FORMS OF DOING BUSINESS IN MEXICO COMPARED TO THE U.S.

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SOLE PROPRIETORSHIP

The simplest form of doing business is as a sole proprietor.

Individual: The owner of the business carries on the business as an individual.

Tax: The owner reports the gains and losses from the proprietorship directly on his own personal income tax return.

Advantages

1. Easy to operate.

Disadvantages

1. The sole proprietor is directly liable for all debts of the proprietorship.

CORPORATION

A corporation is an organization similar to the ***Sociedad Anonima ("S.A.")*** and the ***Sociedad Anonima de Capital Variable ("S.A. de C.V.")*** that exist in Mexico. It is the most commonly used entity because the shareholders' liability is limited to their capital contributions and the stock ownership is freely transferable.

Formation: One or more people may form a corporation by simply filing the articles of incorporation with the Secretary of State.

Artificial Entity: The corporation is an independent entity, separate from the identity of its owners (shareholders), that is treated as a person for many purposes. It can enter into contracts, own property, and sue or be sued.

Created in a Particular State: A corporation is always created under the laws of a particular state, therefore, there are no federal corporations. Moreover, the law of the state of incorporation controls nearly all matters of corporate governance.

Centralized Management: The shareholders participate only by electing the board of directors. The board of directors then appoints officers (i.e., high-level executives). The corporation is managed under the supervision of the board, with day-to-day control resting with the officers. So if the investors desire to entrust management to non-shareholders, or to some but not all shareholders, the centralized management structure of the corporation is helpful.

Perpetual Existence: The fact that ownership (i.e. shares) changes hands, whether by sale, inheritance, gift, etc., does not in any way affect the corporation's continuing existence.

Limited Liability: Each shareholder is normally liable only for the capital that he contributes to the corporation. In contrast, a person operating a sole proprietorship, or a group of individuals operating a general partnership, will normally be personally liable for the debts of the enterprise. However, this advantage is not quite significant as it may at first seem to be. The problem is that banks and other lenders understand the normal rule of limited shareholders' liability. Therefore, if the corporation is just starting and/or has limited assets, lenders usually will not lend money to the corporation without personal guarantees by some or all shareholders. Therefore, the advantage of limited liability boils down mostly to avoiding liability for (1) debts to ordinary trade creditors i.e., suppliers of goods and services to the corporation; and (2) suits by tort claimants (e.g., a person hit by a truck driven by a corporate employee while on corporate business).

Transferability of Interest: Ownership interests in a corporation are readily transferable. Ownership is embodied in shares of stock and unless the shareholders otherwise agree, any shareholder may at any time sell or give his shares to anyone else without consent by the other shareholders.

Federal Income Tax: The corporation is taxed as a separate entity. The corporation has profits or losses, files its own return, and pays its own taxes independently of the tax position of the stockholder.

One consequence of the corporation's status as a separate taxpayer is that there will often be so called "double taxation". The corporation pays a corporate income tax on its profits. If the after-corporate-tax profits are then distributed to the shareholders as dividends, the individual shareholders pay a separate, second tax on these dividends.

Advantages of the Corporation

1. Limited Liability
2. Continuity of life
3. Centralized management
4. Stock ownership freely transferable
5. Possibly lower tax rate

Disadvantages

1. Double taxation in dividend distributions and liquidation
2. Business losses cannot be used personally

S Corporation

If the stockholders of a corporation elect to have their corporation treated as an S Corporation, they will be taxed approximately as if they were partners in a partnership.

Requirements: There must be no more than 75 shareholders; all shareholders must be individuals and U.S. residents, estates or qualified trusts; and there may be only one class of stock outstanding.

Advantages of the S Corporation

1. The S election allows an electing corporation ("S Corporation") to have income taxed to shareholders directly rather than to the corporation. The tax treatment is similar to that of a partnership.
2. In the event there are losses, these losses can be used directly by the individual rather than having the loss merely carried forward by the corporation.
3. Unlike a regular or C Corporation, a S Corporation is not taxed at the corporate level. There is only a tax at the individual level. There is no danger of double tax, and if the individual's income tax bracket is less than the corporate tax rate, there may be a tax savings advantage.

4. Like a partnership and unlike a C Corporation, a S Corporation may furnish the opportunity to shelter income from other sources.

