

1984

Legal Aspects of Mexican Exchange Controls

Fernando A. Vazquez Pando

Recommended Citation

Fernando A. Vazquez Pando, *Legal Aspects of Mexican Exchange Controls*, 18 INT'L L. 309 (1984)
<https://scholar.smu.edu/til/vol18/iss2/8>

This Symposium is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in *International Lawyer* by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

Legal Aspects of Mexican Exchange Controls

I. A Play in Three Acts

The liberal system of Mexican law in force until August 1982 did not require Mexican scholars to investigate deeply the legal aspects of exchange controls, foreign currency obligations and related items. In fact, Mexican legal literature on the legal aspects of money is very scarce, and almost all of it has been presented from an historical approach,¹ or has been published at times of monetary crisis with respect to specific items as, for instance, when Mexico abandoned the gold standard system and when silver was demonetized.²

The present system of exchange controls in Mexico is like a play in three acts. The first act contains a discussion of the benefits and risks of exchange controls in Mexico, and has two principal scenes. The first is the report of the Mexican President Lazaro Cardenas to the Mexican Congress on September 1, 1938, in which the President concluded that, independent of any theoretical benefits or risks, it was not convenient to impose exchange controls in Mexico due to the practical difficulties of implementing the controls. In the second scene, on April 20, 1982, Mr. Miguel Mancera, then General Direc-

*Member of the Mexican Bar; practices law in Mexico City; Professor, Universidad Iberoamericana, Mexico, since 1971.

¹See, e.g., D. LOPEZ ROSADO, *HISTORIA DEL PESO MEXICANO* (published by the Fondo de Cultura Economica (the Economic Cultural Fund)) (1975). Historians have focused their attention on the monetary system of the Spanish period, on which a very large bibliography exists. For one of the most complete bibliographies on this subject, see Fomento Cultural Banamex, A.C. (Banamex Cultural Development), *El Real de a Ocho Primera Moneda Universal* (1976).

²See, e.g., J.D. Casasus, *Estudios Monetarios* (published by the Oficina Impresora del Timbre (Stamp Printing Office)) (1896); Macedo, *La Reforma Monetaria*, included in: *Tres MONOGRAFÍAS QUE DAN IDEA DE UNA PARTE DE LA EVOLUCION ECONOMICA DE MEXICO*, (1905); E.T. SARAVIA, *LA DEVOLUCION DE LOS DEPOSITOS BANCARIOS CONSTITUIDOS EN ORO*, (published by the Banco Nacional de Mexico, S.A.) (1934); R.B. PALAZUELOS, *LA MONEDA Y SU LEGISLACION EN MEXICO*, (1943).

tor of the Banco de Mexico, published a brochure on exchange controls in which he arrived basically at the same conclusions of the Cardenas presidential report.³ Thus, in this first act, the discussions on exchange controls reach the conclusion that exchange controls are not a feasible system for the Mexican economy.

The second act covers the period from August 5, 1982 to December 20, 1982. On August 5th, the Mexican Ministry of Finance and Public Credit and the Director of the Mexican Central Bank announced the establishment of a dual system of exchange rates. That was the prelude to the exchange controls enacted on September 1, 1982, which were in effect until December 20, 1982. The system of exchange controls as established pursuant to the September 1st Decree was very rigid. Its principal guidelines were:⁴ (a) all payments to be made by residents of Mexico to nonresidents were subject to the authorization of the appropriate authorities; (b) no payment in foreign currency was authorized within Mexico and obligations in foreign currency payable in Mexico had to be paid in Mexican currency; (c) all foreign currency received by residents in Mexico was required to be converted into Mexican currency at the applicable rate of exchange; (d) the import and export of Mexican and foreign currency required the prior authorization of the appropriate authorities; and (e) different rates of exchange were established taking into consideration different kinds of transactions.⁵ This system was complicated by the different treatment accorded to different cases, depending on the nature of the transaction. For instance, indebtedness under loans granted by foreign banks was subject to registration with the Ministry of Finance and Public Credit, royalties were subject to registration with the transfer of technology authorities, dividends were required to be registered with the foreign investment authorities, and so on.

