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# TRANSFERS OF TECHNOLOGY IN MEXICO

DAVID H. BRILL, JR.\*

## I. INTRODUCTION

In its pursuit to lessen Mexican economic dependence upon foreign economic interests, the Mexican government, through the Congress, enacted two basic laws which came into effect in 1973. One was the Law to Promote Mexican Investment and Regulate Foreign Investment,<sup>1</sup> while the other was the Law on the Registration of the Transference of Technology and the Use and Exploitation of Patents and Trademarks<sup>2</sup> [Technology Law]. Although both laws are the cornerstone of Mexico's new economic nationalism, it is my purpose to comment on the Technology Law (*Ley sobre el Registro de la Transferencia de Tecnologia y el Uso y Explotacion de Patentes y Marcas*).

There is general agreement among Mexican government circles and the national business community that Mexico, as most developing countries, requires a considerable amount of foreign technology to speed up the rate of development. There obviously must be technological interdependence not only between the developing countries and the industrialized countries, but between the industrialized countries themselves. However, the Mexican government felt that the foreign suppliers of technology were in many cases taking advantage of the Mexican users by supplying inadequate or obsolete technology at high prices. The Mexican government also felt that the foreign supplier of technology frequently imposed improper restrictions on the Mexican user, particularly in the exportation of products produced in Mexico using foreign technology. Such restrictions impeded the development of Mexico's program for exportation of manufactured goods.

## II. TAX REFORMS—TECHNICAL ASSISTANCE PAYMENTS

Before January 1, 1971, the Mexican Income Tax Laws, in some cases, led to abuses by the foreign purveyor of technology. This was particularly true in the case of Mexican subsidiaries of foreign companies which furnished these subsidiaries with technical services. The Income Tax Law applied a fixed rate of 20 percent on the gross amount of the technical service payment made to the foreign supplier of the service. At the same time, payments of royalties for patents and trademarks were subject to essentially the same progressive rate as the corporate tax rate and, as of the date mentioned above, could

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1. *Diario Oficial*, March 9, 1973.

2. *Diario Oficial*, Dec. 30, 1972.

reach 42 percent of the gross payment. It obviously was very beneficial for the foreign supplier of technology, who at the same time was the major stockholder in the Mexican company, to charge as much as he could for technical services at the expense of royalties and dividends. There was of course a double fiscal benefit since the technical service payments made were not only taxed at a very favorable rate, but were also deductible as a normal business expense. Payments of as much as 10 to 15 percent were not uncommon, and in some cases it would have been difficult to demonstrate that the services actually rendered were worth the payment. Furthermore, technical service payments were often made to companies domiciled in capital sanctuary countries like Panama, Liechtenstein and the Bahamas. These payments consequently were subject to little or no taxation in the recipient country, and frequently, the company in the capital sanctuary country receiving the payment was merely a paper company with no facilities of its own to render the technical services.

The Mexican fiscal authorities proceeded to amend the Income Tax Law to remedy these abuses. The law was amended to provide that the company receiving the technical service payment must possess its own facilities to the degree necessary to actually render the services. Such companies could no longer designate another company located in a high tax area to actually render the technical service. Fiscal authorities also became more inquisitive as to the actual services rendered and would disallow deductions for technical services when the Mexican user did not have sufficient documentation in the form of plans, formulas, correspondence, copies of proper immigration documents, etc. to prove that the technical services were actually rendered and received.

Patents and trademarks may of course be owned by companies established in capital sanctuary countries. However, the entire income tax question has become moot, since as of January 1, 1971, the income tax rate on technical services follows essentially the same progressive schedule as the tax on patents and trademarks and on corporate earnings, reaching 42 percent in all cases. The essential difference is that in the case of technical services and patents and trademarks the tax is payable on the gross payment, while on the corporate income, tax is applied to net earnings. The Mexican user is obligated, and held jointly liable under Mexican tax laws, to withhold from payments on technical services and patents and trademarks the appropriate tax and pay it to the fiscal authorities on behalf of the foreign purveyor or owner of the industrial property involved.

