones in the order of its preference. Then the judge shall make the appointment in conformity with the order of preference indicated by the parties. When making the appointment, the judge shall request the arbitrators to make their respective disclosures on their impartiality and independence. The judge's decision is not subject to any recourse, but the parties may challenge the arbitrators so designated (Code of Commerce articles 1467, 1468).

10. The 2006 UMLA provisions on recognition and enforcement of Interim Measures ("IMs") (UMLA 17 H, 17 I), are now incorporated into Mexican law (Code of Commerce articles 1479, 1480). Unless the arbitral tribunal decides otherwise, IMs shall be recognized and enforced by Mexican courts, (i) at the request of any party, (ii) irrespective of the State in which they were issued, (iii) the court cannot review the decision of the arbitrators, (iv) the court may require security when the arbitrators did not make a determination with respect to security or when needed for the protection of the rights of third parties, (v) the grounds for denying recognition and enforcement are limited, and (vi) in general, the burden of proof is on the respondent.

11. The requesting party, or the one that obtained recognition or enforcement, shall promptly inform the court of any suspension, termination or modification of the IMs.

The 2006 UNCITRAL Model Law on International Commercial Arbitration provisions on recognition and enforcement of Interim Measures are now incorporated into Mexican law.



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

12. Grounds for denial are similar to the ones for awards contemplated by the New York Convention and UMLA. Recognition and enforcement may only be denied if the party against whom it is sought proves: (i) the nullity of the arbitration agreement, (ii) lack of notice of initiation of the proceedings or of the appointment of an arbitrator, (iii) lack of opportunity to present its case, (iv) breach of the rules, (v), *ultra petita*, (vi) security ordered by the arbitral tribunal not posted, (vii) termination or suspension of the IMs.
13. Recognition and enforcement may be also denied if the court finds that enforcement would be contrary to Mexican public policy or that the subject matter of the dispute cannot legally be submitted to arbitration.
14. If the court finds that the enforcement of the IMs would be incompatible with its powers and procedures, it may recast the IMs, so to make it compatible with its powers and procedures, but preserving the substance of the IMs.
15. The determination made by the court shall be applicable only for the purposes of the application to recognize and enforce the IMs.
16. The last paragraph of Code of Commerce article 1480 provides for the liability of the party that requested the IMs and the arbitral tribunal that granted them. Only a superficial reading can conclude that this is a case of strict liability. The provision is but a mere restatement of the Mexican torts liability system's essential conditions to impose liability; namely that the IMs be unlawful and the damages a direct and immediate consequence of the unlawful IMs.
17. But, more important, the liability may be regulated by agreement (except in case of *dolus*). As most arbitration rules exempt the liability of the arbitrators, it is not likely to be a problem.
18. A very useful improvement is the creation of a multipurpose, expedited, proceeding, which complies with the due process of law and will serve to decide on (i) recourses against arbitrators' determinations on challenges of arbitrators (ii) jurisdiction, (iii) IMs issued by courts, (iii) annulment of awards, and (iv) recognition and enforcement proceedings (IMs, settlement agreements and awards). Annulment and enforcement proceedings may be consolidated when both are filed in the same jurisdiction and the hearing has not yet been held.
19. Appointment of arbitrators and related measures, judicial assistance on taking of evidence, and the opinion on arbitration fees, are dealt with in *jurisdicción voluntaria* proceedings, which are characteristic of cases in which no legal disputes are submitted to the court.

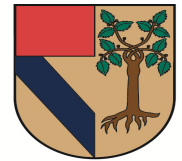
Recognition and enforcement may be also denied if the court finds that enforcement would be contrary to Mexican public policy or that the subject matter of the dispute cannot legally be submitted to arbitration.

Mexico Committee Member Swims English Channel

On September 23, 2011, Mexico Committee Member (and the Mexico Committee's Los Angeles City Coordinator) **Javier Gutierrez** swam the English Channel (from England to France) in 9 hours 40 minutes. This is Javier's second successful swim. He was trying to improve his previous time of 8 hours and 16 minutes, achieved in 1999, but the tides and currents in the Channel were not favorable for a fast swim. In addition, his feeding to restore his caloric expenditures went awry and just swimming across the Channel became a challenge. He is extremely happy on the successful completion of the crossing and wishes to thank everyone who somehow was involved in this year's swim.



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

-Knock knock. -Who's there?

