President Enrique Peña Nieto announced in 2015 the creation of Special Economic Zones in Mexico, which would be located at the South-Pacific coast with the purpose of taking advantage of Mexico’s geographic location.

The Mexican Special Economic Zones regime will provide tax benefits, customs and business facilitation measures, and possibly financial support to investors. Moreover, the federal government, in coordination with State and local authorities, will also implement parallel policies in the region, such as education, security, health, and infrastructure, in order to boost the competitiveness of the geographic location as well as to attract investment.

VTZ has developed this document with the aim to assist potential investors so that they can have a general idea of the legal framework of the Special Economic Zones.

For a more detailed analysis or additional information, do not hesitate to contact Mr. Emilio Arteaga (emilio@vtz.mx) or any other VTZ member.
TABLE OF CONTENTS

I. Introduction ................................................................. 4
II. Background ................................................................. 6
III. General Legal Framework of the Special Economic Zones ...... 8
    A. The Procedure for Creating a SEZ ............................... 9
    B. Governance of a SEZ ............................................... 11
        i. First Level: Integral Administrator ..................... 11
        ii. Second Level: Technical Councils .................... 12
        iii. Third Level: Ministry of Treasury’s decentralized
             body on Special Economic Zones ..................... 13
        iv. Fourth Level: The Inter-Ministerial Commission ..... 14
    C. Incentives and Business Friendly Measures .................... 15
        i. VAT incentives .................................................. 16
        ii. Income Tax .................................................... 17
        iii. Customs Regime ............................................. 17
        iv. Financial Benefits and other incentives .............. 18
        v. Facilitation Measures: Single Window ................. 18
IV. Who can and how to invest in a SEZ? ............................... 19
V. Conclusion ................................................................... 22
VI. About VTZ and its members ............................................ 23
I. Introduction

Special Economic Zones (SEZ) are an economic policy that aims at attracting investment and promoting the economic development within a region. The first SEZ was established in Ireland in 1959, and over the years SEZs have been increasingly popular in several countries and regions, particularly Asia. China’s SEZs, for example in Shenzhen, are highlighted as successful models.
The World Bank has broadly defined Special Economic Zones as follows:

“[d]emarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory. These differential rules principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment; whereby the zone is given a business environment that is intended to be more liberal from a policy perspective and more effective from an administrative perspective than that of the national territory.”

In that sense, enterprises that operate or have activities within the SEZ may benefit from duty, tax and regulatory facilitation measures, including exemptions, because they are located within a designated area.

By placing the SEZ in strategic locations and providing incentives, it is believed that these policies attract investment and promote the economic development within a region. When implemented adequately, this policy may bring, for example, the following benefits: i) regional competitiveness; ii) industrial hubs and investment; iii) infrastructure, and; iv) production diversification and exports.

Mexico has years of experience implementing similar economic policies. For instance, Mexico created a special customs and tax regime, which was applicable to economic operators that were located near the northern border. The new enacted Law on Special Economic Zones has the intention of mirroring successful policies adopted around the globe, such as China’s Special Economic Zones. Moreover, another similar policy is the customs regime called “Recinto Fiscalizado Estratégico” (Strategic Fiscal Facility) enacted by the end of 2006, which has not proven to be very successful.

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1 The World Bank, Special Economic Zones: Progress, Emerging Challenges, And Future Directions, Ed. Thomas Farole And Gokhan Akini, (The World Bank, 2011) at p 3 (Retrievable At “https://openknowledge.worldbank.org/bitstream/handle/10986/2341/638440pubOexto0box0361527b-0Public0.pdf”)
3 In May 20, 1965, the Federal Government established the Program for the Promotion of the Export Maquiladora Industry in the North of the country, with the implementation of the Program of the Implementation of the Northern Border. Ever since, the Mexican government introduced policies that promoted the development of the northern border strip. See Lawrence Douglas and Taylor Hansen, los Orígenes de la Industria Maquiladora en México, Comercio Exterior, vol. 53 (11), (November, 2013) <http://revistas.bancamex.gob.mx/rce/magazines/59/7/RCE.pdf>
4 The customs regime “Strategic Fiscal Facility” is discussed below.
II. Background