On December 13, 1982, the *Official Gazette* published a new Decree on Exchange Controls. This Decree (hereinafter, "the Decree"), effective December 20, 1982, changed the previous system entirely, establishing a much simpler one. Therefore, the second act of the story of exchange controls ended on December 20th when the new exchange control system went into effect, although the old rules are still in force with respect to some transitory problems.⁶ This new exchange control system, which is governed

³M. Mancera Aguayo, *Inconveniencia del Control de Cambios* (published by the Banco de Mexico, S.A., Apr. 20, 1982).

⁴For a discussion at length of this system, see F. VAZQUEZ Pando, *EL CONTROL DE CAMBIOS EN MEXICO (analisis critico y comentarios)* (published by Themis) (1982).

⁵Basically, two exchange rates existed: (i) a general rate applicable to all cases other than those in which a preferential rate was applicable; and (ii) a preferential rate applicable in the case of payments to foreign creditors under certain circumstances (*e.g.*, basic imports, as well as exports by in-bond companies (*maquiladoras*)).

⁶For instance, to be entitled to acquire foreign exchange at the controlled rate for the repayment of loans disbursed between September 1, 1982 and December 20, 1982, it is

basically by the Decree and several rules and regulations implementing the Decree,⁷ is the focus of this article. To explain Mexican exchange controls, however, it is necessary to first summarize some general aspects of the Mexican law on money.

II. The Mexican Monetary System and the New Exchange Controls

The Mexican Congress has the authority to create and govern the activities of the Central Bank (the only entity authorized to issue bank notes),⁸ to govern the creation of mints, to determine the composition of coins, and to enact rules pursuant to which the value of foreign currency is determined.⁹ The Mexican Central Bank has the authority to determine the value of foreign currency pursuant to rules enacted by Congress, as well as to operate exchange controls.¹⁰ In the president of Mexico vests the authority to establish exchange controls by means of decrees,¹¹ which may be supplemented by rules promulgated by the Ministry of Finance and Public Credit.¹² And the Central Bank is authorized to operate exchange controls.¹³

III. General Characteristics of the Exchange Control System

Exchange control rules vary from country to country and within each country rules may vary frequently, taking into consideration economic and other conditions existing from time to time. The following focuses on Mexican exchange control rules and regulations as presently in force, although at times reference is made to the system in force from September 1st to December 20, 1982.

The Mexican exchange control system is only a partial control, i.e., only certain transactions and transfers are subject to controls. As a general rule,

necessary to prove that the proceeds of the disbursement were exchanged into Mexican currency under the provisions then in force.

⁷A detailed chronology of exchange control rules and regulations is available from the author and is on file at the offices of *The International Lawyer*.

⁸*Constitucion Politica de los Estados Unidos Mexicanos (Political Constitution of the Mexican United States)*, proclaimed Feb. 5, 1917, as amended, art. 28.

⁹*Constitucion*, art. 73, §§ X and XVIII.

¹⁰Ley Reglamentaria de la Fraccion XVIII del articulo 73 constitucional (en lo que se refiere a la facultad del Congreso para dictar reglas para determinar el valor relativo de la moneda extranjera) (Regulatory Law of Section XVIII of article 73 of the (Mexican) Constitution) (referring to the power of Congress to promulgate rules for the determination of the relative values of foreign currency); Ley Organica del Banco de Mexico, art. 8-I (Organic Law of the Banco de Mexico, art. 8-I).

¹¹Ley Organica del Banco de Mexico, art. 23 (Organic Law of the Banco de Mexico, art. 23).

¹²*Id.*

¹³*Id.*

residents may freely execute transactions with nonresidents that result in transfers from residents to nonresidents. The controls imply the existence of two money markets; several rates of exchange are applicable, depending on different circumstances. Control is exercised basically with respect to the supply of foreign exchange to the controlled market.