### III. THE TECHNOLOGY LAW

In addition to the very significant tax reforms which effectively eliminated tax abuses, arising from technical service and industrial

property payments, the Mexican Government saw fit to further regulate the transference of technology, and the use and exploitation of patents and trademarks, through the new law governing these activities. This law does not touch nor affect the registration of ownership of patents and trademarks which are governed by the Law on Industrial Property.<sup>3</sup> The new law requires the registration and approval of the transference of technology and the use and exploitation of patents and trademarks.

A. *Introductory Articles—Registration*

Article 1 of the Technology Law provides for the formation of a National Registry of Transference of Technology under the Department of Industry and Commerce. A previous law created the National Council of Science and Technology, charged with the development of basic scientific research and practical technology in Mexico. The Technology Law provides that this Council shall act as a consulting body to the Department of Industry and Commerce for the implementation of the Law.

Article 2 requires the registration of any document or contract of any kind which will result in any act being carried out in Mexican territory with reference to:

- a) The licensing for the use of or authorization to exploit trademarks;
- b) The licensing for the use of or authorization to exploit patents and improvements thereto, models and industrial drawings or designs;
- c) The furnishing of technical know-how, and technical services through plans, diagrams, models, instructions, formula, specifications, training of personnel, etc;
- d) The providing of basic engineering services or details for installations or manufacture of products;
- e) Any type of technical assistance; and
- f) Administrative services and services for the operation of companies.

Not covered by the Law are, among other things, copyrights, commercial names and commissions paid to foreign commission agents engaged in promoting the export of Mexican goods and services. The fact that copyrights are not covered permits a certain flexibility not only in the copyright field, but in any type of design which is subject to copyright, such as furniture and clothing designs.

As Article 2 specifically refers to the licensing of use or authorization, it is clear that the outright sale of patents and trademarks is not subject to the Law. It would seem that a sale of patents and trademarks could be made at any price agreed upon. Perhaps someday a

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3. Diario Oficial, Dec. 31, 1942.

tax audit might raise the question as to whether the purchase price was a reasonable business expense, but this is an entirely different problem.

Physical or juridical persons of Mexican nationality or foreign residents or companies or branches established in Mexico which intervene in, or are beneficiaries of, any of the acts or agreements covered by this Law, have the obligation to request registration of such acts. The foreign purveyors of technology, resident abroad, may request registration of any act in which they take part. Consequently, there are at least two parties in each agreement who may request registration of the agreement, although the obligation is only upon the party resident in Mexico.

The Law of course emphasizes the transference of technology from a foreign purveyor to a Mexican user. However, contracts between two Mexican companies covering those acts regulated by the Law must also be registered. It is true that the Registry authorities tend to look more benignly on contracts between two Mexican companies, even when foreign controlled, than where the purveyor is located outside of Mexico.

Article 4 requires that contracts to be registered must be presented within 60 days following the date of their execution. If they are presented within this period of time, once registered, they will be considered as valid from the date of their execution. If they are presented more than 60 days after execution, their validity is only from the date on which they are presented. All amendments to any registered contract, as well as notice of early termination of an agreement, must also be presented for registration.

The teeth in the Law are contained in Article 6, which states that any contracts or amendments not registered will produce no legal effect whatsoever and, consequently, cannot be enforced before any administrative or judicial authority. This is, of course, also applicable for all tax considerations and any deductions made for payments under an agreement not duly registered will be disallowed by the tax authorities. Even royalty-free contracts must be registered, although the difficulty of registering a royalty-free contract is slight.

#### *B. Restrictive Clauses—Grounds for Refusal*

Article 7 provides 14 different conditions, any one of which, if included in an agreement, is grounds for refusing registration. These are as follows:

1. *When the technology is freely available in the country as long as the same technology is involved.* The application of this condition is very difficult because of the many types of technology available in almost an infinite variety of situations. The Registry has a Technical Department made up of engineers, technicians and spe-

cialists in various fields. They in turn are empowered to call upon the National Council for Science and Technology to help locate and evaluate applicable technology in any given case. One of the two most common grounds for requesting reconsideration of a rejected registration is that the technology, which the Registry believes is available in Mexico, is not in fact the same technology as that being contracted and cannot do the job in question. The Registry has been reasonable in listening to well-founded arguments which tend to demonstrate that the technology being furnished is not freely available in the country.

