

MEMO

**TO:** Boone Nerren  
MXTREP#1, LLC

**FROM:** Patrick J. Kelly

**DATE:** February 21, 2017

**RE:** Corporate Structure-Mexico

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The purpose of this memorandum is to provide you with information concerning the Mexican corporate structure that I propose you use in connection with establishing your subsidiary in Mexico. I have attached to this memorandum a chart which depicts the ownership structure I propose for your project.

**I. Factual Background and Conclusions.**

As I understand your goals, you desire to form a Mexican entity, which will apply to the Comision Reguladora de Energia (CRE) for a permit to import energy into, Mexico. You have indicated that you would like to connect to the electrical lines of the CFE in Mexico, as well as prepare contracts for the provision of such energy, including by negotiated agreements with CFE and OHL. Based upon this information, I recommend forming a Mexican Sociedad de Responsabilidad Limitada in Mexico for your operations.

**II. Choice of Entity for the Mexican Subsidiary - SRL v. SA**

General Characteristics of Both the SA and the SRL. The most commonly used entities in Mexico are the Sociedad Anónima de Capital Variable (hereafter "S.A"), which is roughly equivalent to a C corporation in the United States, and the Sociedad de Responsabilidad Limitada de Capital Variable (hereafter "SRL"), which is roughly equivalent to a limited liability company in the United States. Unlike U.S. entities, which are governed by state law, Mexican entities are governed by the Ley General de Sociedades Mercantiles, which is a federal Mexican law. While formed in one state, Mexican entities can have locations or branches in the different states. Both SA's and SRL's may be one hundred percent owned by U.S. shareholders or quota holders, unless the Mexican Foreign Investment Law restricts foreign ownership in the activity in which the entity is involved in Mexico. The Mexican entity must obtain a permit for foreign ownership, must register with the Foreign Investment Registry (Registro Nacional de Inversiones Extranjeras), and the formation documents of the Mexican entity (whether and SA or an SRL) must contain a so called "Calvo Clause", a clause which contains a representation by the foreign owners of the Mexican entity that they waive the right to seek protection from the laws of their own countries in the event of a dispute relating to the Mexican company.

Both the SA and the SRL are considered to have separate legal personalities apart from their shareholders or quota holders, thus providing liability protection to their owners. Both the SA and the SRL pay an entity level tax in Mexico. Since there is no agency concept in Mexico of apparent authority, unlike in the United States, officers of a Mexican entity have no authority to bind the entity simply by virtue of the fact that they are officers.

Officer Authority and Powers of Attorney. In order to bind the entity in contracts, act as the entity's representative with its banks, or to represent the company before government agencies, the individuals

performing the day-to-day activities in Mexico that officers would perform in a company in the United States must be granted this authority through a power of attorney. Initial powers of attorney can be granted in the entity articles of incorporation (the “Acta Constitutiva”). These powers of attorney may be amended or revoked by amendment of the entity formation documents or by proper corporate resolution. Additional powers of attorney may be granted without the need to amend the corporate formation documents.

Tax Matters. The benefit to forming an SRL in Mexico arises from the eligibility of the SRL to elect to be treated as a disregarded entity for purposes of U.S. taxes, pursuant to the check-the-box rules under Section 7701 of the Internal Revenue Code. An SA is not eligible for check-the-box treatment and its use would typically result in payment of taxes in Mexico at one level, and if earnings are repatriated to the U.S., payment of taxes a second time at the U.S. level. The election may also allow the parent in the U.S. to consolidate accounting of the U.S. parent and Mexican subsidiary from a tax perspective. If you intend to repatriate earnings to the United States, I recommend that you form an SRL. You will then file a IRS Form 8832 in the United States to elect to have the foreign entity disregarded. The election must be made approximately 75 days after the formation of the SRL. If you intend to retain all earnings in Mexico and reinvest them in the country, then we should talk further because I may recommend that you form an SA. Because of the tax treaty between Mexico and the United States, taxes paid by the subsidiary in Mexico are generally credited against taxes paid by the parent in the United States to avoid double taxation.