A. PARTIAL CONTROL

Pursuant to the Decree, only the following transactions are subject to exchange controls:¹⁴ exports, except those excluded from control pursuant to the rules and regulations of the Ministry of Commerce and Industrial Promotion; payments of salaries, rentals and acquisitions of goods not forming part of their assets and services by in-bond companies (*maquiladoras*); loans in foreign currency payable outside of Mexico and granted by foreign financial institutions or Mexican banks to the federal government, entities of the federal public administration, or enterprises established in Mexico; imports and related expenses; expenses of the Mexican foreign service, as well as payments to international organizations to which Mexico is a party; and those transactions deemed subject to control by the Ministry of Finance and Public Credit at the insistence of the Central Bank.¹⁵ With no exception of these activities, in all other cases there are no exchange controls, and therefore, transactions and transfers may be freely made by residents.

B. EXCHANGE RATES

Pursuant to the Decree there are several rates of exchange: (i) the controlled rate, fixed from time to time by the Central Bank;¹⁶ (ii) the free market rate;¹⁷ (iii) special rates, which the Central Bank may fix to make conversion of obligations in foreign currency payable in Mexico.¹⁸

C. CONTROL ON TRANSFERS

Exchange controls in Mexico basically require that foreign currency received by residents under transactions subject to control has to be exchanged at the controlled rate with Mexican banks,¹⁹ and that residents are

¹⁴The "Decree on Exchange Controls," art. 2. (D.O. Dec. 13, 1982) (hereinafter cited as "the Decree").

¹⁵This authority is granted by article 2-f of the Decree. Pursuant to this authority, study outside of Mexico is subject to exchange controls. See text accompanying note 9, *supra*.

¹⁶Decree, art. 8.

¹⁷Decree, art. 10.

¹⁸Decree, art. 12 and 6 Transitory. On this subject, see *supra* note 12 and accompanying text.

¹⁹Decree, arts. 3 through 6.

entitled to acquire foreign currency at the controlled rate to make payments deriving from the transactions subject to control. Strictly speaking, the control is on payments; the transactions themselves do not require the prior consent of the authorities. Although import or export permits may be required, this does not mean that the transaction itself is subject to control.

Loans granted by foreign financial institutions illustrate this characteristic of the Mexican exchange controls. No authorization is required to enter into a loan agreement; residents are free to obtain loans from abroad²⁰ and foreign financial institutions are free to grant loans to residents of Mexico. Nevertheless, if a foreign financial institution grants a loan to an enterprise resident in Mexico, the enterprise is obligated to change the proceeds of the loan into Mexican currency. This conversion must be made at the controlled rate with a Mexican bank. On the other hand, the borrower will be entitled to acquire foreign currency at the controlled rate to pay interest and repay the principal on the loan, provided the transaction is duly registered with the Ministry of Finance and Public Credit. This registration does not imply control over the agreement or the terms agreed upon by the parties; the registration is required only for purposes of acquiring foreign currency at the controlled rate.²¹

Having mentioned these general characteristics, it is convenient to analyze the rules applicable in each specific case subject to controls, as well as the regulations applicable to converting obligations in foreign currency payable in Mexico.

IV. Rules for Specific Cases

A. EXPORTS

Under the Decree, all exports are subject to control, except those specifically excluded by the Ministry of Commerce and Industrial Promotion.²² In the case of exports, basic rules apply. First, prices agreed to have to be in one of the foreign currencies determined by the Central Bank.²³ Second, the

²⁰The government and its instrumentalities require previous authorization to undertake public debt, but that does not derive from exchange control regulations.

²¹Decree, art. 7; *Reglas Complementarias de Control de Cambios Aplicables al Registro de Creditos en Divisas a cargo de Empresas Privadas Establecidas en el Pais* (Exchange Control Supplementary Rules Applicable to the Registry of Credits in Foreign Currency Against Private Enterprises of the Country), rules 4 and 5.

