

# Fibra E Trusts | Energy and Infrastructure Investment Vehicle

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On 29 September 2015, the Fourth Set of Amendments to the Annual Tax Regulations for the 2015 fiscal year (“**Tax Regulations**”), which create and regulate a new investment vehicle called an energy and infrastructure investment trust or Fibra E, were published in the Mexican Official Gazette.

Additionally, on October 20, 2015, a resolution was published in the Mexican Official Gazette amending the general provisions applicable to issuers and other stock market participants for the issuance and registration of trust notes for investment in energy and infrastructure (a/k/a Fibra E) in the National Securities Registry.

With the referenced tax and securities amendments, the Federal Government has created 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**”).

The Fibra E has been designed using the legal framework of REITS, although the proposed applicable tax treatment is influenced by U.S. Master Limited Partnerships (“**MLPs**”).<sup>1</sup>

## Fibra E Trusts

Fibra E trusts are established as security-issuing trusts created pursuant to a trust agreement in accordance with Mexican law, with one of its purposes being to acquire 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). Additionally, the Fibra E trust should deal mostly (75%) with mature projects (with at least one year in operation (see: Permitted Assets)).

Trusts that adopt the rules applicable to the Fibra E trust 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 and, for the most part, registered in the National Securities Registry and listed on the Mexican Stock Exchange. Fibra E trusts, like REITS, may also have an external management structure.

Energy Note holders (“**Holders**”) will benefit directly from revenue generated by the projects developed by the Portfolio Companies. To this end, the Portfolio Companies and Fibra E trusts will be regarded as pass-through vehicles for income tax purposes.

<sup>1</sup> The media has referred to such vehicles as “Mexican MLPs.”

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The Holders will be the taxpayers for purposes of the income tax that is due in respect of the projects in which the Fibra E trusts invest through the Portfolio Companies. Accordingly, Portfolio Companies would only be required to determine their taxable income and income tax due to be distributed to the Fibra E trust (in the proportion corresponding to the Fibra E trust's share participation) as if the Portfolio Companies were a trust themselves, and in turn, the trustee or broker dealer holding the Energy Notes is required to withhold income tax applying a rate of 30% of the taxable income distributed to such Holders (except with respect to exempt Holders).

As with any other issuer of securities placed through public offer, Fibra E trusts will be subject to disclosure rules applicable to corporations with securities registered in the National Securities Registry and listed on the Mexican Stock Exchange in accordance with the Securities Law (*Ley del Mercado de Valores*). They will also be subject to corporate governance rules similar, in some ways, to those applicable to REITS (see: Corporate Governance of Fibra E Trusts).

## Requirements for the Fibra E Trust

Although Articles 187 and 188 of the Income Tax Law (*Ley del Impuesto Sobre la Renta*) (“ITL”) have the express purpose of promoting the real estate market and do not include Permitted Activities assigned to Fibra E trusts (and no such inclusion is proposed in a recent tax amendment bill submitted by the President to the House of Representatives<sup>2</sup>), the main requirements and tax treatment applicable to Fibra E trusts are those set forth in such Articles, although with a few adjustments.

Some of the most important of such adjustments to the eligibility requirements in Articles 187 and 188 of the ITL are described below:

- Fibra E trusts (and the Portfolio Companies) must distribute at least 95% of their taxable income each fiscal year.
- At least 70% of the average annual value of the assets of Fibra E trusts must be invested in Portfolio Companies that meet the requirements of performing Permitted Activities and investing in Permitted Assets and the remainder in securities of the Federal Government registered in the National Securities Registry.
- The Fibra E trust must issue Energy Notes for the entirety of its assets.
- Compensation schemes for the Manager, trustee or similar persons, which are subordinated to the payment of a certain fixed or determinable amount, must be set forth in the respective trust agreement.

## Permitted Activities

Portfolio Companies shall be dedicated exclusively<sup>3</sup> to 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.

Recognition, surface exploration and extraction of hydrocarbons, as well as their transfer, commercialization and public sale, are expressly excluded and therefore not considered Permitted Activities.

- Generation, transmission or distribution of electricity.