In September 2015, Mexican President Enrique Peña Nieto announced a law initiative to create Special Economic Zones in Mexico. The President claimed that Special Economic Zones would be located on the South-Pacific coast in order to take advantage of Mexico’s geographic location, particularly Lázaro Cardenas (State of Oaxaca), Tapachula (State of Chiapas), Coatzacoalcos-Salina Cruz (State of Veracruz and Chiapas). Recently, the plan to create another SEZ in the “petroleum corridor”, located throughout the states of Campeche and Tabasco was also announced.
As of June 1, 2016, Congress adopted the law and its purpose is to close the alarming economic gap between the North and South of Mexico by creating an enabling business environment and integrating the South with global value chains. While the North and Center of Mexico have attracted considerable amounts of Foreign Direct Investment, developed important industrial hubs, and GDP per capita has increased, the South’s economic development has performed poorly and faces the highest poverty levels of the country.

Attracting private investment in the south of Mexico has proven to be a serious challenge. Special Economic Zones and their contouring policies intend to change the face of the Mexican South, making it more business friendly and prosperous. This is the reason why the President has taken this economic policy seriously and announced billions of pesos in infrastructure in the following years, as well as tax and finance incentives. For the 2017 annual budget, the Federal Government has announced 957.1 million pesos of expenditures for the development of Special Economic Zones.

Currently, the Federal Government is developing the regulatory framework and taking the necessary steps to make the Mexican Special Economic Zones a reality by 2018.

Finally, an investor must not forget that Mexico has a large treaty network. Mexico has in force 12 free trade agreements, providing preferential market access to 46 countries, and 9 preferential trade agreements under the ALADI framework (the Latin-American Association for Integration). Mexico also has in force 32 International Investment Agreements.

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1 Regional: Alianza del Pacífico (Colombia, Peru, and Chile), European Communities (28 countries), European Free Trade Association (4 countries), North American Free Trade Agreement (United States of America and Canada); Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua; Bilateral: Israel, Japan, Uruguay and Panama.
III. General Legal Framework of the Special Economic Zones

As noted, the purpose of the Law on Special Economic Zones (Law on SEZ) is to promote economic development in certain regions that are considered ‘under-developed’ by increasing and attracting investments, productivity, competition, and jobs. A SEZ, therefore, will be established in a State with high poverty levels, but it must be located in a strategic location with access to highways, airports, train, ports, or inter-oceanic corridors, and in a city or region with a population between 50,000 and 500,000 inhabitants.

Further, the Law on SEZ orders the relevant authorities to assess and forecast which productive sectors may be established in the SEZ, taking into account the comparative advantage and production profile of the region. In this sense, the relevant authorities must identify potential investors that may become the “anchor” companies, which would serve to attract other investors and, thus, create clusters and productive chains.
A. The Procedure for Creating a SEZ

Prior to issuing a Decree that creates a SEZ, the Ministry of Treasury, through its decentralized body on Special Economic Zones, must first develop a Report, which must be approved by an Inter-Ministerial Commission. The Report must establish and assess, among other matters, the following elements:

i. the geographical demarcation of the SEZ and Area of Influence;  

ii. the letter of Intention of the State and local authorities where the SEZ will be established, indicating their intent to subscribe a “Collaboration Agreement” and the facilitation measures and incentives they will implement;  

iii. a pre-feasibility study that includes, industrial sectors that may be established in the Zone, potential investors, a strategic assessment of the social and environmental impact, land use, and complementary public funding; and,  

iv. information concerning the necessary infrastructure and public policies that must be implemented for the development of the Zone and the Area of Influence, including an estimate of the public funding.

6 The Area of Influence is the nearby urban and rural communities that will benefit from the activities performed within the zone, as well as the complementary policies and actions planned in the “Development Program”.  

