

LABOR ISSUES FOR MAQUILADORAS

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I. OVERVIEW OF MEXICO'S FEDERAL LABOR LAW

A. Introduction

It is common belief that Mexican labor law provides an unfairly low level of protection of worker's rights. However, Mexico's problem is not a lack of legal protection but rather a poor enforcement of fairly extensive "de jure" protection. Workplace safety and child labor are the areas of Mexican law where enforcement is lacking the most because of inadequate resources. (Only five inspectors for 22,000 factories). Moreover, Mexico's labor law protection against anti-union discrimination is unevenly enforced, especially in states with low degree of unionization.

Mexico's first comprehensive labor law was promulgated in 1931, based on principles enunciated in the Federal Constitution. Currently, labor relations in Mexico -- whether in the Maquiladora sector or not -- are governed by the Federal Labor Law (Ley Federal del Trabajo) of May 1, 1970, and its subsequent amendments.

The Federal Labor Law (FLL) is administered by the Secretary of Labor and Social Welfare (Secretaria de Trabajo y Prevision Social). The secretariat, headquartered in Mexico City with offices in every Mexican state, inspects and enforces industrial health and safety, employment of women and minors and minimum wages. Mexico's Federal and State Labor Boards of Conciliation and restitution are entrusted with the solution to conflicts arising between an employer and its employees. Due to the density of industries and population in Mexico, officers of the Federal Board of Conciliation and Restitution operate in each of the 31 Mexican states.

Mexico's Federal Labor Law is founded on Article 123 of the Constitution, which guarantees workers the right to form unions and to join professional associations of their own choosing.

Article 123 sets special standards for:

- minimum wage
- maximum length of normal work day
- overtime pay

- strikes
- child labor
- forced labor

B. Scope of the FLL

The FLL sets forth the following governing standards regarding labor relations in Mexico:

1. Work Contracts:

A labor agreement is generally essential for defining the rights and obligations of both employees and employers, covering an array of issues including place of work, schedules, scope of employee's activities, confidentiality obligations and other matters.

Labor agreements (or work contracts) must be in writing. A single collective bargaining agreement may be signed for all unionized workers or individual agreements between each worker and the employer. Work contracts may be entered into for a specific task, defined period of time (only permitted when work conditions so require) or indefinite, or for the purpose of obtaining coverage for a worker who is temporarily absent.

2. Employees Permanent Status:

In Mexico, a worker acquires permanent status upon his/her hiring and therefore benefits, from this point on, from the protection of Mexico's Federal Labor Law. The FLL provides a 30 day hiatus period where the employer may evaluate the worker's skills and decide if they truly correspond to the job requirements. In the event that the worker lacks the necessary skills for the job, the employer may terminate the employment without severance pay.

3. Minimum Wage:

The minimum wage in Mexico is set by the National Minimum Wage Commission (a tripartite group made up of representatives of business, labor and government). The minimum wage depends upon the zone in which the company is located: Zone A, made up of Mexico City's metropolitan area, border zone and most of the northern states, has the highest minimum wage in the country (\$3.05 per day for 1995). Revisions to the minimum wage generally occur more than once a year, the last revision came into effect on March 31, 1995.

Higher salary rates are adopted for skilled workers (can almost be double the minimum wage), managers and technical people. Men and women are governed by the same minimum wage, although men usually are assigned to jobs in Maquiladoras requiring greater skills or strength and thus receive slightly higher wages.

4. Work Shifts:

The standard work week is six, eight-hour days. The work shifts vary from day shifts (eight hours), mixed shifts (seven and one-half hours), night shifts (seven hours). When doing overtime, workers must be paid twice their normal rate and three times the normal rate if overtime is in excess of nine hours per week.

The hours of work are generally the same in the Maquiladora sector as in similar non-export Mexican firms.

5. Benefits:

Mexican employees are entitled to the following benefits: Christmas bonus, paid vacations, Sunday bonus and one day off for six working days.