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<sup>2</sup> Decree amending, supplementing or repealing certain provisions of the ITL, the Law on the Special Tax of Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios*), the Tax Code (*Código Fiscal de la Federación*) and the Federal Law on Budget and Tax Responsibility (*Ley Federal de Presupuesto y Responsabilidad Hacendaria*) presented by the President to the House of Representatives on September 8, 2015.

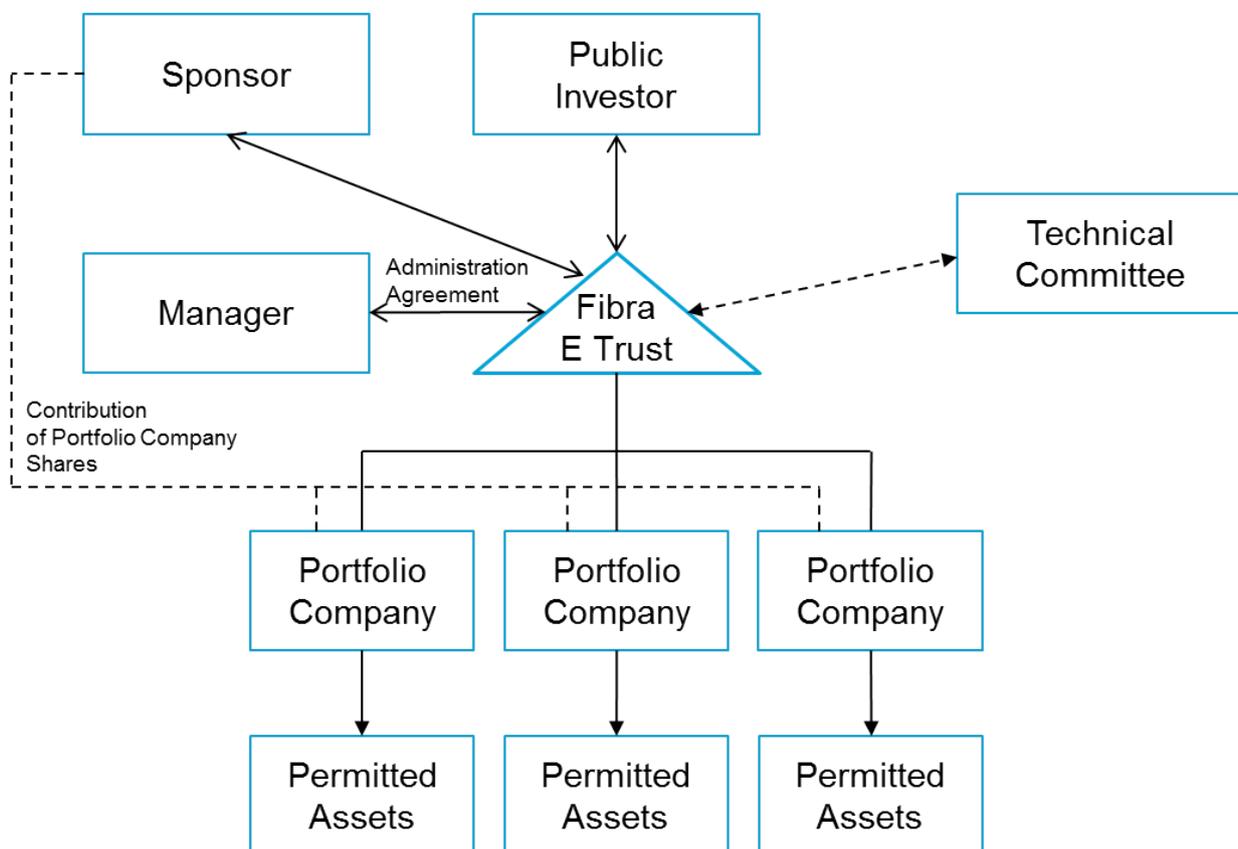
<sup>3</sup> At least 90% of the taxable income of the entity.

- Investment projects in specific areas of infrastructure<sup>4</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.

### Permitted Assets

- No more than 25% of the average annual book value of the non-monetary assets of a Portfolio Company may be invested in new assets. Assets are considered to be new if they have less than 12 months since being *acquired and operated* by a Portfolio Company. That is, at least 75% of the non-cash assets of each Portfolio Company must be mature assets (having at least one year since being purchased and in operation).
- Although there is no eligibility requirement, there is a limit with respect to monetary assets that can be owned by a Portfolio Company at the time of acquisition by a Fibra E trust (See Tax Treatment Applicable to Portfolio Companies).