7 The Collaboration Agreement is an agreement between the Federal Government and the State and local authorities where the SEZ and Area of Influence will be located. The agreement will set forth the duties of each level of government for the establishment and development of the SEZ and the Area of Influence.
Once the Report is adopted, the President will issue the Decree, which will specify the geographical demarcation of the SEZ and area of influence; the administrative facilitation measures and the tax, customs, and economic incentives that will be provided exclusively in the SEZ; the term to execute the Collaboration Agreement; the date in which the Zone will begin its operations; and, the term to develop the “Development Program” among other matters.8

According to the calendar of the program of Special Economic Zones, since October 2016 said reports are being developed. The Decrees that would create each SEZ should be published approximately between May and July 2017.9

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8 The Development Program is a planning instrument that deals with the territorial zoning and the infrastructure projects on transportation, communications, logistics, energy, and hydraulics, among others that are necessary to be performed outside the SEZ, as well as public policies and complementary actions.

B. Governance of a SEZ

i. First Level: Integral Administrator

The Integral Administrator will be in charge of the construction, development and management of a SEZ. An Integral Administrator may either be a Mexican state-owned enterprise or private party, domestic or foreign; however, private parties can only be eligible if the Decree that creates a SEZ so provides. Further, private parties will have to apply for a permit, which is subject to a series of requirements and may also be subject to a public bid.

Notably, the Integral Administrator will have to develop a “Master Plan”, which must be approved by the Ministry of Treasury’s decentralized body on Special Economic Zones. The Master Plan is a document that foresees the general elements and characteristics of infrastructure and associated services that are required for the construction, development and management of the zone. The Master Plan will be reviewed every five years.

The Integral Administrator will have to provide associated services in the SEZ, such as urbanization, electricity, potable water, sewerage, wastewater treatment, telecommunication, security, among others.

The Integral Administrator will play a significant role with the investors. For instance, the Integral Administrator will determine the industrial spaces and lots that will correspond to each investor, in accordance with the Master Plan. Of equal importance, is that the Integral Administrator will develop the “Rules of Operation” regarding the working hours of the Zone, common area rules, control and access of persons and goods, sharing of information with investors, and handling.

Also, the Integral Administrator and Investors will have to agree on the terms and conditions for renting the lots as well as the provision and fees of the associated services.
ii. Second Level: Technical Council

Each SEZ will have its own Technical Council, which will function as an advisory body and as an intermediary between the Ministry of Treasury and the Integral Administrator. The Technical Counsels will permanently monitor the operation of the SEZ, assess their performance, and provide assistance to assure the fulfillment of objectives.

The Technical Councils are a multidisciplinary body that will be formed by representatives of the academic, business, and labor community of the region. Federal, State and local authorities will be invited to the sessions, as well as the Integral Administrator, Investors of the SEZ, and members of the civil society.

Technical Councils will have, among others, the following functions: comment on the Master Plan and its amendments; monitor, evaluate and draft an annual report regarding the performance of the Zone as well as the Development Program; issue recommendations; denounce irregularities. Needless to say, the Ministry of Treasury will have to address the recommendations made regarding the performance of the SEZ as well as the Development Program.
iii. Third Level: Ministry of Treasury’s decentralized body on Special Economic Zones

Besides carrying out the necessary steps for the creation of a SEZ, the Ministry of Treasury’s decentralized body on Special Economic Zones will have multiple functions before and after a SEZ is in operation. In essence, said authority’s functions the functions of the said can be classified into two categories: 1) the development of public policies as well as coordination with other authorities regarding them; and 2) surveillance and enforcement.

As for the first category, this authority will develop the Development Program and will have to work in conjunction with Federal, State, and local authorities. Notably, the Development Program describes the actions that are going to be implemented outside the Zone, such as territorial planning, transport, energy and communications infrastructure, as well as other public policies, such as education, security, finance, among other. The Development Plan will be drawn with the assistance of other authorities, and, if deemed appropriate, an advisory group formed by the private and social sectors may be created to submit proposals and recommendations.

In accordance with the Development Program, this specialized agency will implement policies for the proper establishment and development of the SEZ and coordinate the “actions” of Federal, State, and local authorities, as well as the Integral Administrator and investors.