Christmas Bonus: employees who have worked with a company for the entire year are entitled to a Christmas bonus of at least 15 days of salary. Employees who have worked for the company for less than a year are entitled to a partial bonus. This bonus must be paid before December 20 of each year.

Paid Vacations: all employees are entitled for the first year of services to 6 days' paid vacation and a cash bonus of 25% of the amount of pay for 6 days of work; eight days for the second year; ten days for the third and twelve days for the fourth. From the fifth year on, the employee is entitled to an additional two days for every additional five years of service.

Sunday Bonus: employees whose normal work week includes Sunday are entitled to a bonus of twenty-five percent of their salary for that day.

Days Off and Holidays: employees are entitled to one day off for every six working days. If the employee works on his day off, the employer must pay the normal daily wage plus a premium of two extra days of salary.

6. Benefits Provided Through Mexico's Social Security System:

Social Security legislation, adopted in 1942, created the Mexican Social Insurance Institute (Instituto Mexicano de Seguro Social [IMSS]). The Mexican Social Security System operates as an insurance program which provides workers with a wide variety of benefits. Employers and employees contribute varying

amounts to each aspect of the program. Social Security covers all employees in the private industry, including those in the Maquiladora sector, their spouses and their unemployed children under 18 years of age.

Mexico's social security system provides for the following benefits: day care, work risk insurance sickness and maternity insurance, disability, retirement benefits, death insurance as well as a retirement savings fund.

Day Care: the employer must pay a premium equal to 1% of its employees' "qualifying compensation"¹ for day care.

Work Risk Insurance: similar to worker's compensation in the United States. Employers must pay a premium toward risk insurance, which is akin to the worker's compensation insurance that prevails in the United States. The amount of the premium will be determined by the nature of the employer's activities and its safety record. Typical premiums can range from a low of 0.34% of the employees' qualifying compensation to a high of 10.035 percent.

Sickness and Maternity Insurance: the employer and the employee each pay premiums toward this insurance. The employer's share is 8.75 percent of the employee's qualifying compensation, and the employee's share is 3.125 percent. The maternity insurance pays for 6 weeks before birth and 6 weeks after; must have been employed by the company for 38 weeks in order to qualify.

Disability: much like the U.S. worker's compensation, the Mexican disability insurance covers: temporary disability, permanent disability, medical assistance, rehabilitation, death benefits and funeral costs. The premiums for this insurance will cost the employer 5.67 % of the employee's qualifying compensation, and the employee 2.025 percent.

Retirement Savings Fund: in 1992, the government established a new retirement system in Mexico. Employers now must deposit a tax-deductible 2% of each employee's salary into an individual retirement account. Such accounts may be managed by commercial banks, brokerage houses, and insurance companies. The employees determine how their pension funds will be invested, with permissible choices including government bonds and mutual funds.

¹ As a general rule, qualifying compensation is limited to 25 times the minimum wage in effect for the Federal District of Mexico. For certain programs, such as INFONAVIT, disability, death and retirement insurance, the ceiling is ten times the minimum wage in effect for the Federal District.

7. Mandatory Contributions:

Employers are required to contribute 5% of the employee's qualifying compensation to the INFONAVIT low income housing fund. INFONAVIT offers programs that assist Mexican workers in acquiring a home and also provides working capital to construction companies.

8. Profit Sharing:

All companies that have employees in Mexico must share a percentage of their profits with the employees.² Thus if a U.S. company opens up a Mexican branch, the branch income is subject to the profit sharing obligation. Ten percent of the employer's gross benefits must be shared with workers, 50% apportioned on basis of salary, 50% apportioned on basis of the number of days that each employee worked during the year. Every employee is entitled to participate in the profit sharing fund, except for directors, administrators and general managers. Typically, foreign investors structure their operations so as to minimize profits in Mexico in a manner consistent with applicable Mexican laws and regulations.