²²Decree, art. 2-a. The Ministry of Commerce and Industrial Production has excluded exports deriving from normal migratory movements and some other items from exchange controls. See the *Acuerdo que Exceptua del Mercado Controlado de Divisas las Exportaciones de las Mercancias que se Indican, Incluyendo las que se Realicen Desde las Zonas Libres del Pais*, (Executive Order Excluding from the Controlled Foreign Currency Market the Exportation of Certain Goods, Including that Taking Place from the Free Zones of the Country) (D.O. Dec. 20, 1982).

²³Decree, art. 3. These currencies were determined by the *Determinacion de Divisas* (Determination of Foreign Currencies) (D.O. Dec. 20, 1982).

exporter is obligated to change the proceeds from the exports into Mexican currency at the controlled rate, except for an amount equal to those expenses incurred outside Mexico that are necessary for the export and approved by the Ministry of Commerce and Industrial Promotion. Essentially, the exporter has to agree to sell the foreign currency proceeds to a Mexican bank in order to obtain the export licenses, and then the exporter must sell the proceeds to the bank.²⁴

Foreign currency authorized for export purposes includes Canadian Dollars, U.S. Dollars, Swiss Francs, Sterling Pounds and German Marks, as well as other foreign currencies that are totally and immediately convertible into the above-mentioned currencies.

B. PAYMENTS OF IN-BOND COMPANIES

In-bond companies (*maquiladoras*) are subject to exchange controls in the sense that if such companies need to exchange foreign currency to pay salaries, rents, goods or services in Mexico, except goods forming part of their fixed assets, they must exchange this foreign currency at the controlled rate.²⁵ Additionally, these companies must not make these payments outside Mexico or in foreign currency, and must convert foreign currency into Mexican currency only through Mexican banks.²⁶

Exchange controls applicable to in-bond companies are governed by the Decree as well as supplementary rules.²⁷ Pursuant to these rules, the proceeds from the exports of in-bond companies registered with the Ministry of Commerce are not subject to control, although the goods and services must be sold in one of the foreign currencies authorized by the Central Bank.²⁸

On the other hand, in-bond companies must sell foreign currency at the controlled rate of exchange to Mexican banks in amounts equal in Mexican currency for federal and local taxes incurred by such companies, insurance premiums, interest deriving from loans in Mexican currency, payments for salaries, rents, goods (except fixed assets) and services, as well as other expenses incurred within Mexico. In-bond companies may deduct income from sales or services rendered within Mexico in Mexican currency, provided the Ministry of Commerce has authorized them to execute such transactions in Mexico.²⁹ These sales must be made by the last working day of the month in which such expenses are incurred.³⁰

²⁴Decree, art. 3; *Reglas Complementarias de Control de Cambios Aplicables a la Exportacion*, (Exchange Control Supplementary Rules Applicable to Exportation).

²⁵Decree, art. 5.

²⁶*Id.*

²⁷*Reglas Complementarias de Control de Cambios para Empresas Maquiladoras* (Supplementary Exchange Control Rules for In-Bond Companies) (D.O. Apr. 11, 1983).

²⁸*Id.*, R. 1.

²⁹*Id.*, R. 2., para. 1.

³⁰*Id.*, R. 2., para. 2.

The in-bond companies are not obligated to sell foreign currency to Mexican banks if it is used to pay credits granted by foreign financial institutions to third parties for the construction of real estate used by the companies, and, pursuant to the agreements, the rents or payments to be made by the companies will be applied to repay the loans. These credits must also be registered with the Ministry of Finance and Public Credit.³¹ Additionally, in-bond companies must inform the Ministry of Finance and Public Credit monthly the amounts of Mexican currency sold to Mexican banks and the amounts of foreign currency applied to the payments.³²

C. LOANS IN FOREIGN CURRENCY PAYABLE OUTSIDE OF MEXICO

Loans in foreign currency payable outside of Mexico are subject to controls when the lender is a foreign financial institution or a Mexican credit institution, and the borrower is the federal government, an entity of the federal public administration, or an enterprise established in Mexico.³³ This means that loans granted by foreign commercial companies that are not financial institutions are not subject to controls. Similarly, controls do not apply if the borrower is a private individual, regardless of whether the lender is or is not a financial institution or a Mexican bank.

