

# Fibra E | Energy and Infrastructure Investment vehicle

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On September 17, drafts of the Fourth Set of Amendments to the Annual Tax Regulations issued by the Ministry of Finance for the fiscal year 2015 (“**Tax Regulations**”)<sup>1</sup> and the amendments to the general provisions applicable to issuers and other stock market participants<sup>2</sup> were released proposing the establishment and regulation of a new investment vehicle called energy and infrastructure investment trust or Fibra E.<sup>3</sup>

With the proposed amendments, the Federal Government intends to create a new investment vehicle called Fibra E to promote investment in hydrocarbon, power and infrastructure projects under a legal and tax regime that is similar to those applicable to *fideicomisos de infraestructura en bienes raíces* (Real Estate Investment Trusts, or “**REITS**”).

Fibra E has been designed using the legal framework of REITS, although the proposed applicable tax treatment is influenced by the U.S. Master Limited Partnerships (“**MLPs**”).<sup>4</sup>

## Fibra E

Fibra E shall be established as security-issuing trusts created pursuant to a trust agreement entered into in accordance with Mexican law, where the trustee, which must be a bank or broker licensed to operate in Mexico, acquires shares in Mexican companies (“**Portfolio Companies**”) devoted exclusively to the activities set forth in the Tax Regulations (i.e., projects related to hydrocarbons, power and infrastructure).

Trusts that adopt the rules applicable to Fibra E will issue trust notes for investment in energy and infrastructure (*certificados bursátiles fiduciarios de inversión en energía e infraestructura*, “**Energy Notes**”), which will be publicly traded in the Mexican stock market, registered in the National Securities Registry and listed on the Mexican Stock Exchange. It is also proposed that Fibra E trusts, like REITS, have an external management structure.

It is expected that Energy Note holders (“**Holders**”) will benefit directly from revenue generated by the projects developed by the Portfolio Companies. To such end, the Portfolio Companies and Fibra E trusts shall be regarded as pass through vehicles for income tax purposes. Additionally, such vehicles will be granted wide flexibility to distribute revenue obtained in their operations (i.e., it is expected that distributions by the Portfolio Company to Fibra E trusts will not be deemed as dividends for tax purposes, that Fibra E trusts will not be

<sup>1</sup> SAT published on its website the Draft of the Tax Regulations, which, once approved and published in the Official Gazette, will define the regulatory framework through which Fibra E trusts are created and regulated.

<sup>2</sup> Through the Federal Regulatory Improvement Commission, the Federal Government submitted for public consideration the draft amendment to the general provisions applicable to issuers and other stock market participants.

<sup>3</sup> Both drafts are subject to change and are not definitive accordingly.

<sup>4</sup> Some sources have referred to such vehicles as “Mexican MLPs.”

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regarded as business trusts (*fideicomisos empresariales*) and further that Fibra E trusts will not be required to make provisional income tax payments).

Holders shall be the taxpayers for purposes of the income tax that is due in respect of the projects in which the Fibra E trusts invest. Accordingly, Portfolio Companies would only be required to determine their taxable income and income tax due to be distributed to the Fibra E trust as if the Portfolio Companies were a trust themselves, and in turn, the trustee or intermediary holding the Energy Notes is required to calculate, withhold and pay income tax in the name and for the account of the Holders based on the taxable income distributed to such Holders.

As any other public securities issuers, Fibra E trusts will be subject to disclosure rules applicable to companies with securities listed on the Mexican Stock Exchange. They will also be subject to corporate governance rules substantially similar to those applicable to REITS, including rules pertaining to holders' meetings, minority rights and powers of the technical committee.

### Permitted Activities

Portfolio Companies shall be dedicated exclusively<sup>5</sup> to any of the following activities ("**Permitted Activities**"), which must be carried out in Mexico:

- Treatment, refining, transportation and storage of oil; processing, compression, liquefaction, decompression, regasification, transportation, storage and distribution of natural gas; transport, storage and distribution of petroleum products and pipeline transportation and subsequent storage of petrochemicals.
- Generation, transmission or distribution of electricity.
- Investment projects in specific areas of infrastructure<sup>6</sup> implemented through concessions, service contracts or any other contractual framework for the provision of services to the awarding authority or end-users, which are at the operation phase and whose remaining term at the time of the Portfolio Company's acquisition of the shares is equal to or greater than seven years.
- Fibra E management activities.

Additionally, it is anticipated that only up to 25% of the average annual book value of the non-monetary assets of Fibra E trusts may be invested in new assets (that is, assets used for the first time in Mexico), reflecting an intent to encourage Fibra E trusts to invest in existing projects with a proven operating track record.