9. Optional Benefits:

Mexican companies are not required to, but may also offer the following benefits: qualified savings plan, food assistance, life insurance and medical insurance. Mexico's Income Tax Law permits the employer to establish a qualified savings plan for its workers. Contributions must be made by the employer and the employee in equal amounts and are capped at 13 percent of that portion of the worker's salary which does not exceed ten times that applicable minimum wage. These funds are distributed annually and may be borrowed against during the year. Many employers also grant their employees food stamps.

10. Termination and Severance Pay:

The FLL permits an employer to terminate employees, without severance pay, only upon the occurrence of specific events such as mutual consent of the parties, completion of the work project, cost inefficiency of the operation, force majeure or the worker's commission of certain specified acts, i.e dismissal for cause.³

² For the first year of operation a company is exempt from profit sharing.

³ Historically, employees have been unwilling to accept mutual termination unless the employer is willing to pay an additional termination payment. Such a payment is usually less than what the employee would have received under a termination without fair cause. A termination agreement should be ratified with the local Labor Arbitration Board before presentation to employees. Absent such ratification, the agreement could theoretically be open to challenge by employees later arguing unfair dismissal.

"Cause" (justified dismissal) is defined by the FLL as followed: if the worker obtains his or her position through false documents or by misrepresenting his or her credentials, if the worker engages in acts of dishonesty or disruptive or violent behavior on the job, if the worker intentionally or negligently damages the workplace, if the worker comes to work drunk or under the influence of any narcotics or non-prescribed drugs, if the worker refuses to follow prescribed health and safety procedures, and finally, if the worker is absent more than three times in a period of 30 days, without the permission of the employer or without justified cause.

When the legal contract is rescinded with legal "cause", there is no liability on the part of the employer. In such cases, the employer shall only pay the following benefits:

- a) seniority bonus, equivalent to 12 days of pay per worked year, at a maximum rate of two times the minimum salary;
- b) Christmas bonus (15 days' salary for a complete year of service), or the proportional payment at the time of discharge.
- c) vacations owed and not enjoyed by the employee, as well as the vacation bonus equivalent to 25 percent of the vacation days' pay.

If an employer cannot establish justifiable cause for termination of its employees, in accordance with the above, the employer is required to make severance payments (three months of integrated salary). Severance payments are mandatory when labor relationships are terminated and are based on the actual daily salary of the employee. The term "salary" here comprises the cash equivalent of base salary plus all the payments the employee is entitled to receive, such as bonuses, commission and other benefits. Some fringe benefits and incentives may not be included in the "salary." In calculating commission, the total monies received during the calendar year or calendar year-to-date are divided by the number of days worked.

In the event of an employment contract terminated without justifiable cause, the worker may apply to a Conciliation and Arbitration Board for his reinstatement in the post he occupied or for compensation (severance payments), at his choice. If the employer fails to furnish proof of cause for dismissal at the hearing, the worker shall be furthermore entitled to payment in arrear of his wages from the day of dismissal until the day the award carried out.

11. Minimum Working Age:

The minimum working age in Mexico is 14. Employees between 14 and 16 are considered minors and can only be employed under special conditions

(e.g. they cannot be employed in certain hazardous jobs). A minor is required to show the following documents in order to work: a special authorization from the Labor Department as well as a letter of authorization from the minor's parents or legal guardians.⁴ As for workers between 16 and 18, they may not perform night work in industrial establishments.

12. Unions:

Workers have the absolute right to unionize. When two or more employees affiliate with a union, the employer must enter into a collective bargaining agreement with that union, upon the worker's demand.

A company may only sign a collective bargaining agreement with a single union. The collective bargaining agreement will apply to all of the company's workers. Workers may replace current union by filing a special lawsuit before the Arbitration and Conciliation Board. All unionized workers will then vote for the union they wish to belong to. The union that holds the majority support will be awarded the right to represent the workers.

Unions are divided into two categories: company unions and industrial unions. Company unions are agreements with only the workers of a single company. The union must be formed by at least twenty of the company's workers and are most often autonomous from the government.