With the exceptions and under the conditions indicated, the Decree and the Registry of Credits rules³⁴ govern loans in foreign currency payable outside of Mexico. The borrower is obligated to exchange the proceeds of the loan at the controlled rate with a Mexican bank, except those proceeds that are used for any of a limited number of specified purposes.³⁵

³¹*Id.*, R. 2., last para.

³²*Id.*, R. 3.

³³Decree, art. 2-c and art. 6.

³⁴*Reglas Complementarias de Control de Cambios Aplicables al Registro de Creditos en Divisas a Cargo de Empresas Privadas Establecidas en el Pais y a favor de Entidades Financieras del Exterior* (Exchange Control Supplementary Rules Applicable to the Registry of Credits in Foreign Currency Against Private Enterprises of the Country and in Favor of Foreign Financial Entities) (D.O. Mar. 24, 1983).

³⁵The following purposes may qualify: (i) Payment of imports if the import permit is granted with the right either to acquire foreign currency at the controlled rate or to apply the proceeds from this kind of loans; (ii) Payment of interest and repayment of principal of indebtedness incurred before December 20, 1982, in favor of foreign suppliers; provided, the indebtedness has been duly registered with the Ministry of Commerce and Industrial Promotion, the Central Bank grants authorization to apply the proceeds for this purpose, and the loan is a long-term one; (iii) Payment of indebtedness incurred before December 20, 1982, under loan agreements granted by foreign financial institutions; provided, the indebtedness is duly registered with the Ministry of Finance and Public Credit, the Central Bank grants its authorization, and the new loan is a long-term one; (iv) Payment of indebtedness incurred after December 19, 1982, under loans granted by foreign financial institutions; provided, the indebtedness is duly registered with the Ministry of Finance and Public Credit and the new loan is a long-term loan; (v) Payment of indebtedness under loans granted by Mexican banks in foreign currency payable outside of Mexico incurred before December 20th; provided, the new loan is a long-term one and the Central Bank grants its authorization.

The borrower is also entitled to acquire foreign currency at the controlled rate to pay interest and principal; provided:³⁶ (i) it has exchanged the proceeds of the loan for Mexican currency at the controlled rate (except those proceeds specifically enumerated *supra*; and (ii) the indebtedness is duly registered with the Ministry of Finance and Public Credit. (To obtain this registration, the borrower has to prove that the proceeds have been changed into Mexican currency at the controlled rate or that any of the five exceptions applies.)

D. IMPORTS

In the case of imports, exchange controls exist to the extent an import permit confers to the importer the right to acquire foreign currency at the controlled rate. The Ministry of Commerce and Industrial Promotion issues two kinds of import permits: (i) normal permits, or (ii) permits conferring the right to acquire foreign currency at the controlled rate.³⁷ When an import involves, in the discretion of the Ministry of Commerce and Industrial Promotion, goods essential to the Mexican economy, the Ministry issues an import permit conferring the right to acquire foreign currency at the controlled rate.

E. FOREIGN SERVICE AND INTERNATIONAL ORGANIZATIONS

For expenses of the Mexican foreign service and payments to international organizations of which Mexico is a member, the Central Bank supplies foreign currency at the controlled rate to the governmental entity that has to make such payments. No special regulations have been published on this subject at this time.

F. OTHER PAYMENTS SUBJECT TO CONTROL

The Ministry of Finance and Public Credit may subject to control other payments or transactions. As of this writing, the Ministry of Finance has used this authority only with respect to studying outside of Mexico. On February 8, 1983, the Ministry of Finance and Public Credit issued the Supplementary Rules for Studying Abroad.³⁸ Pursuant to these rules, for-

³⁶See *supra* note 34, at R. 2.

³⁷See the *Acuerdo que Determina las Mercancias Cuya Importacion Queda Comprendida en el Mercado Controlado de Divisas, Incluyendo la que se Realice a las Zonas Libres del Pais* (Executive Order Determining the Goods Whose Importation Is Included in the Controlled Foreign Currency Market, Including that Taking Place Through the Free Zones of the Country) (D.O. Dec. 20, 1982) (as amended, D.O. Apr. 11, 1983).