Disadvantages

1. No more than 75 shareholders
2. Nonresident aliens and foreign corporations cannot be shareholders
3. Only one class of stock allowed

PROFESSIONAL CORPORATION

This form of organization is similar to the ***Sociedad Civil ("S.C.")*** that exists in Mexico. Professionals such as lawyers, doctors, engineers and accountants often provide services through a Professional Corporation. There are many rules and restrictions placed upon ownership interests in a Professional Corporation and the transfer or sale of those interests.

SELECTION OF STATE OF INCORPORATION

Assuming a person intends to operate an active trade or business and assuming they decide that the corporate form is the most preferable form of doing business, an important early consideration is the selection of the appropriate state of incorporation. The State of Delaware is the state of incorporation for many of the largest, most prestigious corporations in the United States. Delaware state law is extremely protective of the officers, directors and managers of companies with regard to their liability to the corporation's shareholders. Both the Delaware Corporation Law and the Delaware Chancery Court are considered "friendly" to businesses and corporations. Delaware is not as protective as some other states of the rights of minority shareholders. For instance, Delaware corporations are not required to have cumulative voting; whereas, all California corporations must have cumulative voting, unless the corporation is listed on a National Securities Exchange and, in some cases, has over 800 shareholders.

In 1987, the California General Corporation Law was amended in an attempt to encourage and attract businesses to incorporate in California. One of the changes allowed California corporations to eliminate or limit the personal liability of a director for money damages in actions brought by or in the right of the corporation for breach of the duty of care that the director owes to the corporation and its shareholders. Liability cannot be eliminated for acts of intentional misconduct, knowing violations of the law, acts not taken in good faith by the director or where the director derives an improper personal benefit. These changes have made the law relating to director liability more consistent with the law in states like Delaware. Most of these protective shareholder provisions have benefit to the directors, officers and majority shareholders primarily when the corporation is publicly held or at least ownership is broadly disbursed. If the company will be closely held by the owners and will be operating in a particular state, it will normally be most advantageous to incorporate in the state where the trade or business will be carried on. Therefore, if the primary business will be conducted in the State of California, it will almost always be preferable to incorporate in the State of California.

QUALIFICATIONS BY FOREIGN ENTITIES

Any corporation which is not incorporated in the State of California, is treated under California law as a "foreign corporation". Therefore, a foreign corporation whether incorporated in Delaware, Texas, or under the laws of Mexico is prohibited from transacting business solely within the State of California without first qualifying to do business in California with the California Secretary of State. The qualification is done by filing a Statement and Designation By Foreign Corporation and by paying the appropriate fees. California corporations do not have to qualify to do business with the California Secretary of State, since by virtue of their incorporation in California, they have already been granted the authority to conduct business within the state.

The Statement and Designation by Foreign Corporation which is filed with the Secretary of State is a matter of public record. The information required includes the following:

1. The foreign corporation's name and state of incorporation (including approval by the California Secretary of State of the business name);
2. The address of the foreign corporation's principal executive office;
3. The address of the foreign corporation's principal office within California, if any;
4. The name of the agent for service of process for the foreign corporation, which generally must be updated annually; and
5. The foreign corporation's irrevocable consent to service of process upon that designated agent.

GENERAL PARTNERSHIP

This form of organization is similar to the ***Sociedad en Nombre Colectivo*** that exists in Mexico. In most states, general partnerships are governed by the Uniform Partnership Act (UPA). The UPA defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit".

Formation: In contrast to a corporation, a general partnership can come into existence by operation of law (merely by virtue of the joint operation of a business), without the need to file any formal papers with any state official.

No Centralized Management: All partners have an equal voice in managing the enterprise, unless they otherwise agree.

Limited Existence: A general partnership is dissolved by the death or withdrawal of any general partner, unless the partnership agreement otherwise provides.

Transferability of Interest: A partnership interest is not readily transferable. Ordinarily, all partners must consent to the admission of a new partner. A partner may "assign" his partnership interest, but this does not make the transferee a partner; instead, the transferee merely obtains limited economic rights.

Federal Income Tax: Partnerships, unlike corporations, are not separately taxable entities. Instead, the partnership is viewed as an aggregation of individuals for tax purposes. The partnership files an informational tax return, which shows how much the partnership earned and how those earnings are distributed among the partners. The actual tax is paid by each individual, and is therefore a function of such individual's tax bracket and the other earnings and losses he or she has.

Advantages of the General Partnership

1. Avoids double taxation: There is no corporate tax, therefore distributions are taxed at the individual level.
2. Flexibility in allocations of profits and losses: The partners may allocate the gains and losses from the partnership to individual partners pretty much as the partners decide.
3. Shelter: Partnerships offer significant opportunities for sheltering gains from other activities. So long as the partner is actively involved in management of the partnership, he or she may offset his share of losses incurred by the partnership against gains from other activities.