Industrial unions (CTM, CROC, CROM, COR) are formed by workers from two or more companies in the same industry, are far more prevalent than company unions and have close relationships with the government.

Mexico's official unions cooperate with and are closely tied to the government. The structure of Mexico's governing party, the PRI, is established to include official trade unions. The *Confederacion de Trabajadores de Mexico* (CTM) has long been and remains the dominant labor union in Mexico. It claims to represent over seventy-five percent of all organized workers in Mexico.

Unions in Mexico tend to be less aggressive and demanding than labor unions in the U.S. Although Mexican labor unions have substantial power over workers, they tend to be weaker, both financially and politically, than their U.S. counterparts.

The rate of unionization of in-bond export industries varies by area, but is comparatively low for Mexico's manufacturing sector. As one moves from east to west along the northern Mexican border, the share of Maquiladora firms

⁴ The request for special authorization from the Labor Department must be made by the parents of the minor or its legal guardians.

that are organized (and their size) declines. This is particularly true in Baja California, where industrialization began only recently and the in-bond exporters have small plants. Some assert the relatively good wage and benefit privileges of the large in-bond export plants reduce the incentive to unionize. The low rate of unionization in Maquiladoras may also be due, in part, to additional varying factors: an anti-union attitude held by many Maquiladora operators in most locations, the perception by some Maquiladora workers and managers that trade unions have little to offer them and the inability or unwillingness of unions to represent zealously workers against foreign manufacturers.

13. Occupational Safety and Health:

Under the FLL, the employer is required to build factories, workshops, clinics and other work premises in keeping with safety and health standards to prevent dangerous situations and to avoid contaminants that exceed the maximum tolerances set in the regulations and rules issued by the competent authorities.

Companies in Mexico are governed by the following health and safety regulations: Rules on Prevention of On-the-job Accidents, Rules on the Inspection of Steam Generators and Pressure Vessels, Rules on Mine Workers and, finally, the General Regulations governing Job Safety and Health.

Safety and health conditions for Maquiladoras are probably better, on the average, than conditions that prevail in other Mexican industrial settings, due to U.S. and Japanese parent companies' high safety and health standards.

14. Shop Rules

Any company, whether or not a union is involved, should adopt Internal Working Regulations, also known as "shop rules". These shop rules form an intrinsic part of the employment contract for they specify in great detail how the plant will operate, how the rights of management and of each individual will be dealt with in the day to day operations and, most importantly, which disciplinary measures will be taken against employees. Without shop rules, a company may not take disciplinary measures against its workers.

15. Wages for Maquiladoras

Maquiladoras tend to provide a level of compensation that is higher than the minimum wage by providing a number of additional non-wage benefits to workers (e.g., attendance and - to help counter the border and/or high labor turnover rates in the Maquiladoras - seniority bonuses, cafeteria and transportation subsidies, etc.).

Nominal Maquiladora wages and compensation in U.S. dollar terms have fallen systematically since 1980 as the result of massive declines in the value of the peso in U.S. dollar terms. The more recent peso's drop vis-a-vis the dollar has boosted Mexico's attractiveness as an offshore site for assembly activities, as Maquiladora wages dropped from \$2.50 per hour to \$1.80 per hour.

16. Labor Conflicts

Labor conflicts between employers and workers are adjudicated by local reconciliation and arbitration boards, which may render different interpretations of the law in accordance with state and regional labor practices. Conciliation and Arbitration Boards are formed by a government representative, employer's representative and a worker's representative.

Tripartite Boards of conciliation and arbitration promote voluntary worker-employee negotiations of disputes. Individual grievances are much more common than collective disputes and involve issues such as accident compensation, unjustified dismissals, and termination of a worker's employment contract. The Board will first hold a hearing in order to try to affect conciliatory settlement between the parties. In the event of no settlement, a trial will follow. The Boards have additional statutory responsibilities such as the registration of collective bargaining agreements reached between labor and management.

