

New FIBRA-E investment structure for the Energy Industry in Mexico

Background

The Mexican authorities have published the rules setting out the requirements for the creation of a new Energy and Infrastructure Investment Trust (FIBRA-E), in addition to details on the tax regime that will be applicable to these types of vehicles.

The new FIBRA-E will provide vehicles for investment by both, investors and the general public, offer significant tax and economic advantages similar to the Master Limited Partnership (MLP) structures used in other countries. This structure effectively permits a deferral of income tax of up to 5% of the taxable profits on the activity and eliminates the Mexican dividend tax on distributions pertaining to the designated activities.

General aspects

The FIBRA-E will be required to invest in entities (Qualifying Companies) that engage in, operate and generate its revenues from one of the following “exclusive activities”:

- Those provided in article 2 of the Hydrocarbons Law, not including the recognition, seismic testing, exploration and production of hydrocarbons and the transfer, commercialization or sale to the public of hydrocarbons.
- The generation, transmission and distribution of electricity.
- Investment projects involving contracts between the public and private sectors for the provision of services to the public sector or final user, provided that the projects are in operation at the time of the investments made and have a remaining term of at least seven years. The investment projects can be in any of the following areas:
 - Roads, highways, railways and bridges;
 - Urban transportation systems;
 - Ports, maritime terminals and port facilities;
 - Civilian airfields, excluding those with private services;
 - Growth of the nation’s telecommunications network;
 - Public safety and social regeneration;
 - Drinking water, drainage, sewerage and wastewater treatment.

Key considerations of FIBRA E compared to FIBRAs and CKDs

- The FIBRA-E must invest in projects or assets of the energy and infrastructure sector. It is distinct from the Mexican investment trust vehicles currently in existence and commonly used, such as the Real Estate Trusts (*Fideicomiso de Inversión en Bienes Raíces*, or “FIBRA” an acronym in Spanish) which focuses on investments and rights to income from the leasing of real estate; or Development Trusts (“CKDs” an acronym in Spanish), which can be used for broader activities including investments in infrastructure projects, real estate, mining, business in general, technology development among others.
- Unlike the Fibra-E, the FIBRA and CKD may make investments during the development stage. However, these projects normally require greater resources. The objective of the investments in Fibra-E is that businesses in this sector with ongoing projects may obtain resources from the FIBRA-E so that they can destine them to other projects from within the sector.
- As with FIBRAs, the FIBRA-E must distribute at least 95% of their taxable income each year (subject to certain rules). This makes investments in the FIBRA-E an attractive option for the investment market. It’s worth noting that the need for reinvestment for energy and infrastructure projects should also be considered, so it is likely that in the future this requirement will be more flexible. In the case of CKDs distributions shall be made when the projects reach maturity and positive cash flows.
- As in the case of CKDs and FIBRAs, the FIBRA-E is an equity instrument that does not require a credit rating from a credit rating institution. However, in these cases the participation of an independent appraiser is required to determine if the investments or other

assets of the FIBRA-E have been valued reasonably. Additionally, the involvement of an expert appraiser may also be required for certain assets, for example, in the case of the FIBRA-E for investments in hydrocarbon reserves.

- Whether the issue of FIBRA-E will be carried out through capital calls has not been specified (capital calls are possible in the case of CKDs and FIBRAS).
- The need for security guarantees or personal guarantees for FIBRA-E has not yet been clarified (no such guarantees are required by CKDs or FIBRAS).
- The level of indebtedness permitted for FIBRA-E it is not mentioned in the rules it may be reasonable to assume that there will be no restrictions (CKDs are required to set their own parameters regarding leverage or debt coverage). In the case of FIBRAS their indebtedness is limited to 50% of value of assets, although this may be modified if prior approval has been provided by the Technical Committee).

Key tax considerations

The administrative rules released by the Mexican authorities establish the tax regime applicable for the FIBRA-E, the holders of CBFs issued by the FIBRA-E and also Qualifying Companies whose shares are contributed to a FIBRA-E.

In general, the tax regime for investment trusts such as the FIBRA is set out in articles 187 and 188 of the Income Tax Law (Mexican Income Tax Law or "MITL"). However, the tax regime is provided in administrative rules for FIBRA-E vehicles (3.21.3.7 and 3.21.3.8) which include various exceptions and require that FIBRA-E to comply with the following:

- The primary activity of the FIBRA-E is the investment in shares issued by Qualifying Companies resident in Mexico whose exclusive activity is one or any combination of the "exclusive activities" mentioned above.
- At least 90% of the accruable income received by the FIBRA-E from its investment in Qualifying Companies must be derived from "exclusive activities" under certain rules. No more than 25% of the non-monetary assets of a Qualifying Company can be invested in assets considered as new tangible assets, those with less than 12 months of being acquired and put into operation in Mexico by the Qualifying Companies.
- The FIBRA-E must distribute at least 95% of its determined tax result on an annual basis under certain rules.
- Distributions made by the FIBRA-E to holders of its CBFs will be subject to income tax withholding at a 30% rate, unless the holders of the CBFs are exempt from tax on such distributions.

- CBFs issued by the FIBRA-E must be registered at the National Securities Registry of the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores).

Treatment of Qualifying Companies

Under the rules, the tax regime for Qualifying Companies who undertake the "exclusive activities" will be the same as that applicable to business Trusts and shall meet the following requirements:

- Qualifying Companies must distribute their taxable income to stockholders, including the FIBRA-E, however, these distributions will not be subject to income tax withholding, including the 10% withholding tax for shareholders who are individuals or those who are residents abroad.
- Qualifying Companies will not need to make monthly estimated income tax payments.
- The sale of shares issued by Qualifying Companies will have the same tax treatment applicable for the sale of land, fixed assets or deferred expenses, as the case may be.
- Gains resulting from the sale or contribution of shares issued by Qualifying Companies to the FIBRA-E cannot be deferred for income tax purposes. The FIBRA-E must be able to take into account the profit or loss obtained from the sale of such shares in order to determine the taxable income, subject to certain conditions, which must be distributed among its trustees.

Holders of CBFs

The tax treatment for distributions made by the FIBRA-E to holders of CBFs will depend on the nature of each CBF holder.

The sale of CBF investment units will be exempt from income tax when the CBFs have been offered to the public and the sale is realized by those who are: a) exempt from tax in Mexico; b) individuals resident in Mexico; and c) foreign residents without a permanent establishment in Mexico.

Non-residents

Foreign pension funds will be subject to income tax on distributions received from their participation in the FIBRA-E.

The participation in a FIBRA-E by foreign residents will create a permanent establishment in Mexico for income tax purposes. However, such entities will be exempt from the compliance with formal tax obligations (e.g. obtaining a tax ID number), providing that income tax is withheld on the distributions made by the FIBRA-E. This withholding tax is considered definitive for nonresidents.



PwC support:

At PwC Mexico we are a leading advisory firm in the energy and infrastructure sectors that combines proven expertise in strategic, regulation, financing and taxes, and we can support our clients in:

- Independent valuations of the investments or assets of the FIBRA-E.
- Tax and legal advice relating to the operation of the FIBRA-E, including its projects or investments, in addition to the structuring of the FIBRA-E's operations.
- Undertaking commercial, financial and tax due diligence on targeted Qualifying Companies.
- Corporate Finance and market analysis to assist in the search for new investments in the infrastructure and energy sector.
- General advice as part of the creation of the FIBRA-E and issuance of CBFs.
- Accounting, financial and audit advice for the FIBRA-E and its Qualifying Companies.
- Corporate governance advice for the FIBRA-E.

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