-It's the NAFTA auditors. -The NAFTA what?

by *Luis F. Martinez**

The author of this contribution is chairing a program at the 2012 Spring meeting of the ABA's International Law Section in New York City, with Mexico Committee sponsorship, entitled *How Many Ways Can North American Importers Get Certificates of Origin Wrong? Stories from the Attorneys with Battle Scars.*

Customs officials in Canada, Mexico and the US are selecting targets for verification of compliance with NAFTA Rules of Origin and finding non-compliance. Mexican officials are finding phantom entities in Canada and the US that import from overseas and provide NAFTA certificates of origin. US customs officials are finding Canadian companies that have off-shored production, but neglected to change their paperwork to exclude NAFTA certificates of origin. US, Canadian and Mexican customs officials are finding that suppliers have switched sources during the economic crisis such that regional value content requirements are no longer satisfied or downstream suppliers have become unavailable to provide certificates of origin. All three customs organizations are focusing on transshipment of goods. Although the rules are uniform across the three countries, they are not being interpreted uniformly.

The panelists, leading practitioners from Canada, Mexico and the United States, plus a senior official of Mexico's Customs Service, will share their personal experiences. They will discuss the recent instances where customs administrations have found significant errors, resulting in substantial fines that could have been easily avoided. They will also discuss NAFTA shortcomings, areas where a common policy may result in job creation and how the "common-law" written rules have resulted in different interpretations from civil-law courts.

This article explores developments of interest to companies operating across borders, in respect of a

type of audit aimed to verify compliance with international trade rules that define the country, or region, of origin of a good. These rules are generally known as "Rules of Origin" and the type of audit is generally called an "Origin Verification". Mexican authorities are aggressively conducting Verifications of Origin of products imported to Mexico and which are exported by Canadian and United States companies. This article sets forth knowledge that such companies should have about how to respond to audit inquiries of this type.

Rules of Origin are technical rules that embody economic principles and oblige a producer to maintain a minimum percentage of domestic content in the finished good by domestically sourcing raw materials and/or manufacturing the good, e.g. to satisfy a United States Rule of Origin, a producer would need to be able to establish that American parts, inputs and value added were a part of a final good sufficient to consider the good made in the United States. Rules of Origin are typically product-specific, and they vary in substance under the various international trade agreements, even as to identical products.

Associated with Rules of Origin are the prerequisites to issuance of a Certificate of Origin. Depending on the relevant trade agreement, a Certificate of Origin may be issued by an exporter or an administrative authority of the country where the goods are produced, as well as the producer. A Certificate of Origin attests to compliance with the domestic content requirement. This Certificate of Origin is then generally filed, together with the importation documents at the time of import, to obtain a preferential duty.

Background

The Mexican consumer market has grown steadily in

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MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

the last twenty years, benefitting from general population growth and a rising middle class.(1) Statistics show that the Mexican economy imported over US\$221 billion in 2005, US\$256 billion in 2006, US\$281 billion in 2007, and US\$308 billion in 2008. The worldwide economic crisis led to a drop in imports during 2009 (US\$234 billion), but they quickly recovered to US\$301 billion in 2010.

By and large most of these imports are from countries with which Mexico has a free trade agreement. To date, Mexico has signed twelve trade treaties, encompassing the majority of the Americas and most major markets (U.S., Europe, and Japan).(2)

International audits are fundamental to prevent illegal trade practices, so as to avoid market distortions and to protect a country's tax revenue. From 2007 to 2009, Mexican authorities initiated 4,500 cases focused on so called "technical contraband", and assessed over US\$8.6 billion in additional taxes.(3)

Technical contraband arises when the documents filed at the time of importation appear to be correct and legal, but are however either simply false or purposefully incorrect. In recent years technical contraband has become an even greater concern than traditional contraband. To counter this rising concern of technical contraband, authorities rely on many resources, including verifications of origin through audits.

Many honest companies have been and will be affected by a recent surge of verifications of origin and it is important for company officials to respond properly to any communications sent by the Mexican government and prove compliance with trade rules. Because of the size of the North American market and due to the significant trade among the Parties to the North American Free Trade Agreement (NAFTA), the balance of this essay focuses on the origin verification procedure established under NAFTA.

NAFTA Verifications of Origin

Compliance with NAFTA rules of origin, mostly contained in NAFTA's Chapter Four, is presumed when a Certificate of Origin is issued. NAFTA Certificates of Origin can be issued by either the producer or the exporter of the good, in the latter case in reliance on a written representation from the producer.

NAFTA Certificates of Origin can easily be drafted with false or inaccurate information, or signed by someone other than the producer or exporter. This has opened the door to abuse by unscrupulous merchants, resulting in losses to domestic industry and in government revenue. NAFTA Article 506 contemplates procedures to verify Certificates of Origin. The verifications may be conducted through

written questionnaires to producers and exporters, or direct visits to their premises.