³⁸*Reglas Complementarias de Control de Cambios Relativas a Estudios en el Extranjero* (Exchange Control Supplementary Rules for Studying Abroad) (D.O. Feb. 8, 1983).

eign currency may be acquired at the controlled rate to transfer money to students outside of Mexico in two cases: (1) when scholarships granted by the National Council of Science and Technology, and (2) when approved by the Council or the Central Bank as trustee of the trust created by the federal government entitled The Fund for the Development of Human Resources.

G. PAYMENT OF PREVIOUS OBLIGATIONS

To facilitate repayment of obligations in foreign currency payable outside of Mexico and the restructuring of foreign debt, the government has undertaken four programs to: agree with foreign banks on the principles for the restructuring of the Mexican public debt; create a program for the payment of the public debt to foreign suppliers; create special deposits for the payment of interest on the public debt; create a program to cover exchange risks deriving from the existence of foreign debt. The first is beyond the scope of our topic, and therefore only the last three programs will be addressed here.

1. *Repayment of Matured Indebtedness to Foreign Suppliers*

Under this program, the Mexican debtor creates a deposit in Mexican currency with a Mexican bank and in favor of the supplier. The supplier must consent to the creation of the deposit and accept as payment the rights deriving from it. The supplier may transfer these rights to third parties. In accordance with the program, the Central Bank pays the foreign creditor pursuant to the repayment schedule established on July 19, 1983. This program does not apply to payments to other Latin American countries whose central banks have compensation agreements with the Mexican Central Bank. In these cases, payments are made in accordance with the appropriate agreement.

2. *Deposits for the Payment of Interest*

The Central Bank telex circular 121/82 of December 19, 1982 authorized Mexican banks to open accounts in U.S. Dollars in favor of foreign financial entities. The debtors may deposit Mexican currency in these accounts to pay interest on loans granted by these foreign entities maturing between August 1, 1982 and January 31, 1983. Ten percent (10%) of these amounts were paid by the beginning of February 1983 and up to ten percent will be paid in the following months, depending on the availability of foreign currency. Unpaid balances by September 30, 1983 are negotiable by the Central Bank with the foreign financial entities.

3. *Program to Cover Exchange Risks*

In March 1983, the federal government and the Central Bank created a special trust pursuant to the Executive Order Authorizing the Creation of

the Trust for the Coverage of Exchange Risks.³⁹ The Central Bank, which serves as trustee for the trust, announced the program to cover exchange risks on April 6, 1983. The basic purpose of the trust is to cover and exchange risks in the case of indebtedness incurred prior to December 20, 1982 that remains unpaid for any reason. The trust establishes four different systems by which the debtor may cover exchange risks involving indebtedness in foreign currency. The first covers the exchange risk with respect to the principal amount of the indebtedness by means of a cash payment in Mexican currency. The second covers the exchange risk with respect to principal by enabling the debtor to obtain a loan for its repayment. The third system permits covering the exchange risks with respect to principal and unmatured interest through a cash payment in Mexican currency. And the fourth system permits covering the exchange risks of unmatured principal and interest by enabling the debtor to obtain credit in Mexican currency.

The trust only applies to indebtedness incurred prior to December 20, 1982 from loans in foreign currency payable outside of Mexico in favor of Mexican banks or foreign suppliers, provided that, under the third and fourth systems, the indebtedness is duly registered with the Ministry of Finance and Public Credit or the Ministry of Commerce and Industrial Promotion, as the case may be. In all cases, the indebtedness must be "long-term" indebtedness, or be restructured into a long-term basis. In the case of the first and second systems, "long-term" indebtedness is indebtedness payable in six years from the fifth day of the month following the agreement to cover the risk, by means of quarterly equal payments, with a grace period of not less than three years. In the case of the third and fourth systems, indebtedness payable in eight years with a four-year grace period is "long-term" indebtedness.