Regarding the second category, the Ministry of Treasury’s decentralized body on Special Economic Zones will grant permits, monitor activities, and impose sanctions. Notably, this specialized authority will be in charge of authorizing which companies may invest in the SEZ; it will also verify whether the integral administrators and investors are complying with their relevant obligations and it can also request them information; and, it can impose sanctions to integral administrators and investors when they are not complying with the Law on SEZ or other instruments (e.g. permits).

Extraordinarily, the Ministry of Treasury’s decentralized body on Special Economic Zones may request assistance from other authorities and, in the case of emergency, also intervene directly as the Integral Administrator.
iv. Fourth Level: The Inter-Ministerial Commission

Finally, the Inter-Ministerial commission will serve as a high-level government meeting. This Commission will have as its purpose to coordinate the actions of the different government agencies that participate in the SEZs and to ensure the development and sustainability of the Zones and their Areas of Influence.
C. Incentives and Business Friendly Measures

It is highlighted that enterprises that invest within the SEZ will receive benefits, such as tax, customs, and financial, and enjoy “flexible” regulations. However, to date, it is only possible to have a general idea of how the value-added tax (VAT) incentives will work, because the Law on SEZ informs the specific VAT rate applicable for operations involving investors within the Zone.

The Law on SEZ does not provide any specifics regarding the exact amount of the other “benefits” or “incentives”. In this sense, we stress that the Decrees that will create SEZ’s are of paramount relevance, as they will –or should– specify in greater detail the tax incentives, applicable customs regimes, among other matters.

Needless to say, it is important to bear in mind that tax incentives will be of a temporary nature and will gradually decrease. Moreover, some tax incentives will most likely be conditioned on the creation of permanent jobs and productive investments that promote the economic development of the region.
i. VAT incentives

It is clear that VAT incentives aim at facilitating economic activities within the Zone, however, are they a sort of a rabbit pulled out of a magician’s hat that radically differ from Mexico’s international trade and customs regime? Not really, if one looks from a historical perspective at the regime applicable to the maquiladora industry (IMMEX), one can find that the SEZ regime shares several traits.

It is noted that the Law specifies that a 0% VAT rate will be levied on goods and services that are sold or performed by “outsiders” and introduced or enjoyed in a SEZ.

Such rate, obviously, aims at promoting economic activities within the SEZ because it will allow businesses located outside thereof—the “outsiders”—to sell goods or provide services to companies located within the SEZ—the “insiders”—and apply for tax returns. Meanwhile, those located inside the SEZ will enjoy of liquidity and a much less burdensome VAT regime applicable to the rest of the country.

Furthermore, the commercial operations performed between insiders will not be subject to VAT.

If goods are extracted from the SEZ and introduced into the country, such goods will be subject to VAT, unless, of course, they are to be exported through another customs-house.

As for the VAT upon importation, the Law on SEZ is silent in this regard. However, we assume that companies within the SEZ that import goods will not be subject to VAT upon importation. It is important to note that IMMEX companies, nowadays, have to pay the VAT upon importation; use a security bond to avoid paying the tax; or apply for a certification program to apply a tax credit equal to the amount of VAT applicable to the goods imported temporally. In our view, everything indicates that companies located in a SEZ will not have to be “certified”, like an IMMEX company, to “avoid” the payment of VAT upon the importation of goods or services.
ii. Income Tax

Turning to the Income Tax, the Law on SEZ does not specify rates or amounts. However, the Law on SEZ does provide that the benefits should promote productive investments, training, and develop human capital. We, therefore, expect that potential investors will have to comply with certain requirements or conditions in order to benefit from income tax incentives, which may take the form of a preferential income tax rate, as it also occurs with IMMEX companies that are owned by a foreign resident.

As noted above, tax incentives are of a temporal nature and will gradually decrease. Income tax incentives are no exception, which will be in force for at least eight years. The Decrees that create the SEZs will further specify the income tax incentives, and additional regulation on this regard will be issued in the future.

iii. Customs Regime

According to the Law on SEZ, a special customs regime will be created for the goods that are introduced into a SEZ, which will aim to facilitate trade and activities within the zones. We expect that this custom regime will exempt the payment of import duties.