Case law of Mexico's *Tribunal Federal de Justicia Fiscal y Administrativa* distinguishes questionnaires from visits to premises as distinct types of proceedings, each with its own set of rules.(4) This administrative court and Judicial Tribunals have ruled that notifications in a different country must be made using certified mail and delivered to the legal representative of the company, with proof of receipt.(5)

Written questionnaires initially inquire whether the recipient issued the Certificates of Origin. Subsequently, the governmental authorities may request evidence to show that the company complied with the rules of origin. Producers may additionally be asked to describe the productive process, including the location where each step of the process took place, and to provide bills of materials, invoices with details on the origin, tariff classification, and supplier's name. The detection by authorities of Certificates of Origin signed by phantom companies explains the current surge of these types of audits.(6)



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

Visits to the premises have the purpose of reviewing a foreign company's records and of observing the facilities used in production of the good. Prior to a visit, the inspecting customs administration must deliver a written notice of its intention to conduct the visit to the exporter or producer whose premises are to be inspected, and to the customs administration of the country in whose territory the visit is to occur. Visiting authorities must obtain prior written consent of the exporter or producer.

Further, the visiting authorities are to accord the audited company the appointment of two witnesses for the visit.

The trend of increasing international audits will probably continue, in an effort to deter foreign and domestic companies from creating or tolerating technical contraband.

Importance of Verifications of Origin

The trend of increasing international audits will probably continue, in an effort to deter foreign and domestic companies from creating or tolerating technical contraband. Legitimate and honest companies will likely be reached by the investigations, and hence it is important that they take precautions. This means that companies must respond to any official communications served by the Mexican government, complete Certificates of Origin accurately, and keep accounting and production records long enough to back the Certificates of Origin. Under Mexican law, imports are *generally* auditable five years following import, but since a verification of origin may continue over up to two years,⁽⁷⁾ it is advisable that importers, exporters and producers keep records for longer periods of time. Exactly how long depends on the type of goods imported and the type of importation.

The competent authority in Mexico to perform verifications of origin is the Central Administration for Foreign Trade Taxation [Administración Central de Fiscalización de Comercio Exterior]. It has the legal authority to verify compliance with international treaties to which Mexico is a party, and can audit any individual or legal entity, including importers,

exporters, producers, and liable third-parties.⁽⁸⁾

As mentioned above, the Mexican government provides notifications to foreign companies that produce and/or export to Mexico using Certificates of Origin. These notifications are done using an international carrier. Too frequently, these notifications transmitting questionnaires or requests for visits are overlooked by United States or Canadian companies. Failure to respond to an official

communication does not impede the Mexican government from making a potentially adverse determination. Officials can only make decisions based on information they have, and if

the foreign company fails to respond, most likely the decision of the Mexican authority will be adverse. The decision by the Mexican government can be to:

- invalidate NAFTA Certificates of Origin issued by the producer or exporter,
- deny NAFTA preferential duty treatment for the products exported under those Certificates of Origin,
- initiate legal procedures against *the importers* who used those NAFTA Certificates of Origin in order to collect the normal import duty rate, plus VAT, applicable antidumping duties, fines, penalties and surcharges,
- undertake further NAFTA verifications of origin with the target producer and exporter for other fiscal years, and
- deny future NAFTA preferential duty treatment for identical goods.

The adverse consequences likely concern not only the importer of record into Mexico as the entity against which a legal procedure is initiated by the government to collect unpaid duties. Because of the errors made by the producer or exporter who issued the NAFTA



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

Certificate of Origin, the Mexican importer may then initiate a claim against the producer or exporter in the United States or Canada. Grounds for such a claim may include contractual breaches as well as claims under provisions of Mexico civil and commercial law.

In addition to the damage that may be caused to producers and exporters that do not pay sufficient attention to verifications of origin, importers often become involved, much to their surprise. Indeed, they typically are not apprised by the Mexican authorities of the initiation of an investigation. Mexican case law supports this harsh result, through rulings to the effect that because these international proceedings have the sole purpose of verifying Certificates of Origin, which can only be issued by a producer or exporter abroad, the importers need not be notified by the Mexico government.⁽⁹⁾ Since information is not shared by the Mexican government with importers until they are sanctioned, producers and exporters are well advised to inform their Mexican contacts of verifications of origin, so that importers may assist in any way possible, including by providing access to documents and facilitating contact with Mexican officials.

Special attention is given by authorities to merchandise considered “sensitive” by the Mexican government. Companies in the automotive, auto parts, textiles, toys, and steel industries are most likely to become subject to investigation, and should pay closer attention to all mail deliveries.

