Corporate Finance/M&A - Mexico

Foreign trade implications of M&A transactions

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Introduction

The term 'mergers and acquisitions' involves several schemes of transaction (eg, joint ventures, management buy-outs, takeovers, tender offers and corporate reorganisations), which often not only include the acquisition of a principal target company, but may also affect one or more of the target's subsidiaries.

In this type of operation, it is likely that the acquiring company will be more interested in performing a thorough due diligence on the target than on the subsidiaries. As the target is the acquiring company's main focus of business, the target's subsidiaries are often disregarded and ignored. However, on certain occasions, failure to perform a thorough due diligence on the respective subsidiaries, especially in light of foreign trade matters, may result in customs implications. Under Mexican law, penalties for the violation of customs provisions are considerably high. Acquiring companies should therefore conduct a comprehensive due diligence of the whole group that is to be acquired.

Subsidiaries with an IMMEX programme

As mentioned, the term 'mergers and acquisitions' involves several different schemes of transaction; thus, it is always important to define the scope of one's business.

When acquiring shares of a company which in turn holds shares of a Mexican company with a Manufacturing, Maquiladora and Exportation Services Industry (IMMEX) programme, certain factors should be taken into consideration.

The IMMEX programme is an authorisation granted by the government that allows Mexican companies to import certain assets on a temporary basis in order to produce or manufacture goods and thereafter export them.

When goods are imported on a temporary basis, the importing Mexican company is exempt from import duties (except when the importation is of fixed assets) or value added tax; however, the company is obliged to export its final products.

Even though there are various types of IMMEX authorisation (eg, services, industry, controller, shelter, tertiarisation), for tax purposes only two categories are relevant:

- *maquila*; and
- manufacturing.

To be considered as a *maquila* IMMEX entity for tax purposes, a Mexican company must comply with certain tax and operative requirements in order to:

- avoid its foreign partner being considered as having a permanent establishment (for tax purposes); and
- be allowed to pay its taxes under a preferential scheme.

Consequences of non-compliance with obligations under the IMMEX programme

When acquiring a company with a Mexican IMMEX company subsidiary, the subsidiary will automatically be acquired. All implications derived from the operations of the latter will reflect on the acquiring company.

Customs

The government generally seeks not only to recover all unpaid taxes, but also avoid any type of tax fraud, which is why penalties for customs violations in connection with IMMEX transactions are usually high.

Customs authorities are entitled to take different actions against a company in violation of the IMMEX programme, including the enforcement of tax liabilities, a stay of the company's regular business operations and the determination of criminal liability of the company and its officers.

Tax

With regards to tax liabilities, the authorities are entitled to set the amount of the liability, which may include not only the import duties and all associated taxes payable, but also surcharges, adaption due to inflation and the imposition of fines that can amount up to 100% of the commercial value of the corresponding goods.

Mexican Importers Registry

With regards to the company's business operations, the authorities may suspend the respective IMMEX programme. Consequently, the company will no longer be able to import on a temporary basis. The company's registration with the Mexican Importers Registry may be suspended, which will impede importation, and the bank accounts of the company may be seized, which would make any further business operations of the company nearly impossible.

Criminal liability

With regards to criminal liability, the authorities may initiate a criminal procedure against the company, alleging that the crimes of smuggling and tax fraud have been committed.

Annex 24

One of the most important obligations of IMMEX companies is to possess and maintain a management inventory control system (known as and referred to as 'Annex 24'). This system allows companies to log as evidence that they are returning all goods abroad that are imported on a temporary basis and that they are doing so in a timely manner.

The Annex 24 system is an important control tool that should be updated on a daily basis, as it is difficult to correct and update after too much time has lapsed. If a subsidiary company does not have the system or is failing to maintain and manage it correctly, this should be a red flag during the acquisition process.

Annex 24 should thus be one of the principal concerns of any company (directly or indirectly) acquiring an IMMEX company, since this is one of the first facets that Customs will review during an audit.

Comment

It is easy to understand why an acquiring company focuses its attention on examining the status of the specific target during the acquisition process. Nevertheless, if the target has a Mexican IMMEX subsidiary, it is important to verify whether this subsidiary comes with customs risks in order to avoid corresponding problems in terms of time and money.

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