#### Characteristics of the SA.

- Must have the words “Sociedad Anónima” or “S.A.” following its name.
- Requires at least two shareholders, but may have an unlimited number of shareholders.
- Ownership interests are designated as shares. Share certificates must be issued. Bearer certificates (certificates that do not identify the owner) are not permitted. Shares may be transferred by endorsement.
- No requirement that officers or directors be Mexican residents or citizens.
- Can be governed by either a board of directors or a sole administrator, but in either case, the members of the board or the sole administrator must be granted a power of attorney authorizing the board members (or some of them) or the sole administrator to act on behalf of the entity. Note that foreigners being granted a power of attorney must obtain a Mexican business visa (FM-3).
- Minimum initial capitalization. There is no minimum capital requirement.
- The company must appoint an independent corporate examiner/auditor or “comisario” who cannot be related to management to in effect represent the shareholders’ interests vis a vis management. In practice the comisario is usually the company accountant.
- Require annual shareholder meetings and allow corporate action to be taken by written resolution.
- Subject to complying with Mexican securities laws, can sell shares to the public.
- Can have fixed or variable capital.

#### Characteristics of the SRL.

- Must have the words “Sociedad de Responsabilidad Limitada” or “S. de R.L.” following its name.
- Requires at least two, but not more than fifty, owners who are called “quota holders”.



- Can be more flexible in changing general defaults in the formation documents relating to management of the entity than with an SA.
- Ownership interests are designated as quotas. Quotas are uncertificated.
- No requirement that managers be Mexican residents or citizens.
- Can be governed either by quota holders or by a manager, but in either case, the members or the manager must be granted a power of attorney authorizing the members (or some of them) or the manager to act on behalf of the entity. Note that foreigners being granted a power of attorney must obtain a Mexican business visa (FM-3).
- Minimum initial capitalization. There is no minimum capital requirement.
- No requirement to have a comisario.
- Quota holders vote and share in profits and losses in proportion to their ownership interest, except otherwise provided in the Bylaws.
- Require annual quota holder meeting and can take action by written resolution.
- Restrictions to raise money from the general public apply.
- Can have fixed or variable capital.

### **III. What Entity Should You Form?**

If you want to disregard the Mexican entity for U.S. tax purposes, you will need to form an SRL.

### **IV. How Many Mexican Entities to Form?**

In the past, we generally recommended that clients form two entities in Mexico. One of the entities was formed to perform the business operations (the “Operating Entity”) and another entity was formed to hire the employees (the “Services Entity”) and provide the labor force to the Operating Entity through a services agreement. The benefit of structuring the relationships this way was that all of the employer’s liabilities and obligations would be kept at the Services Entity level. Those liabilities and obligations would include the statutory 10% profit sharing, statutory severance payment and union obligations (if the business becomes unionized). This was a very common organizational structure in Mexico. While Mexican law always considered the employer the entity that received the benefits of the employees’ services, and there was always a possibility of the employees pursuing both the Services Entity and the Operating Entity, most U.S. companies forming subsidiaries in Mexico used this model. In November 2012, however, Article 15 the Mexican Labor Code was revised to restrict the outsourcing of employees to a company solely for purposes of limiting employee benefits (such as the 10% profit sharing). The amended Labor Code further provides that if the employees in the Services Entity are providing all of the services required by the Operating Entity, the Operating Entity will be considered the employer for all purposes under the Labor Code. Finally, companies forming Services Entities in violation of this amendment will be subject to fines equal to 250 to 5,000 times the daily minimum wage in force in the Federal District (16,190 Mex Pesos to 323,800 Mex Pesos).

