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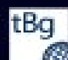

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XX Merger, transformation and dissolution of business entities

The dissolution of business entities is described within the Companies Law. Examples of dissolution provided by the aforementioned law include dissolution and liquidation, merger, transformation, and split-off. Bankruptcy proceedings may also result in the extinction of a business entity.

A. Dissolution and liquidation

1. Legal grounds for dissolution

The Companies Law provides for five grounds for dissolution of business entities:

a) Expiration of the term provided for in the company' s charter;

b) Impossibility to realize the principal purpose of the company as per corporate charter, or completion of said purpose;

c) The agreement of all of the partners or shareholders adopted in accordance with the company's charter and the law;

d) Reduction of the number of partners or shareholders to less than the minimum as provided for by the Companies Law, or ownership of all partnership interests or shares by one person; and

e) Loss of two-thirds of the capital.

Once the company has evidence of the existence of the causes of dissolution, the administrators should call for a general shareholders or partners meeting to note the situation, and assure that the proper measures are taken. Although the law seems to call for an automatic dissolution, in practice, there is no such automatic procedure. The partners or shareholders shall adopt a resolution at a meeting, which will be recorded in the Public Registry of Commerce. The legal capacity of the company continues until final liquidation. The auditors of the company will usually put a note on the company's balance sheet, reporting the cause of dissolution.

If the registration is not made, even though the cause of dissolution exists, any interested party may appear before the judicial authority in a summary proceeding and request that the authority order the registration of the cause of dissolution.

The directors or administrators of the company cannot engage in new operations after the expiration of the term of the company, after the resolution of dissolution, or after having evidence of the existence of a cause of dissolution. If they breach these prohibitions, they may be jointly liable for the operations they perform.

2. Liquidation

After the partners or shareholders have agreed to the dissolution of the company, the company shall be liquidated. The liquidation shall be performed by one or more liquidators, who will be the legal representatives of the company, and will be liable for the acts performed that exceed their authority. The partners or shareholders, by unanimous vote, should appoint the liquidators when approving the dissolution. The administrators of the company shall continue to discharge their duties until the designation of the liquidators is recorded in the Public Registry of Commerce.

Some of the duties of the liquidators include the following: to conclude the operations of the company pending at the time of the dissolution, to collect all amounts due to the company and to pay its liabilities, and to sell the goods of the company.

The liquidators shall prepare a final balance sheet determining the amount corresponding to each partner or shareholder of the remaining capital account. The final balance sheet of liquidation shall be published three times, once every ten days, in the

Official Federal Gazette of the company's domicile. The shareholders may present their claims to the liquidators within the following 15 days, counted from the date of the publication. After this term is over, the liquidators will call a general shareholders' meeting for final approval of the balance sheet. Once the balance sheet is approved, the liquidators will pay each partner or shareholder the corresponding amounts against cancellation of their share certificates, and once liquidation is concluded, will proceed with the cancellation of the registration of the company at the Public Registry of Commerce. Liquidation in kind is possible, and may include assets such as patents and trademarks, to which the shareholders may have attached a value.

3. Tax consequences

Within the month following the date of termination of the liquidation, the liquidator shall file the final tax return of the fiscal year of liquidation, and must also file monthly returns until the total liquidation of assets, and a final liquidation on the month following the termination of the abovementioned liquidation of the assets.

The liquidator must request the cancellation of the registration of the company at the Taxpayers Registry. The amounts received by the shareholders as reimbursement of capital will be tax free, and there will be no corporate tax on dividends as long as they are paid out of the net taxed profit account.

Liquidators are jointly liable for tax amounts, which should have been paid on behalf of the company during the liquidation process, unless the company filed all notices and information in accordance with, and as provided by the Law.

4. Labor consequences

The liquidator shall pay workers compensation, which will be calculated in the same terms as those for termination of the labor relationship.

Provisions of the Labor Law permit employers to terminate the collective labor contract and work relationships by bringing an action before the competent board of conciliation and arbitration. The termination may occur where there are justified causes, such as clear evidence of unprofitability in the operation.

The purpose of formal notification to the labor board is to establish a basis for negotiation with the union or the workers, and to pay a reduced compensation to the workers. If the union or workers object to said negotiation, they have the right to request payment of the total indemnity calculated on the basis of their "integrated" salary.

B. Merger and transformation

The merger of companies should be approved by a special shareholders meeting of each company, and the resolution of merger should be recorded in the Public Registry of Commerce, and published in the Official Federal Gazette of the domicile of each merging company. Each company shall publish its last balance sheet, and the companies that are merged into the surviving company should also publish the manner in which their liabilities will be satisfied.

The merger will produce effects three months after the registration of the merger resolution in the Public Registry of Commerce, giving creditors of the merged companies the opportunity to oppose such merger. **In** which case, the merger may be suspended upon court resolution recognizing the opposition.