2. *When the price to be paid for the technology being transferred is out of line with the technology acquired, or constitutes an unjustified burden on the national economy.* Within the Registry, the Economic Evaluation Department, among its other functions, approves or disapproves the amount of royalty or technical service payment being contracted. Although nothing in the Law stipulates what the royalty may be nor sets up any guidelines for this royalty, this is, nevertheless, probably the most serious stumbling block as far as the foreign purveyor of technology is concerned. Unfortunately, in many cases, there is disagreement between what the Department of Industry and Commerce is willing to approve and what the purveyor considers the going world price of his technology to be.

It is very difficult to determine what rate of royalty or technical service payment will be approved. As a general rule, the Department of Industry and Commerce has unofficially stated that 3 percent of the total sale of the user of the technology would be the maximum rate, requiring in many cases a lower rate. If it can be shown that the technology is truly unique and that the product or service being produced is of special value to the economy, higher rates may be approved, although there has not been any rate over 6 percent authorized to date. Of course, if the rate is to be applied only to a certain product line and not to the total production of the user, then a higher rate limited to that particular product line can be negotiated.

The situation of a Mexican user, wholly owned or majority controlled by the foreign purveyor of technology, creates a special problem. The Department of Industry and Commerce has tended to disallow any royalty for trademarks between parent and subsidiary, although occasionally approving a rate of one percent. In the case of technical services rendered, and patents licensed, by the parent to the subsidiary, the Department has been more lenient and has usually judged these contracts on their merits. There is, generally, no restriction on the Mexican user paying a royalty or technical service fee to more than one foreign purveyor, if the foreign purveyors are unrelated. In other words, it is entirely possible to justify a 3 percent

royalty to each of two, or more, unrelated foreign purveyors. The problem of pricing technology will probably remain as the greatest point of contention between the purveyor and the Department of Industry and Commerce.

3. *When clauses are included by which the purveyor is permitted to regulate, or to intervene directly or indirectly, in the administration of the acquirer of the technology.* Under Mexican law, the administration of a company generally refers to the Board of Directors. It would be a most unusual contract which permitted the purveyors of technology to interfere with the operation of the Board.

4. *When the acquirer is obligated to transfer, whether for consideration or gratuitously, to the purveyor of the technology, any patents or improvements obtained or developed by the acquirer.* In the past, many contracts have required the licensee to transfer to the licensor any such improvements. Although this is no longer possible, there would seem to be no prohibition on obligating the acquirer of the technology to license to the licensee, although not transfer in ownership, any improvements developed by the acquirer.

5. *When limitations are placed upon the acquirer with reference to research or technological development.* This does not seem to be a serious matter as such limitations have always been extremely rare.

6. *When the licensee is obligated to acquire tools, equipment, parts or raw materials exclusively from a determined origin.* In addition to commercial considerations, this clause has generally been put in to assure the licensor that high quality standards are maintained by the licensee, and often this could only be done by purchasing certain material from the licensor. However, as long as this is not an exclusive obligation, there would seem to be no prohibition upon the licensee being obligated to purchase a certain amount of equipment or material from the licensor.

7. *When exportation of the goods or services produced by the acquirer is prohibited or limited in a manner contrary to the interests of the country.* This is one of the most important considerations in determining whether an agreement shall be registered. In many cases, it has been the custom of the licensor to drastically limit the export possibilities of the licensee, usually to protect the licensor's own national market, its other export markets or countries where it already has license arrangements. Such restrictions are basically in contradiction with one of the principal, current Mexican economic policies, which is to encourage exportation in every way possible. However, some limitation on exportation is possible, if not contrary to the interests of the country, as determined by the Department of Industry and Commerce. It is difficult to determine what this means

except in each individual case. However, it is easy to imagine that a world wide prohibition on exportation would be completely unacceptable, whereas limitation in certain areas where existing license agreements already were in force, would probably be acceptable. Where there are already license agreements emanating from the same licensor, the domestic legislation of the other countries in question would, usually, prohibit the importation of the same licensed products from a third country, thereby eliminating in most cases the need for export restrictions.