Producers and exporters should obtain legal advice and perform a NAFTA content analysis to confirm they comply with the applicable rule of origin. They should educate employees in completing NAFTA certificates correctly. It is also important to identify and respond to requests for information by the Mexican

government. Failure to do so may result in denial of preferential duty treatment, resulting in price increases. It may also result in duties being levied against the Mexican importer, who may then initiate legal action in the United States or Canada against the producer and exporter.

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(1) In the World Economic Forum COMPETITIVENESS REPORT FOR 2010-2011, Mexico’s best score is its market size, ranked 12 out of 139 countries. According to the United Nations Population Division, Mexico is the world’s eleventh most populated country, and almost 55% of Mexicans are 24 years old or younger, a crucial statistic for retail sales. Retail sales are forecast for strong growth between 2009 and 2014.

(2) For text, plus listing of all trade agreements signed by Mexico, see <<http://www.sre.gob.mx/tratados/index.php>> (last visited April 26, 2011).

(3) *Duties are being evaded through technical contraband*, EL NORTE (March 2, 2010).

(4) *Federal Tax and Administrative-Law Tribunal. Second Section from the Superior Chamber. Book I, Volume 77, Page 398. 5th Epoch, May 2007. Verifications of origin. The enforcement of the proceedings established in NAFTA is of discretionary nature.*

(5) *Federal Tax and Administrative-Law Tribunal. Second Section from the Superior Chamber. Year III, Volume 25, Page 189. 4th Epoch, August 2000. Notice to the exporter of the document that communicates intent to perform a verification visit. Its validity when it is made through courier companies.*

(6) *Canacero complains of unfair trade practices*, EL NORTE (March 3, 2010).

(7) Pursuant to Articles 67 and 46-A of the Federal Tax Code [Código Fiscal de la Federación] D.O. December 31, 1981.

(8) Pursuant to Articles 20 sections A-V and B-VI and 21 of the Tax Administration Service (SAT)’s Internal Regulations [Reglamento Interior del Servicio de Administración Tributaria] D.O. October 22, 2007.

(9) *Supreme Court [Suprema Corte de Justicia de la Nación]. Second Chamber. Volume XII USJF, Page 450. 9th Epoch, December 2000. North American Free Trade Agreement. The origin verification proceeding over imported goods and the obligation to maintain secret any confidential information, established in articles 506 and 507, do not breach the importer’s right to due process.*

Failure to respond to requests from Mexico’s government may result in duties being levied against the Mexican importer, who may then initiate legal action in the United States or Canada against the producer and exporter.



MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

PRESUMED GUILTY:

A glimpse at Mexico's penal system and criminal procedure laws

by *Lorena Martínez León*

In Mexico, it is not enough being innocent in order to be free. This is how the recently released film, *PRESUNTO CULPABLE (PRESUMED GUILTY)*, advertises around the world. This documentary by Mexican lawyers Roberto Hernandez and Layda Negrete, cinematographer John Grillo, and documentary filmmaker Geoffrey Smith, reveals the story of Antonio Zúñiga, a wrongly convicted man and his struggle in the search for justice and freedom.

The movie can be described as an exposé of the many contradictions of the Mexican judicial system that presumes suspects guilty until proven innocent. It portrays a conviction system full of corruption and obstacles for justice hiding underneath piles of paper and bureaucratic barriers.

Antonio, a computer technician in the local market, received a twenty-year sentence after being arrested by a group of police officers on the charge of the murder of a man whom he had never met. He was convicted largely on the testimony of one man. However, the man was a close relative of the victim and had no consistent evidence against Zúñiga, while the accused produced several witnesses able to place him far from the scene of the crime at the time of the murder.

His long-time fiancée, together with neighbors, found a team of lawyers that, after studying his case, identified various irregularities, starting with the fact that the attorney provided by the State to defend Zúñiga did not have a valid license to practice law. Following this discovery, the authorities grudgingly agreed to a new trial, but with the same judge presiding.

The judge showed little interest in the evidence that Zúñiga presented in order to prove that he had been falsely convicted. Battling an arrogant judge, delays, constant negative answers to their requests, an

uncooperative witness, and a legal system riddled with corruption, Antonio's lawyers found that it was easy to establish Zúñiga's innocence, but difficult to obtain acknowledgement by the authorities of this fact.

The film also shows a general view of the prison system and of the conditions under which people serving time have to live. Packed cells, uncontrolled plagues, cold walls, and poor food are some of the characteristics of the prisoner's quality of life.