Mexico's Federal and State Labor Boards of Conciliation and Arbitration are each assigned a certain section of the industry over which they have jurisdiction. All labor matters arising in industries operating under Federal Charters and/or Federal concessions, or within the territorial limits of Federal zones, are heard by the Federal Labor Board (mining, electric industry, airlines, radio and television, oil industry, etc...). State labor boards have jurisdiction on all matters arising within the territorial limits of each state that are not under Federal jurisdiction.

There are no appeals before Labor Boards. The party affected by an adverse decision must seek injunction relief before a Federal Tribunal. If the judgment is against the company, it must post a bond. The Federal Court's decision is final, no further appeals are possible.

If an employer refuses to submit his differences to arbitration or to accept the decision rendered by the Board, the labor contract shall be considered terminated and he shall be obligated to indemnify the worker the amount of three month's salary in addition to any liability resulting from the dispute. If the refusal is made by workers, the labor contract shall be considered terminated.

II. WHICH LABOR LAWS WILL GOVERN

Mexico's national labor legislation applies to all firms operating in Mexico, whether in the export or non-export sector. There is no special labor legislation relating solely to Maquiladora operations, as labor practices and procedures in Maquiladora industries are similar to those practiced in non-Maquiladora Mexican firms. Working conditions, including wages and safety and health conditions in the Maquiladora sector are generally as good as, if not better, than similar operations throughout Mexico.

The FLL only applies to "Mexican employees." American employees are not entitled to the benefits accorded Mexican employees and American companies are not, therefore, obligated to comply with Mexican Labor Law unless such employees are deemed to be "Mexican employees."

According to Mexican law, labor relationships are established, regardless of the existence of a labor agreement, when two elements are present in the working relationship: subordination and dependency. Subordination is defined when employees follow the directions of the employer and dependency is economic in nature. Commercial and sales agents are considered employees when their services are permanent, unless they only participate in isolated operations or do not personally perform the work. In order to determine if an employee is a "Mexican employee" the law examines key elements such as the source of the employee's salary and the nature of the employee's subordination relation vis-a-vis his employer. If an employee's salary is paid by a Mexican company, or if an employee is essentially under the supervision of a Mexican company, then the employee will be considered a "Mexican employee" for purposes of the FLL.

Determining if an employee is a "Mexican employee" for purposes of the FLL is not always a black or white issue. For example, if an American employee, paid by the U.S. parent company, is physically working full time in Mexico, these working conditions would lean heavily toward a finding of Mexican employment, if the issue was ever challenged by the employee. An American parent company will therefore want to have minimal contacts with Mexico in order to limit the application of Mexican law to its U.S. employees. This, in order to assure low or reasonable cost to the U.S. parent company overtime. To further protect itself, the U.S. company should enter into written agreements with these individuals defining the employment terms, for clarity of the relationship, so as to avoid a confusion between U.S. employee or considered "Mexican employee" for legal purposes. Nonetheless, there remains the risk that, at termination of the labor relationship, a disgruntled employee will file a grievance with the Mexican Labor Board claiming that in spite of the contract with the American company, he was in effect, a Mexican employee. By keeping a tight control on its employee and provided the employee does not have a full time presence in Mexico, the risks of finding such an employee "Mexican" will be greatly reduced.

III. MEXICAN WORKING VISAS

Foreigners may work in Mexico as "non-immigrant visitors" if they demonstrate to the Mexican authorities that a Mexican company or person is requesting their services in Mexico, or demonstrate their capacity to provide independent services in Mexico. Foreigners also must prove that they have sufficient economic resources to support them during their stay.

United States or Canadian citizens have two options to enter Mexico for business reasons: via the traditional FM-3 non-immigrant visa or via the new FM-N Temporary Non-immigrant visas, created to provide entry into Mexico as part of NAFTA.