Upon expiration of the three-month period, the merger becomes effective, and the surviving company or the newly created company shall acquire all rights and obligations of the merged companies.

However, the merger may produce effects upon the registration at the Public Registry of

Commerce if: (i) the surviving company agrees to pay all liabilities of the merged companies, (ii) the amounts owed are deposited in a bank, or (iii) the creditors have granted their consent to the merger.

A business entity may change its legal form to another type of company by following the same procedure as mentioned herein, i.e., a S.R.L. or S.C. to S.A.

1. Tax consequences

Merger of companies shall not be a taxable event for federal taxes if actions, notices, returns, and information mentioned in (a), (b), (f) and (g) listed below, are fulfilled.

a) The surviving company shall present a notice of merger to the tax authorities within the month following the date of the merger, and with some exceptions contained in the law, the surviving company must continue to carry on, for one year, the same activities it was engaged in before the merger, as well as those of the merged companies.

b) The surviving company must present the last annual tax return of the merged company, as well as the informative returns.

c) It is necessary to present notices of cancellation of the registration at the Taxpayers' Registry for each merged company, attaching a copy of the minutes of the shareholders meeting containing the resolution of merger. The merger of companies entails the obligation to audit the financial statements of the surviving company and of the merged company by an independent public accountant.

d) If real estate is transferred as a consequence of the merger, the surviving or newly created company shall pay the Real Estate Acquisition Tax at the rate prevailing in each state, which currently throughout Mexico, is between 2 percent and 4 percent of the value of the property.

e) No VAT shall be paid in connection with property transferred as a result of a merger of companies if the requirements for not considering the merger as a taxable event are met. The balance of the merged cornpany's Net Taxed Profit Account may be transferred to the surviving or newly created company. Fiscal losses pending amortization in the merged company are not transferable to the surviving company.

f) An authorization from the tax authority will be required to carry out a merger if the company participated in a split-off or merger in the past five years.

g) If the merger is being made as a result of a reorganization of a group of companies, additional requirements must be fulfilled.

2. Labor consequences

A merger entails the transmission of an economic entity, therefore, for labor purposes, an employer substitution takes place

3. Intellectual property

The Industrial Property Law mentions that a transfer of the rights on registered patents and trademarks takes place as a result of the merger of companies, unless the parties agree otherwise, or the existing licenses prohibit such transfer. It is necessary to register the resolutions of merger at the Mexican Institute of Industrial Property for legal recognition of the new authorized user or owner of patents or trademarks. The transfer of any Copyright must be recorded at the Copyright Office.

C. Split-Off

A split-off takes place when: (i) a company, without continuing in existence, transfers all

or part of its assets, liabilities, and capital stock, to one or more new companies; or, (ii) the company transfers part of its assets, liabilities, and capital stock, to one or more new companies, and continues in existence.

A split-off can only be agreed upon by resolution of the partners' or shareholders' meeting, adopted by the majority required for the modification of its charter. Each of the shareholders or partners of the original companies must have the same proportion of the new companies' capital as they had in the original company.

The resolution approving the split-off must contain a description of the terms and mechanisms for the transfer of the assets, liabilities, and capital, which correspond to each new company. Also, the obligations to be assumed by each new company must be determined.

New companies have obligations to creditors by virtue of split-offs. If those companies breach any of their obligations to creditors, who did not approve the split-off, the original and other new companies shall be jointly liable for a three-year period, counted as of the publications mentioned hereinafter. If the original company continues in existence, it will be liable for all obligations until the statute of limitations expires for each obligation, which usually is between five and 10 years. The resolutions approving the split-off must be authenticated with a Public Notary, and must be recorded in the Public Registry of Commerce.

Also, an extract of the resolution must be published in the Official Federal Gazette, and in one newspaper of wide circulation in the original company' s domicile, together with a summary of the information regarding transmission of assets, liability, and capital stock. After a period of 45 days, counted as of the registration in the Public Registry of Commerce and after the publication, without any opposition from creditors or shareholders, the split-off will produce full effects. For the creation of new companies, it will be necessary to register their charter with a Public Notary, and in the Public Registry of Commerce.

If the split-off entails the extinction of the original company, its registration will be cancelled from the Public Registry of Commerce once the split-off becomes effective.

1. Tax consequences

The Tax Code considers that there is no transfer of property in a split-off as long as the shareholders of at least 51 percent of the shares, with a voting right in the original and new companies, did not change in the year prior to, and the two following years from the date of the split-off. The surviving company must be empowered to file the tax returns and tax information of the disappearing company. When the split-off is part of a reorganization of a group of companies, additional requirements must be met.

Tax losses pending amortization may be divided between the original and the new companies in proportion to the division of inventories and account receivables, if the original company is engaged in commercial activities. Otherwise, the division will be on the bases of the fixed assets division. The balance of the capital account and the net taxed profit account may be transferred proportionally by the split-off. VAT credit can only be taken by the surviving company, and not by the new company or companies.