Needless to say, this special customs regime will be detailed in each Decree that creates a SEZ. We believe that this special customs regime will share common traits from existing customs regimes already established in the Customs Law, particularly that regime called “Strategic Fiscal Facility”.

In essence, the Strategic Fiscal Facility regime entails that a “facility” that is within the territory constituency of a customs house, owned or used by a private company, is enabled by the Customs authorities to introduce goods. A company, who also has to be authorized by the customs authorities, will administer the facility. This regime, in essence, is of a temporary nature and allows the introduction of goods, foreign or domestic, into the facility to be handled, stored, in custody, exhibited, sold, distributed, manufactured, transformed, or repaired. Moreover, goods imported under this regime are not subject to import duties and to technical barriers to trade, except for those regarding human, animal and plant health, environment, and national security.
iv. Financial Benefits and other incentives

In a similar fashion, the Law on SEZ only provides that additional incentives and support mechanisms will be established. Additional incentives and support mechanisms, such as financial, lower or exempted social security taxes and local taxes, will also be described in each Decree that creates a SEZ.

v. Facilitation Measures: Single Window

The Law provides the creation of a “single window”, which will receive and process all administrative formalities that are necessary for the establishment and operation of economic activities in the SEZ, from import permits to construction licenses. The single window will function physically and electronically. All Federal, State and Local bureaucratic formalities will be processed through this mechanism with the aim to reduce the number administrative procedures and paperwork. It is possible that the single window may be extended to those investors located in the area of influence of a SEZ.

In sum, the single window aims to create a business friendly environment for the investors with the purpose of enhancing the efficiency regarding administrative formalities. In order to ensure the proper functioning of the single window, the Ministry of Treasury’s decentralized body on Special Economic Zones will work as a liaison between the different levels of governments and the Integral Administrators and Investors, and will even assist investors in the administrative fillings.
IV. How can and how to invest in a SEZ?

Domestic and foreign companies are allowed to invest and have operations in the SEZ, provided that they obtain an authorization, which is not conditioned on the nationality of the owner. Though there are still few economic activities that the Foreign Investment Law restricts the participation of foreign investors, foreign-owned companies or companies with foreign capital that intend to invest in the SEZ must bear in mind that certain activities may require a permit by a relevant Ministry (e.g. oil & energy) or a favorable opinion of the National Commission on Foreign Investment.
Interestingly, the Regulations of the Law on SEZ provide that foreign state-owned entities, including funds, may participate as shareholders of the companies that obtained an authorization to invest in the SEZ. However, to obtain the authorization, these types of economic agents must prove that they do not exercise public powers in their territory and that the corporate governance of the entity operates in an independent manner from the foreign government. The Ministry of Treasury’s decentralized body on Special Economic Zones will enjoy of ample discretionary powers in granting authorizations to these entities; therefore, foreign state-owned entities or funds that intend to invest in the SEZ, directly or indirectly, should embrace and comply with the Santiago Principles for Sovereign Wealth Funds or OECD Guidelines on Corporate Governance of State-Owned Enterprises, since the Ministry will probably be referring to these instruments in its decisions.

As noted, a potential investor will have to apply and obtain an “authorization”, which will be issued by the Ministry of Treasury’s decentralized body on Special Economic Zones. The said authority will accept or reject the prospective investors pursuant to some future guidelines that will be published in the Official Gazette (described below). According to the regulations of the Law on SEZ, these guidelines will provide that the potential investors will have to submit the following information:

i. Evidence that proves the technical and financial experience to perform the economic activities;

ii. Financial forecasts, in particular, the amount of available capital and debts, as well the amounts of the proposed investments;

iii. Approximate amount of workers required for the economic activities;

iv. The description of the economic activities, and the mechanism regarding the transfer of technology, as well as the actions to develop human capital in the zone;

v. Description of the spaces and industrial lots to be requested;

vi. The calendar program that sets forth the terms and stages for the construction and operation;

vii. The environmental impact authorization;

viii. The description of the associated services that will be requested and their amounts.
As for the economic activities that will be performed in the SEZ, the Law on SEZ provides a non-exhaustive list of activities that are encouraged to take place within the Zone:

i. Manufacturing activities;
ii. Agroindustry;
iii. Processing, transformation, and storage of the primary goods and inputs;
iv. Scientific and technological innovation and development; and
v. Logistic, financial, informatics, professional, technical services.