Disadvantages

1. No Limited Liability. Partners can be held jointly and severally liable for all of the debts and liabilities of the partnership. This joint liability applies even when on partner does not participate in the act that causes the partnership to become liable.

LIMITED PARTNERSHIP

This form of organization is similar to the ***Sociedad en Comandita Simple or Sociedad en Comandita por***

Acciones that exist in Mexico.

In most states, limited partnerships are governed by either the Uniform Limited Partnership Act (ULPA) or the newer 1976 Revised Uniform Limited Partnership Act (RULPA).

LIMITED LIABILITY COMPANY

This form of organization is similar to the Sociedad de Responsabilidad Limitada ("S. De R.L.") that exists in Mexico.

A Limited Liability Company is an entity that is a cross between a corporation and a partnership. LLCs are generally intended to provide limited liability to equity holders (like a corporation) and, at the same time, offer the advantages of one level of tax (like a partnership) without the restrictions placed on S Corporations.

Advantages of LLCs over other entity forms:

(a) C Corporation

1. No corporate-level tax.
2. Ability to specially allocate income and losses.
3. No double-tax liquidation.

(b) S Corporation

1. LLCs can have more than 75 members.
2. Corporations, partnerships, certain trusts and **nonresident aliens** cannot be shareholders of an S Corporation, but they may be members of LLCs.
3. S Corporations may only have one class of stock, and income and losses must be allocated among the shareholders pro rata. LLCs permit non-pro rata distributions and special allocations of income and losses.
4. Failing to satisfy the requirements to be an S Corporation results in the loss of the eligibility and C Corporation status. This risk is avoided with LLCs.
5. Currently, in California, S Corporations are subject to a 1-1/2% income tax, whereas domestic LLCs are not.

(c) General Partnership

Unlike general partnerships, members of an LLC are not jointly and severally liable for partnership liabilities.

(d) Limited Partnerships

1. Although limited partners of a limited partnership have limited liability and pass-through tax advantages, under most limited partnerships acts, limited partners may jeopardize their limited liability by participating in the control of the business of the partnership. Members of an LLC, on the other hand, are permitted to actively participate in the LLC's business and are granted limited liability.
2. Under the LLC statutes, no member is required to have the general liability of a general partner.

Disadvantages of LLCs

1. Members may not have limited liability if the LLC conducts business in a state that does not recognize LLCs.
2. LLCs which have nonresident alien or foreign corporate owners or investors are subject to a

federal (and probably a state) withholding tax of 35% to 39.6% on the distributive profits of the LLC. This withholding tax is applicable even if no distributions of profits are made to the owners.

3. In California, LLCs that are engaged in business are subject to a gross receipts tax that is a minimum of US$800 up to US$7,500 annually.

Formation: Unlike general partnerships, but like corporations, limited partnerships may only be created by filing a formal document with a state official. Also there must be a written agreement among the partners.

Nature: Limited partnerships have two kinds of partners: (1) one or more **general** partners, who are each jointly and severally liable for all debts and financial obligations of the partnership; and (2) one or more **limited** partners, who are not liable for the debts of the partnership beyond the amount that they have contributed to the partnership.

Centralized Management: The General Partners manage the enterprise. Limited partners may not actively participate in management without losing their limited liability. So, generally, limited partnerships do have centralized management.

Limited Existence: A limited partnership is dissolved by the death or withdrawal of any general partner, but it is not dissolved by the withdrawal or death of a limited partner.

Transferability of Interest: A partnership interest is not readily transferable. Ordinarily, all partners must consent to the admission of a new partner. A partner may "assign" his partnership interest, but this does not make the transferee a partner; instead, the transferee merely obtains limited economic rights.

The transferability features of limited partnership interests are strong enough that there actually exist "public limited partnerships" whose limited partnership shares are traded on major stock exchanges. One buys and sells "limited partnership interests" in such partnership much as one would buy or sell stock in a corporation.

Advantages of the Limited Partnership

1. Limited liability for limited partners.
2. Flexibility in allocation of profits and losses.
3. Distributions taxed at personal level (no corporate tax).

Disadvantages

1. Limited Liability only for limited partners. Moreover, the limited partners lose this limit on their liability if they participate actively in the management of the partnership.
2. There are many restrictions which are imposed upon the transfer of ownership interest.
3. Deductions may be limited to "at risk" situation.

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