### **V. Recommended Structure for the Subsidiary.**

According to Mexican law, an SRL must have at least two quota holders. I recommend forming two new limited liability companies in the United States to serve as the quota holders. Because the two quota holder requirement is essentially a formality, we typically have one limited liability company own 1 quota having a 99% interest; with the other limited liability company owning a 1% interest.

**VI. Costs of Setting Up the Mexican Subsidiary.**

Our fees for forming each Mexican subsidiary will be between \$3,000.00 and \$5,000.00 USD, depending upon the city and state in which the subsidiary is formed. Please note that this amount includes Mexican notary fees and public registry fees associated with the formation of the companies.

Our services for the incorporation of the entities would include:

- a) Preliminary checking and application for name availability in Mexico;
- b) Drafting of powers of attorney (POA) to be executed by the initial shareholders, to have the company incorporated on their behalf;
- c) Processing of certification (apostille) of the POA's with the Secretary of State, so that they will be accepted in Mexico;
- d) Drafting, reviewing and revising of draft of deed of incorporation/bylaws;
- e) Follow-up with Mexican notary public on the execution of the deed of incorporation and its further recording with the public registry of commerce;
- f) Filing of initial notice with the Mexican Foreign Investment National Registry;
- g) Opening of company's corporate books and initial entries (shareholders' meetings minutes book, board of directors' meetings minutes book, if applicable, stock registry book and capital variations registry book).

Our fees in connection with forming two limited liability companies to be the members of the Mexican entity will be approximately \$1,500. If the limited liability companies are formed in Delaware or another state, the fees and expenses relating to the formation of the limited liability companies may vary.

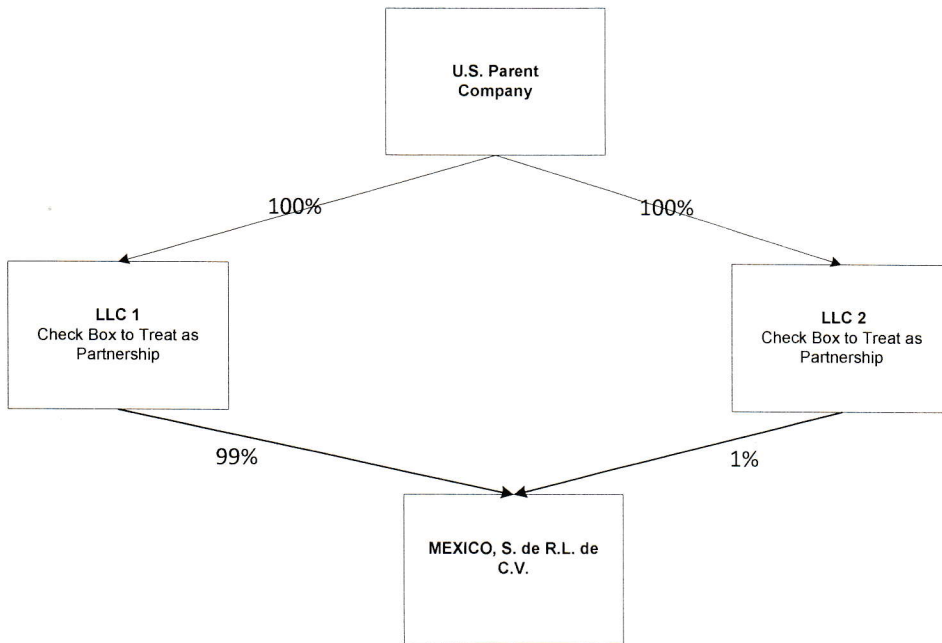
**VII. SRL Formation Questionnaire.**

Attached to this memorandum is our Formation Questionnaire. Please review and complete the questionnaire. If you have any questions, please call me and we can go through the questions together.

**VIII. Structure Chart.**

Attached to this memorandum you will also find a chart showing the recommended structure for forming your SRL.

**CHART SHOWING MEXICAN SUBSIDIARY STRUCTURE**



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