1. FM-3 Visitors Visa

Mexico's FM-3 visa permits foreign administrators, officers and technicians to work in Mexico for a period of one year, with multiple entry, and is renewable for four years after which time a new FM-3 must be requested.

It is required to apply in advance for the FM-3 visa in person to the Mexican Embassy or one of the consulates. The business persons' fingerprints will be taken at that time. The business person may not submit fingerprints taken by another authority other than the Mexican Embassy or one of the consulates.

To obtain a business visa, business persons must present the following documents to the Mexican Embassy or Mexican consulate:

- passport
- 2 passport sized photos
- letter from the U.S. company stating that they are sending this business traveller to work in Mexico and that he/she will be **remunerated from the U.S. company**. The letter from the company should describe the purpose of the trip, including dates for travel. If the business person foresees making multiple trips to Mexico, a multiple entry visa should be requested.
- if a technician, he/she should provide a letter from the Mexican company requesting the need for this technician's work.

i) FM-N Visa

The FM-N enables U.S. and Canadian citizens to work in Mexico for a period of 30 days, so long as the business activity does not result in remuneration in Mexico, i.e., the person remains in the employment of the U.S.

company. Under the new regulations, NAFTA qualified visitors may fill out a simple form, called an FM-N form (Formulario Migratorio NAFTA), upon entry into Mexico. The FM-N does not replace the tourist card, Mexico's tourist card will continue for tourists. The FM-N is free and the form can be obtained from Mexican consulates in the U.S. and Canada, airlines and from Mexican immigration officials at entry points into Mexico.

The form must be kept by the traveler while in Mexico; upon leaving Mexico the traveler must turn the form in to Mexican immigration officials. However, if the traveler intends to return to Mexico before the 30-day expiry period, the traveler may retain the form. Travelers returning after their FM-N expires may fill out a new form.

The applicants may secure as many visas as may be required, provided that they always return expired visas. However, until recently, the Immigration office has changed such criteria enabling the applicants to obtain a limited number of such visas with the purpose of promoting the FM-3 visa.

The applicant must personally fill in the above-mentioned form, as well demonstrate the following:

- (a) His/her nationality with an original document (i.e., passport, birth certificate).
- (b) That his/her activities will be paid in his/her country of origin: **they cannot be remunerated in Mexico.**
- (c) In the case of business visitors, documentation evidencing the activities described in the application; and
- (d) In the case of professionals, they will have to secure a professional certification from the Ministry of Public Education (Federal Mexican Government). Significant delay is associated with obtaining such professional certification.

Four classifications of travelers are eligible for entering Mexico under the FM-N: Business Travelers, Traders and Investors, Intercompany Transferees and Professionals.

1. Business Visitors: Individuals that will carry out business activities related to research and design; cultivation, manufacture and

production; commercialization; sales; distribution; post sales services and general services

2. Merchants and Investors: Individuals that will perform commercial exchange of items and services or establish, develop, administrate or provide advice or technical services in order to administer an investment in which foreign capital has been or will be involved.

3. Transfer of Personnel: Employees of corporations wishing to perform managerial or executive activities or activities that represent specialized skills for the corporation or for any of its subsidiaries located in any of the countries that participate in NAFTA.

4. Professionals: Individuals wishing to perform professional activities (e.g., medicine, law).

For travelers who do not qualify to use the FM-N or if they plan to remain in Mexico longer than 30 days, a FM-3 business visa must be obtained.

ii) FM-VC Visa

The FM-VC visa allows temporary entry into Mexico by foreign business individuals of diverse nationalities (other than U.S. and Canadian Citizens subject to the benefits of the FMN-visa).

The following individuals are considered as temporary visitors for purposes of the FM-VC visa:

1. Business Visitors: Individuals that will carry out business activities in order to negotiate and execute mercantile agreements, verify the compliance of same, seek alternate investments or carry out direct investment in the country.

2. Board Members: Foreign individuals with the purpose of entering the country in order to participate in Board Member meetings of duly organized Mexican corporations.