8. *When the use of complementary technology is prohibited.* Normally this is not a problem.

9. *When the acquirer is obligated to sell exclusively to the purveyor of technology the goods produced under the technology agreement.* The operative word, again, would seem to be "exclusively," and as long as the obligation was non-exclusive, we would not anticipate any objection. Also, there seems to be no restriction on naming the purveyor of the technology as sales agent for export. Such designation could be exclusive, although the acquirer would be free to accept or reject the export opportunities presented by the agent.

10. *When the acquirer is obligated to permanently utilize personnel designated by the purveyor of the technology.* Again, this would not seem to present any difficulty, as rarely, if ever, does the purveyor expect to have a technician on a permanent basis at the plant of the user. It is quite normal to have such technicians for a temporary period, which would vary in accordance with the uniqueness or difficulty of the technology concerned. In any event, the immigration authorities, upon authorizing the work permits of such foreign personnel, generally limit them in time and usually require that two or more Mexicans be trained in the same speciality.

11. *When the volume of production is limited or when prices for sale or resale either nationally or for export are imposed by the purveyor upon the acquirer.* The Department of Industry and Commerce prohibits any clause which requires return of technical information, except for patented data, upon expiration of the contract, on the grounds that such return would henceforth limit production. Additionally, the licensee cannot be restricted from manufacturing licensed products, after termination of the license agreement.

12. *When the acquirer is obligated to enter into exclusive sales or representation agreements with the purveyor of technology, in national territory.* Normally, the acquirer wishes to be named exclusive agent, which would not, in fact, be prohibited by this restriction. Rather, this restriction is an attempt to prevent the usual clause, that the acquirer cannot engage in the production of a competitive product or undertake a competitive representation. This can cause serious



trouble for the purveyor, but is one of the restrictions which can be waived by the Department of Industry and Commerce, as will be seen below.

13. *When excessive period is established for the life of the agreement.* In no case may such periods exceed 10 years obligation upon the acquirer. This means that 10 years is the maximum period which may be obligatory upon the acquirer of the technology. However, there is nothing to prohibit a contract which is obligatory upon the purveyor, but voluntary on the part of the acquirer, after the 10 years have expired. In many cases, the Department of Industry and Commerce is insisting upon lesser periods than 10 years.

14. *When any differences or interpretation or compliance with the agreements are submitted for resolution to foreign tribunals.* This of course is one of the pillars of Mexican economic policy and is not subject to waiver by the Department of Industry and Commerce. This restriction would apply only to foreign courts but not to foreign arbitration tribunals and therefore disputes could be submitted to the various existing international tribunals for arbitration which have been often designated in these contracts in the past. All contracts must also be governed by Mexican law, and no clause stipulating the application of a foreign law will be allowed.

Article 8 permits the Department of Industry and Commerce to register those contracts which violate one or more of the foregoing restrictions, when the technology being transferred is considered of particular interest for the country. However, the Department may not waive those restrictions stipulated in numbers 1, 4, 5, 7, 13 and 14.

### C. *Activities Not Subject to Registration*

There are certain activities, according to Article 9, not included within those acts or agreements subject to registration. These include the following:

1. *The use of foreign technicians for the installations of factories and machinery or to carry out repairs.* This is a most important point to keep in mind when determining the technical service fee applicable to the initial installation of equipment. Rather than list this charge as a separate item, it is more convenient to include it within the overall purchase price of the machinery and equipment.

2. *The furnishing of designs, catalogues or assistance in general which are acquired with machinery or equipment and which are necessary for installation as long as this does not imply an obligation to make subsequent payments.* This point, similar to the foregoing, emphasizes the necessity of not separating charges for these items from the overall price of the equipment being purchased.