Since its premiere, the film has been surrounded by legal controversy. The prosecution's sole witness, Victor Daniel Reyes, brought a lawsuit in which he claimed that he had never authorized the taping of the trial or the public exposition of his testimony. The court granted Mr. Reyes a temporary suspension of the exhibition of the film, with the result that movie theaters around Mexico halted their screenings. Subsequently, another court, presented with an *amparo* challenge to the ruling of suspension, set aside the suspension on the condition that the film be modified so as not to further divulge the identity of the witness.

The Mexican company promoting and distributing the film, Cinepolis, has committed to donate part of the income from the film's screening to a foundation that dedicates its efforts towards helping people who are victims of an irregular criminal procedure.

PRESUMED GUILTY has become the highest grossing Mexican documentary in Mexico's film making history. *PRESUMED GUILTY* has received several awards and has been displayed in leading international film festivals such as Los Angeles, London, and Copenhagen. This movie is a wake up call for the authorities to clean up the system and for society to demand that reforms be made in the judicial procedure.

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MEXICO UPDATE



UNIVERSIDAD
PANAMERICANA

Highlights of the Symposium

US-Mexico Relations Today--Law, Society & Business, Seattle, July 19, 2011

On July 19, Mexico Committee member **Ben Rosen** chaired the CLE Symposium, *US Mexico-Relations Today: Law, Society & Business*. The event was organized by Seattle University School of Law in cooperation with the Mexico Committee of the American Bar Association's International Law Section, the United States-Mexico Chamber of Commerce, NW Chapter, the Latino/a Bar Association of Washington, and the International Law Section of the King County Bar Association. It brought together international legal practitioners, law students, faculty, business executives, and government to discuss US-Mexico relationships, law and business.

Jorge Madrazo, formerly Mexico's Attorney General and Consul-General of Mexico in Seattle, Washington, and now Vice-President, Community Relations of SeaMar, delivered the keynote address, touching on the important role played by Mexican Americans and Mexican immigrants in US society and demographics, the immigration debate, the resolution of the NAFTA trucking dispute, and the customary law of indigenous peoples living in Mexico and the Pacific Northwest.

Ben Rosen, a US-educated attorney licensed to practice law in both Mexico and Washington state, delivered two presentations, the first on *NAFTA as it Nears its 20th Birthday*, which touched on how NAFTA has benefited both the United States and Mexico and included recent US-Mexico trade data; and the second, on *Cross-Border Real Estate Transactions*, providing an overview of the legal aspects of acquiring and financing real estate transactions in Mexico by foreigners, including trust and corporate structuring issues, tax and due diligence. (*ndr*, see his article in a 2010 issue of this MEXICO UPDATE.)

David Spencer, a Washington state attorney, member of the Mexico Committee and co-founder of the

United States-Mexico Chamber of Commerce, NW Chapter, spoke on *Franchising in Mexico*, including the contractual and regulatory aspects of setting up a franchise in Mexico.

Other speakers shared their expertise on topics such as *US Immigration Law* including discussion of policy adopted by the Obama administration, *Issues Affecting Undocumented Workers in Personal Injury Actions*, *Legal Issues Facing Mexican Immigrants in the Northwest*, the *Mexican Banking System*, and *International Family Law*.

When asked why the event addressed such a wide range of issues, Mr. Rosen responded, "Too often US-Mexico affairs are looked at in a capsule. People either talk about, on the one hand, legal and business issues such as trade under NAFTA or buying a second home in Mexico, or on the other hand, the immigration debate and border security, but not often are cross-border business, legal and social issues looked at together. In the end, they are all interrelated. Plus, in an academic setting, the whole approach is to let ideas flow. We wanted to be inclusive and thought-provoking in our discussion of US-Mexico relations today."

The symposium was also aired live as a Webinar, with Mexico Committee Members in attendance by internet. For those who missed the event, Seattle University Law's CLE homepage, [http://www.law.seattleu.edu/Continuing Legal Education.xml](http://www.law.seattleu.edu/Continuing%20Legal%20Education.xml) and <http://prolumina.adobeconnect.com/p7wbkw8rrpn/>, provide information on how to view the webinar recording online. Washington state CLE credits are available.

The organizers intend to make this an annual event in Seattle. Volunteers are welcome for the next event in Seattle on US-Mexico Relations!

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Mexico Committee's City Coordinator initiative:

The Mexico Committee's City Coordinator Initiative embraces Committee Members in nine cities in Mexico and The United States who organize occasional gatherings of interest to members. Mexico Committee Members **Ben Rosen** (left) and **David Spencer** at the symposium on *US-Mexico Relations Today: Law, Society & Business*, Seattle, Washington, July 19, 2011.



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