It is unclear how the Ministry of Treasury’s decentralized body on Special Economic Zones will assess and weight each factor to determine which potential investor is accepted or rejected. Nevertheless, we believe that said authority would be guided principally by the (economic) objectives of the law, namely the promotion of economic growth and human capital, the creation of permanent jobs, industrial development, etc. In this sense, the levels of investment, employment, and the type of activity to be performed in the SEZ may be the critical factors that will determine whether an authorization is granted. Other relevant considerations to bear in mind when filing for an authorization are whether the activity and investment may attract other investors and create industrial hubs; the investors’ Corporate Social Responsibility program and reputation; integrating Mexican enterprises in the investor’s supply chain; the investors commitment to adhere to the Development Program, particularly, involving the local communities with the investment.
V. Conclusion

The SEZ may be an excellent opportunity for new investments, as the government is taking very seriously this government policy by spending 957.1 million pesos next year; moreover, given the tax, customs, and other incentives, companies that locate in the SEZ will surely benefit from Mexico’s large treaty network that grows by the years. It is thus crucial for potential investors to come close to the government authorities, particularly with the Ministry of Treasury’s decentralized body on Special Economic Zones, to get a head start in the process of filing an authorization to prevent setbacks.

Having ample experience and specialized knowledge in trade, customs, and tax matters, Vázquez Tercero & Zepeda is ready to start advising and assisting companies who are interested in investing in SEZ or Mexico.
VI. About VTZ and its Members

VTZ does not present itself as a general practice firm. Rather, our practice is highly specialized in few areas of the Law, particularly trade related matters. We aim to maintain a specialized and reduced boutique-like practice to better address the specific needs of our clients. The members of the firm provide a joint approach, where the experiences of all parties are placed at the client’s disposal.

VTZ is recognized by international rankings, such as Chambers and Partners, Who’s Who Legal, and Legal 500, as one of the most respected and influential firms in international trade and customs law practice in Mexico.
Emilio Arteaga Vázquez
Associate (emilio@vtz.mx)

Mr. Arteaga is a Mexican licensed lawyer with a strong academic and professional background, particularly in the field of International Economic Law and Trade Law. Given that he is closely monitoring and assessing the developments of policies involving Special Economic Zone, Mr. Arteaga was interviewed by The Economist and quoted in the article “How the Bottom Half lives”, published in June 25, 2016. Mr. Arteaga has advised and represented companies in trade and customs matters.

Adrián Vázquez Benítez
Managing Partner (adrian@vtz.mx)

Mr. Vázquez is considered as an outstanding specialist in WTO/Trade Law by international rankings. He advises and represents multinational companies, as well as foreign governments in trade and market access issues, particularly on antidumping, subsidies, safeguards, origin of goods, as well as in the interpretation of trade agreements. Mr. Vazquez frequently appears before administrative agencies, the Federal Tax Court, Federal Courts and NAFTA Panels. Additionally, he has advised foreign governments on dispute resolution matters in connection with WTO challenges.
Eduardo Zepeda Grimaldo
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Mr. Zepeda is well-known for his maquiladora practice (export manufacturing industry) and is an expert in tax aspects affecting international trade and customs operations. He advises and supports importers, exporters, and companies with IMMEX program in customs and foreign trade programs. Eduardo has a deep knowledge in tax complexities that arise in the business operations of companies with IMMEX program.

Horacio A. López-Portillo Jaso
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Mr. López Portillo acts as head of the firm’s business and taxation practices. He also advises on a broad range of trade and customs matters, including WTO law, export controls, customs security, and related tax planning. Mr. López Portillo appears before customs, trade and tax enforcement agencies, as well as courts.