### Tax Regime of Fibra E Trusts

Although Articles 187 and 188 of the Income Tax Law ("ITL") do not include Fibra E trusts (and no such inclusion is proposed in a recent amendment bill submitted by the President), the main requirements and tax treatment proposed for Fibra E trusts are those set forth in such Articles, although with a few adjustments.

Upon complying with the eligibility requirements set forth in Article 187 of the ITL and the Tax Regulations, all participants in a Fibra E trust (i.e., Portfolio Companies, Fibra E trust, trustee, securities depositories holding the Energy Notes, shareholders or partners of the Portfolio Companies ("**Shareholders**") and Holders) may apply the tax regime summarized below:

#### Tax Treatment applicable to Portfolio Companies

- Portfolio Companies will be regarded as pass through vehicles for income tax purposes. To such end, they will regard their Shareholders as if they were undertaking business activities through a trust;<sup>7</sup>

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<sup>5</sup> At least 90% of the taxable income of the entity.

<sup>6</sup> (i) Roads, highways, railways and bridges; (ii) systems for urban and inter-urban transportation; (iii) ports, terminals, marinas and port facilities; (iv) civil aerodromes, excluding those of a particular service; (v) projects for the expansion of the telecommunications backbone network; (vi) public safety and social rehabilitation; and (vii) water, drainage, sewage and wastewater treatment.

<sup>7</sup> Several provisions to regulate such transparency are established. Among them are the characterization of the sale of shares of a Portfolio Company as a sale of assets and that the fiscal year starts and ends upon the Fibra E trust's opting in or out of the Fibra E tax treatment.

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- Portfolio Companies shall not be required to withhold a 10% income tax on dividends distributed to individuals and residents abroad, nor will their shareholders be required to pay income tax on such dividends. Articles 10, 77 and 78 of the ITL will not apply to Portfolio Companies either and as such Portfolio Companies will not be required to pay income tax on amounts distributed to their Shareholders as dividends or as a reimbursement of contributions by reason of a capital reduction;
  - When shares of a Portfolio Company are first acquired by a Fibra E trust, its fiscal year will terminate early on the acquisition date, and the provisions of the general ITL regime will apply to such fiscal year. A new irregular tax year will then be deemed to have begun on the day immediately following the early termination and last until December 31 of the calendar year, and the Fibra E trust must then fulfill its tax obligations applying the Fibra E tax regime;
  - Monetary assets of the Portfolio Company may not exceed more than 5% of its total assets at the time it becomes subject to the Fibra E tax regime or else such assets will be deemed to be distributed to its shareholders as a reimbursement.

### Tax Treatment applicable to Fibra E Trusts

The trustee must determine the taxable income for the respective fiscal year and withhold the applicable income tax of the Holders in accordance with Article 188 of the ITL. To such end, the trustee shall consider the portion of taxable income for the fiscal year for each Portfolio Company, in the proportion that corresponds to such Portfolio Company's shareholding as of the last day of the fiscal year, as well as the deduction of deferred expenses arising from the acquisition of the assets dedicated to the Permitted Activities and operating expenses deductible from the trust itself.

### Tax Treatment applicable to Holders

Holders are subject to the same rules as holders of securities issued by REITS, as follows:

- Holders resident in Mexico or resident abroad with permanent establishment must declare the taxable income distributed to them and shall be entitled to credit the tax withheld against their income tax liability;
- Foreign-resident Holders without permanent establishment will not be required to register with the Federal Taxpayer Registry (RFC) and the withholding of such income tax shall be deemed as a definitive payment;
- Holders who are natural persons or foreign residents without permanent establishment are exempt in respect of the gains obtained in the sale of Energy Notes provided such sale is made in the stock market;
- Foreign pension and retirement funds are exempted from income tax on all income obtained through Fibra E Trusts;
- Income obtained through Fibra E trusts is considered as passive income, hence Fibra E trusts are not considered as business trusts. This is true despite the fact that taxable income distributed to individuals resident in Mexico is considered income from business activities.

*Please note these proposed changes in tax and securities matters are in draft form and, therefore, they remain subject to review and changes and the final content of the provisions to be included as part of the tax and securities regulation is uncertain.*

*Furthermore, we note that further changes will be required to other secondary financial provisions, particularly in connection with investment rules for mutual funds specializing in retirement funds and insurance companies, so that such institutional investors are entitled to invest in Fibra E trusts.*

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