3. *Assistance in repairs or emergencies, as long as this is derived from some act or contract which had been previously registered.* Notwithstanding the provisions of this paragraph, it is believed that subsequent emergency repairs, implied or explicit, in the warranty of the sale of any equipment, are not subject to the Technology Law.

4. *Instruction or technical training provided by educational institutions, personnel training centers or by companies to their workers.*

5. *The operations of In Bond, or jobbing plants, which are regulated by special legal rules or dispositions.* These "In Bond" plants are, generally, engaged in labor intensive manufacturing procedures, and their entire output is exported. These plants enjoy privileged treatment under the Foreign Investment Law, wherein they may be wholly foreign owned and may, also, import machinery, raw materials, components and semi-finished parts free of duty. Following this privileged treatment, the Technology Law totally exempts these operations from its terms.

*D. Acceptance, Rejection and Reconsideration*

In order to prevent bureaucratic delay, Article 10 requires the Department of Industry and Commerce to determine whether a contract shall be registered within 90 days of the presentment for registration. If the Department fails to render any resolution during that period of time, contracts shall be automatically registered. Insufficient time has transpired to determine the policy of the Department of Industry and Commerce as to the percentage of contracts which will be accepted for registration.

Transitory Article II of the Law provides that arguments executed before the effective date of the Law would enjoy a period of two years to adjust to the dispositions of the law and to be registered. In order to enjoy this two year grace period, it was necessary to present existing contracts to the Registry officials, within 90 days following the date on which the law went into effect, in order to take note of same (not to register them). Although the Law went into effect on January 30, 1973, the Registry officials computed the 90 day period on the basis of official government working days, and thus the period expired on June 25, 1973. Up to that date, virtually no contract was presented for registration, but only for taking note thereof. Subsequent to that date, new contracts enjoy a period of 60 official working days from the date of execution to be presented for registration, after which government has 90 official working days to accept or reject them. In reality, this is a period of anywhere from 6 to 7 months subsequent to June 25, 1973, and therefore, it can be seen that not too many contracts have been either accepted, or rejected, as of the date of this writing.

It would be fair to state that the majority of contracts presented for registration, and acted upon, have been initially rejected by the Department on the basis that they did not comply with some requirement of the Law. The majority of these rejections have been based on the allegation of the Department of Industry and Commerce that the royalty was too high.

In case of rejection, the affected party may, under Article 14 of the Law, request a reconsideration of the resolution, accompanying any elements of proof which he deems pertinent. A period for hearing the proofs will be opened, and after all elements of proof are presented, the Department of Industry and Commerce must resolve the reconsideration within 45 days. If the Department has not rendered its decision upon the reconsideration within that period, it will be presumed that the reconsideration is resolved in favor of the moving party. Currently, we know of a number of contracts under reconsideration, which have been finally rejected. In several cases the reconsiderations have been resolved in favor of the moving party. But we shall need several more months of experience before we can determine the current policy of the Department of Industry and Commerce.

If administrative reconsideration should be denied, the affected party has other judicial remedies available. If he feels that his constitutional rights have been violated, for example, failure of the Department to properly motivate the original denial of registration or of the reconsideration, the affected party may bring an "amparo" proceeding in a Federal District Court. The best procedure is of course to negotiate the terms of the contract prior to its initial rejection and, certainly, prior to any negative ruling upon the reconsideration.

Article 11 of the Technology Law permits the Department of Industry and Commerce to cancel the registration of any contract which is amended or altered in a manner contrary to this Law.

#### IV. CONCLUSION

The National Registry for the Transference of Technology is not a public registry and, consequently, not open to the public. As a matter of fact, one of the concerns of the owner of the technology is the fear that secrecy might be violated and confidential manufacturing processes divulged to competitors. To try to avoid this problem, Article 13 states that the personnel involved in the operations of the Registry are obligated to maintain absolute secrecy with respect to the technological information subject matter of the agreements or acts which must be registered.

The supporters of the Technology Law believe that it will help ensure Mexico's economic independence without impeding the trans-

ference of technology so essential to its economic development. As in the case of every well-intentioned law, its success rests in the hands of those entrusted with its implementation.