A local Real Estate Acquisition Tax between 2 percent and 4 percent must be paid in connection with a transfer of real estate property as a consequence of split-off.

2. Labor consequences

As the employer will change, work relationships will be affected. The employee rights and obligations cannot be modified as a consequence of the split-off. Such rights and obligations continue against the original company and/or the new companies, the 1atter as substitute employer.

3. Intellectual Property

Any Intellectual Property rights or related licenses should be modified to reflect the change in ownership or right to use.

D. Commercial Insolvency Law in Mexico

The Commercial Insolvency Law applies to the insolvency of merchants, who according to Mexican law, are individuals, companies, and equivalent entities, that in the ordinary course of business, perform commercial and industrial operations. The Law also applies to Mexican branches of foreign companies or corporations.

There are three conditions required to initiate an insolvency proceeding: (i) a merchant debtor; (ii) a plurality of creditors, and (iii) a generalized default on payment obligations. In addition, there are two conditions needed to establish the existence of a generalized default: (i) the failure to pay debts owed to at least two creditors, the failure to pay debts with a default of at least 30 days from maturity, or the failure to pay debts representing 35 percent or more of the total amount of the debtor's debts at the moment of filing the insolvency proceeding petition; and (ii) the fact that the debtor has no liquid assets, which according to the Law, are debts that amount to at least 80 percent of the total defaulted debts as of the moment of filing the insolvency proceeding petition.

The proceeding is divided in two periods: conciliation and bankruptcy/liquidation. No conciliation is opened when the debtor has applied directly for a bankruptcy judgment. If the conciliation period expires without an agreement being reached, the bankruptcy-liquidation period starts. Jurisdiction is given to the competent federal judge in the domicile of the debtor's place of business. However, as a result of the concurrent jurisdiction of federal and state courts on commercial issues, state courts may also handle the case.

The Law contemplates a range of specialists who have the obligation to handle commercial, administrative and financial tasks (rather than legal ones), which are decided by the courts. Selecting and hiring such specialists has to be decided and controlled by the Board of Specialists. The specialists included in the Law are the following: (i) the visitor, who acts during the pre-declaration of the insolvency proceeding period; (ii) the conciliator, who performs his or her duty during the conciliation period; and (iii) the administrator, who fulfills his or her obligations during the bankruptcy period.

Within the first part of the insolvency proceeding, a conciliation period of 185 calendar days is opened. At the request of the conciliator or of creditors representing at least two-thirds of the recognized credits, the period may be extended another 90 calendar days. A further 90 calendar-days extension, requiring the consent of 90 percent of the recognized credits, may be granted. However, the total duration of the conciliation period may not exceed 365 calendar days. Ongoing execution proceedings against the debtor are stayed, including proceedings involving tax credits and labor wages.

The conciliator sees to the insolvency judgment and the notification of creditors, requesting them to submit their petition for credit recognition. In addition, the conciliator is obliged to verify the accounting books and related documents to survey the debtor's business performance, and to report and recommend the court to adopt protection measures.

The conciliator also has to assist the court in determining the legal validity, nature and amount of all credits against the debtor. Once this is accomplished, the court issues its judgment regarding the recognition, graduation, and order of the credits. In addition, each group of creditors representing 10 percent of the credits as registered in the debtor's accounts are entitled to appoint a controller, who acts on their behalf.

The conciliation agreement may include the privileged and secured creditors if they consent to it. Ordinary creditors may be bound by the agreement, even against their will, provided that certain minimum terms are agreed too Once the court approves the agreement, the insolvency proceeding is ended. However, if no agreement is reached within

the allowed time, bankruptcy is declared in a judgment. Bankruptcy may also be declared before the elapsing of the fixed time, if the merchant directly applies for it, or if it is found that there is no practical purpose in pursuing a conciliation agreement.

In the bankruptcy judgment, the administrator replaces the conciliator, and the debtor is dispossessed and separated from the direction and management of the business and assets. The purpose of the bankruptcy period is to sell, at the earliest opportunity, the merchant's assets, and to pay the creditors. In making such decisions, the administrator has to keep the priority of preserving the whole business concern. If this is not feasible, then the obligation is to preserve the commercial or entrepreneurial units, and maximize their value when selling them. The bankruptcy period may be finished either by payment, or by lack of sufficient assets to be sold, or by agreement between the debtor and its creditors.

Among other interesting features, including special insolvency proceedings or criminal provisions, international cooperation is highly relevant, as the Law incorporates the UNCINTRAL Model Law on Transborder Insolvency. Accordingly, foreign insolvency proceedings may be recognized either principally or secondarily. In addition, foreign insolvency administrators may act in Mexican insolvency proceedings, mainly with the aim of obtaining interim measures of protection regarding the assets of the debtor located in the country. As established in the Model Law, Mexican specialists also may be empowered to intervene similarly before foreign courts.