3. Technicians: Foreign individuals who enter the country for purpose of providing a specialized service previously foreseen or contemplated through previous agreements such as a transfer of technology, machinery and equipment sale or industrial property, or any other agreement or contract related to the production process of the Mexican company.

4. Transfer of Personnel: Employees of corporations wishing to perform managerial, executive or certain activities that represent specialized skills for the subsidiary Mexican corporation.

The FM-VC Temporary Non-Immigrant Visitors Visa is available at Mexican Consulates located abroad as well as in the Mexican Immigration ports of entry.

The applicant must personally comply with the following requirements:

a) Evidence his/her nationality with a valid passport, or, in its case, his/her legal residency either in the United States of America or Canada.

b) Submit a letter issued by the Mexican based corporation addressing the purpose of his/her visit and extending its invitation therefore.

c) In case of transfer of personnel, a letter issued by the foreign corporation (in Spanish) acknowledging that the applicant is his/her employee and shall thus cover his/her salary.

d) In case of Board Members, evidence of their formal appointment to such position.

FM-VC Temporary Non-Immigrant Visitors Visas shall be granted free of charge and with a limited duration of 30 calendar days as of the first entry into Mexico. If the holder of an FM-VC visa wishes to extend his/her presence in Mexico in order to continue the same activities, he/she should contact the nearest immigration office in order to request an FM-3 Non-Immigrant Visitors Visa for non-remunerated activities.

IV. TAX ISSUES

Maquiladoras are assured the right to determine their staffing needs and to recruit and fire personnel on their own, provided that at least 90 percent of the Mexican company's work force - excluding high-level executives - be composed of Mexican nationals.

Maquiladora managers will most often staff key management and technical positions with expatriates who live in the U.S. and commute to Mexican border plants daily. This avoids many of the hardships associated with offshore assignments, thus enabling Maquiladoras to retain better district managers than

would be possible in more distant offshore sites. Therefore, expatriates and their families do not have to live in the foreign country, they just work there.

For immigration and tax purposes the expatriate will be considered as either an "American employee" or "Mexican employee." The key elements that will be considered to establish the country of employment will be the source of the employee's salary and the relation vis-a-vis his employee.

A. Individual Employee Taxes

The U.S.-Mexico Tax Treaty, which became effective in January 1994, is designed to eliminate double taxation of people and companies doing business in both the U.S. and Mexico. The treaty complements the NAFTA and is aimed at reducing the overall tax on investment income flowing between the two countries. Under the Treaty, wages, salaries and other similar remuneration derived from services performed in Mexico by an employee who is a resident of the United States may be taxed by Mexico. However, if the employee is present in Mexico fewer than 184 days in a 12-month period, is not a resident of Mexico, and the compensation paid to the employee is not deducted by a permanent establishment of the employer in Mexico, the employee will only be subject to tax in the U.S. Consequently, employees of an American company working in Mexico for a period exceeding 183 days generally will be subject to Mexico's income taxes as follows:

1. American Employee

An American employee, working in Mexico, and receiving compensation from a U.S. company must pay a 15% income tax ("Gringo Tax") for salaries ranging from \$8,389 - \$67,577.33 and for any salary over this range a 30% tax will be applied⁵.

2. Mexican Employee

An American employee receiving compensation in Mexico, is considered a "Mexican employee" for tax purposes and will be subject to the following income tax: a Federal tax of 35 % (for salaries \$70,000 range and up) and a State tax of 1.25% of the gross amount of the employee's pay.⁶

⁵ Current rates as of July 10, 1995.

⁶ In addition to his/her income tax, the "Mexican employee" must pay the remaining 25% of the social security tax otherwise paid for by the employer.

B. Taxes Paid by American Company

1. American Employee

An American Parent company will be subject to the following U.S. federal and state taxes when its employee is physically working in Mexico⁷:

i) Federal Taxes

Social Security: The employer must pay 7.65% of the employees salary to FICA (Federal Insurance Contributions Act). In 1995, this percentage consists of social security tax of 6.2% on first \$61,200 and Medicare of 1.45% on all wages.

