



JONES DAY
COMMENTARY

DUE DILIGENCE OF MEXICAN COMPANIES WITH FOREIGN TRADE ACTIVITIES

On occasion, global investors considering the potential acquisition of Mexican import/export companies will conduct corporate audits of the target companies, and their audit procedures will be primarily focused on a detailed review of the corporate documents that support the targets' commercial relationships with their shareholders, creditors, customers, and suppliers. These global investors should be aware of the need to analyze the documentation relating to the companies' foreign trade transactions and, in particular, the areas concerned with the day-to-day conduct of said transactions.

A dramatic example of the potential risks and serious consequences that can result from failing to review the daily foreign trade activities of companies with cross-border commercial activities, particularly *maquila* (in-bond) companies involved in

global corporate restructuring processes, is the case¹ of a *maquila* company located in the border region between the United States and Mexico. In this case, the new investors realized only after the acquisition of the *maquila* company that it was being used as a warehouse for illegal substances.

Although this case reflects an extreme and unusual situation, it reinforces that investors should always have a more in-depth knowledge of the foreign trade transactions of the Mexican companies that they intend to acquire, for the following reasons:

¹ The lawsuit was filed in California by two companies that had purchased an industrial plant in the State of Tamaulipas, México against the former owner, a conglomerate whose Mexican plant built specialized furniture. According to the complaint, the seller focused on providing information on the profitability of the plant but hid regular incursions of a Mexican drug cartel to the facilities. See www.themonitor.com, May 18, 2013.

- The penalties in Mexican customs matters are much higher than the tax penalties applicable to equivalent conduct (for instance, fines of 130 percent of the allegedly omitted foreign trade contributions, compared to fines of 55 percent of the value of other unpaid taxes).
- In addition to the payment of fines, there is a risk of seizure of machinery or raw materials that do not meet the documentary formalities pertaining to their importation.
- The description of the conduct considered to be administrative wrongdoing in Mexican Customs Law is similar, and in some cases identical, to the description of the criminal conduct in customs matters set forth in the Federal Tax Code in force in Mexico, which unfortunately, allows the authorities significant discretion with regard to the type of penalty to impose.

During a due diligence procedure to acquire a Mexican company with significant foreign trade transactions, investors should be aware when reviewing the target's audited financial statements that such financial statements may not properly reflect the company's foreign trade activities. The reasons include the following:

- The internal tax department most likely does not review foreign trade transactions due to the special nature of the subject, notwithstanding their potential adverse tax consequences.
- The auditors who prepared the audited financial statements were not obligated to analyze the company's foreign trade activities, because such review is not required by the Mexican Federal Tax Code and its Regulations, even though these activities are within the sole regulatory authority of the Mexican Tax Administration Service. In fact, Mexican auditors often do not consider foreign trade activities important to the scope of their review because they know it is highly unlikely that they will be questioned on such matters by the tax authorities.

In accordance with Mexican Customs Law, importers must retain the documents supporting the lawful introduction of foreign-origin assets for as long as they have such assets

in their possession. If they do not do so, these assets can be seized by the authorities even after a five-year period, which is the mandatory maintenance period for accounting records relative to domestic transactions.

It is therefore advisable, during the course of a legal review of Mexican companies with cross-border trade activities, to establish a specific procedure for the review of their activities. Such procedures could include requiring the disclosure of the representative documentation supporting the lawfulness of these activities and even requesting the opportunity to pose specific questions to employees tasked with the traffic areas, to detect the risks that could arise from these transactions for future shareholders.

Finally, it bears mentioning that due to the high percentage of errors and discrepancies in foreign trade transactions of Mexican companies, the Mexican Tax Administration Service created in its organization chart a specialized office for the audit of foreign trade transactions in the year 2012. The purpose of this office, which shows the focus being given to the area, is to increase taxation in these areas and avoid, to the fullest extent possible, the evasion of payment of foreign trade taxes and the noncompliance with non-tariff permits.

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