Each of the four systems deserve further explanation. Under System 1, the debtor may acquire foreign currency at a very cheap rate of exchange by a cash payment of the amount to the Central Bank as trustee. The debtor must acquire this foreign currency by a cash payment. The trustee then delivers, outside of Mexico, in equal quarterly installments, the amounts of matured principal required to discharge the payment obligations of the debtor. Under this system, the debtor is liable for the payment of interest on foreign currency that may be acquired at the controlled rate of exchange from the bank with which the agreement to cover the exchange risk was executed. System 2 is essentially the same as the first one, except that the debtor obtains a loan in pesos to acquire the foreign currency. Under System 3 the debtor may acquire foreign currency at the controlled rate by a cash payment not later than the fifth day following the date of execution of the

³⁹*Acuerdo por el que se Autoriza la Constitucion del Fideicomiso para Cobertura de Riesgos Cambiarios (FICORCA)* (Executive Order Authorizing the Creation of the Trust for the Coverage of Exchange Risks) (D.O. Mar. 11, 1983).

agreement with the bank covering the exchange risk. With the dollars acquired from the trust, the debtor must simultaneously grant to the bank a loan in an amount equal to the amount of foreign currency acquired. The term must be eight years, with a four-year grace period for the payment of principal, paying interest at the London Inter Bank Offering Rate (LIBOR). It is possible to cover the principal and interest up to the amount equal to that offered on three month LIBOR deposits under this system. System 4 is essentially the same as System 3, except that the debtor may obtain loans in Mexican currency to acquire the foreign currency.

V. Conversion into Mexican Currency

A. INDEBTEDNESS IN FOREIGN CURRENCY PAYABLE IN MEXICO

Under article 8 of the Mexican Monetary Law, obligations in foreign currency undertaken to be paid in Mexico are payable in Mexican currency at the exchange rate in force at the time of actual payment. It is perfectly possible to undertake valid obligations in foreign currency, but if the obligations are payable in Mexico, the debtor may make the payment in Mexican currency, and the applicable rate of exchange will be that in force at the time of actual payment. This provision has never been repealed, and is therefore still in force. Thus, no restrictions prevent Mexican residents from undertaking obligations in foreign currency.

An in-depth consideration of whether it is legally possible in the case of obligations in foreign currency payable in Mexico to make the payment in foreign currency if the parties so agree by the time of payment is beyond the scope of the article. However, it is clear that such an agreement will not be valid if executed before payment, since this is clearly forbidden by article 9 of the Mexican Monetary Law. But it is unclear whether payment *may* be made in foreign currency or *must* be made in Mexican currency when the parties are willing to deliver and accept foreign currency.

Since several exchange rates presently exist, clarification is necessary of which rate applies to make the conversion into Mexican currency of indebtedness in foreign currency payable in Mexico. In theory, several responses are possible. As a general rule, the conversion must be made at the free market rate; in the case of transactions subject to control, the conversion must be made at the controlled rate. A second approach would be to apply one rate (either the free market or the controlled rate) to all cases. A third possibility would be to establish a special rate of exchange for the conversion of obligations in foreign currency into Mexican currency.

The Exchange Controls Decree adopts a solution which mixes these three possibilities. In the case of obligations incurred *before December 20, 1982*, the special rate enacted from time to time by the Central Bank applies. This

special rate may be one rate or several rates, depending on the facts and circumstances of the transactions. This rule does not apply to indebtedness covered by the special program of the Central Bank to cover foreign exchange risks,⁴⁰ for which the Central Bank has established only one special rate. The special rate applicable to indebtedness incurred before December 20, 1982 is equal to the controlled rate for sale.⁴¹

In the case of indebtedness incurred *after December 20, 1982*, the conversion must be made at the controlled rate for sale, although the Central Bank may exclude from this general rule those cases it considers appropriate, taking into consideration the circumstances of particular transactions.⁴² In fact, the Central Bank has determined that the applicable rate of exchange would be that agreed to by the parties in the following two cases:⁴³ (i) payments to enterprises rendering public transport services; provided, the indebtedness derives from the transport of persons or goods from abroad to Mexico or from Mexico abroad; and (ii) payments to enterprises of international credit cards; provided, the indebtedness derives from expenses incurred outside of Mexico.