FUTA (Federal Unemployment Tax Act): The employer must pay 6.2% on first \$7,000 (\$434.00) but will get a credit depending on the payments he/she makes to state unemployment, which can be brought down to .8%.

ii) California Taxes

A California employer will be subject to the following California taxes for its employee who works in Mexico, provided the employee has not lost his California residency: an unemployment tax of 3.4% on first \$7,000 (\$238.00) as well as a training tax of .1% on first \$7,000 (\$70.00).

iii) Additional Company Costs

A U.S. company may continue to incur the following additional expenses for its employee: 401 K plan benefits, car company costs, life insurance, LTD insurance, health insurance, executive health plan and workers compensation.

2. Mexican employee⁸

If the American employee is considered a "Mexican employee," Mexico's Social Security Taxes of 17-21% must be paid on the employee's wages. The Company must pay at least 75% of this tax. The remaining 25% will be covered by the employee. Furthermore, the employer must pay 5% of the employee's wages for the worker's housing fund (INFONAVIT) and 2% of the salary to a retirement fund.

⁷ No Mexican taxes apply in this case to the American company.

⁸ No. U.S. taxes apply to a company when its employee is remunerated in Mexico.

C. Risk of Permanent Establishment

If an American company has employees working in Mexico -- the employees remaining "U.S. employees" for purposes of Mexican law -- it may risk creating a "permanent establishment" for Mexican tax purposes. Whether a permanent establishment is created will depend upon the nature and extent of the activities performed in Mexico and will be determined under the provisions of the U.S.-Mexico Tax Treaty. If a permanent establishment is created, the American company would have its own legal and tax presence in Mexico and would be required to do the following:

1. Register in Mexico as a "Branch" of a U.S. corporation. This means that the U.S. company is a registered business in Mexico, in addition to its subsidiary;
2. Obtain a Federal taxpayer ID number in Mexico;
3. Withhold Mexican taxes from its employees working in its Maquiladora; and
4. File corporate tax returns and pay tax in Mexico.

It should be noted, however, that the formation of a Mexican subsidiary will not, in and of itself, cause the U.S. parent to have a permanent establishment in Mexico.

V. CONCLUSION

The Maquiladora sector has definitely become more alluring for American companies over the last decade. The accrued benefits of cheaper labor and cheaper infrastructure have not only attracted numerous American textile and technology firms but many Japanese assembling and manufacturing companies as well.

Throughout this decade, Americans will become more familiar with Mexico's labor laws and working conditions. The closer the tie between the U.S. employer and its Mexican employees, the better the results will be. By understanding the Mexican culture, a U.S. parent company will extract the most benefits from its Maquiladora plant. Knowing and respecting Mexico's labor laws is only the stepping stone to a real understanding of Mexico's labor force.

When considering labor issues, it is important to note that Latin customs have not surrendered to the pursuit of the "American dream." Instead, a key aspect of the Mexican identity is the importance of personal relationships in the advancement of both business and other interests. Another is the patience for and tolerance of a slower pace of life. Most Mexicans are not as materialistic as their American

counterparts and thus are less likely to be motivated by exclusively financial incentives.

Foreign business people in Mexico will be regarded for their ability to communicate common goals and interests, if shared with the same degree of courtesy and patience expressed by their Mexican associates. Although this may initially appear to denote form over substance, Mexicans place strong emphasis on personal conduct. Foreign business people who take care to observe this custom will engender respect and build good relationships with business associates at all levels.

Companies should approach a Mexican project with the knowledge that "western" or U.S.-style business practices are not necessarily applicable in all contexts. Mexicans want modern business practices to take hold as their country expands relationships in the international community, but they still have an equally profound desire to maintain their national identity. To willfully disregard the unique aspects of the Mexican culture may hinder one's ability to conduct business competitively in Mexico.