B. CONVERSION OF AMOUNTS IN FOREIGN CURRENCY FOR TAX PURPOSES

The payment of Mexican taxes in the case of amounts of foreign currency raises the issues of the timing of the conversion into Mexican currency and which exchange rate to apply. For this purpose, it is necessary to distinguish taxes to be withheld by Mexican residents on payments made or to be made to foreign creditors from taxes which are paid outside of Mexico.

Article 20 of the Fiscal Code clearly provides that Mexican taxes are incurred in Mexican currency and must be paid in Mexican currency. If the tax has to be paid outside of Mexico, payment may be made in the currency of the country in which payment is made. The same provision provides that, for the payment of taxes and accessories, conversion must be made at the rate of exchange fixed by the Ministry of Finance and Public Credit by means of general provisions published in the Official Gazette.⁴⁴ On the other hand,

⁴⁰Decree, art. 6.

⁴¹See the *Determinacion de Tipos de Cambia* (Determination of Exchange Rates), published in the Official Gazette of April 12, 1983.

⁴²Decree, art. 12.

⁴³See the second provision of the *Determinacion de Tipos de Cambio*, published in the Official Gazette of December 20, 1982.

⁴⁴The provision is *doubtfully* valid from a constitutional point of view, because pursuant to the *Ley Reglamentaria de la fraccion XVIII del articulo 73 Constitucional, en lo que se refiere a la facultad del Congreso para determinar el valor relativo de la moneda extranjera* (Ruling Law of Section XVIII of the Constitution, art. 73, concerning the authority of Congress to determine the relative value of foreign currency), Official Gazette, December 27, 1982, the rate of exchange must be fixed by the Central Bank and the Ministry of Finance has no authority on the subject.

article 144 of the Income Tax Law clearly provides that, in the case of taxes to be withheld by persons resident in Mexico to creditors outside of Mexico, the conversion must be made at the exchange rate in force at the time of maturity of the payment.

Under the rules for the Fiscal Year of 1983 dated March 31, 1983, the applicable rate is the controlled rate or the free market rate, as the case may be, pursuant to the Decree (rule 42). Thus, in the case of payments made by Mexican residents to creditors domiciled abroad, if such payments are in foreign currency and subject to Mexican income tax, the tax is determined by converting the amounts of the payment into Mexican currency at the controlled or free market exchange rate, as the case may be, in force at the time of maturity of such payments.

It is not clear from the rules and regulations, however, if the controlled rate applies whether or not the debtor has actually acquired controlled foreign currency to make such payments. For example, assume that a borrower receives from an American bank a loan registered with the Ministry of Finance and Public Credit, and has to determine the Mexican income tax. Assume also that the transaction has been duly registered with the Ministry of Finance and Public Credit and entitles the borrower to acquire foreign currency at the controlled rate. Finally, assume that the borrower has no cash with which to pay the tax. Under the circumstances, the borrower is obligated to pay to the Mexican authorities an amount equal to the tax as if the payment is made. What remains unclear is whether the borrower must, in this case, make the conversion at the controlled rate (since he is entitled to acquire foreign currency at the controlled rate) or at the free market rate (although entitled to acquire foreign currency at the controlled rate, he is not obligated to do so, and assuming he actually has not acquired at the controlled rate). In these cases, I consider the applicable rate of conversion for tax purposes to be the free market rate; the controlled rate should apply only when the debtor acquires foreign currency at the controlled rate to produce payment, or when the debtor makes payment in foreign currency subject to controls.

Notwithstanding the above, on April 21, 1983, the Ministry of Finance and Public Credit published an "Acuerdo" (an "Executive Order") by which the controlled rate for sale must be used for tax purposes in all cases. If this "Acuerdo" is followed, it may create several problems in those cases in which the person making the payment is not entitled to acquire foreign currency at the controlled rate, or, although entitled, has not in fact done so.