### Structure of a Fibra E Trust



<sup>4</sup> (i) Roads, highways, railways and bridges; (ii) systems for urban and inter-urban transportation; (iii) ports, terminals, marinas and port facilities; (iv) public airfields, excluding those of a particular service; (v) projects for the expansion of the telecommunications network; (vi) public safety and social rehabilitation; and (vii) water, drainage, sewage and wastewater treatment.

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## Corporate Governance of Fibra E Trusts

### *Energy Note Holder Meetings*

Holder's meetings shall approve, among other matters, the following: (a) changes in the investment regime, (b) rules for incurring (either by the trustee or Manager) of financial liabilities of the assets of the Fibra E, which will establish the maximum borrowing limit, (c) removal and replacement of the Manager (as detailed below), (d) increase in compensation and management fees or any other item on behalf of the Manager, (e) changes in the purpose of the Fibra E or its early termination, and (f) increases in intended issuances (in value or in number of notes).

It is worth mentioning in this respect that one of the most important changes compared to REITS, is that in the Holders' meeting (unlike for the holders of real estate notes), it's not necessary approve intended investments and acquisitions if they represent 10% (or more) of the assets of the Fibra E trust.

### *Removal and Substitution of the Manager*

Unlike traditional REITS, in the case of Fibra E trusts, removal and replacement of the Manager can only occur if there is a favorable vote of at least 66% of the outstanding Energy Notes. Additionally, the minimum grounds for the removal and replacement of the Manager must include at least the following:

- Lack of accountability;
- Fraud, negligence or willful misconduct;
- Failure to make agreed distributions; and
- Serious breaches of legal or contractual obligations.

These rules are similar to the structure of the MLPs, in which the removal of the Manager is an extraordinary circumstance and not something that happens commonly. This is derived from the important role of Manager in such funds, in which investors generally make their investment decision based largely on the reputation and track record of the Manager. These rules contrast with the rules applicable to REITS, where the percentage of holders of trust bonds in circulation can never exceed 66% and no minimum grounds are established for removal.

### *Series of Energy Notes*

One of the new elements introduced by the new rules is that Fibra E trusts can issue different series of Energy Notes with limited voting rights, in which case they must grant a preferential right to certain distributions and minimum voting rights.

### *Minority Rights*

Among other minority rights, Holders that, individually or collectively, represent the percentages of outstanding Energy Notes (or higher percentages) listed below may:

- With 20%, judicially oppose resolutions of Holders' meetings, provided they have not attended the meeting or have voted against the relevant resolution;
- With 15%, bring actions for damages against the Manager;
- For every 10%, designate a member of the Technical Committee, unless the Manager, the trustee or similar persons have been granted the right to appoint all the members of the Technical Committee; and
- With 10%, request the convening of a general holders' meeting or postpone the vote of any matter (in each case, for 3 calendar days) in respect of which they are not well-informed.

In addition, Holders are entitled to have at their disposal, free of charge and with at least 10 calendar days' notice prior to the holding of a Holders' meeting, information and documentation relating to the matters contained in the meeting agenda.

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## Technical Committee

The Technical Committee may be comprised of a maximum of 21 members, of which the majority must be independent (in terms of the Securities Law). Independence is also measured with respect to the trustee and the Manager. The auxiliary committees set up by the Technical Committee may only be formed by independent members.

The Technical Committee of Fibra E trusts has the following delegated powers:

- Monitor the performance of the Manager;
- Review the quarterly reports of the Manager;
- Require information and documentation from the Manager that the Technical Committee considers necessary for the performance of its duties; and
- Require that the trustee or common representative call a Holders' meeting and ask that issues that the committee considers appropriate be inserted into the agenda when it detects serious breaches of the obligations of the Manager.

## Tax Regime of Fibra E Trusts

### Tax Treatment Applicable to Portfolio Companies

- Portfolio Companies are regarded as pass-through entities for income tax purposes and accordingly, their shareholders will be considered as if they were undertaking business activities through a trust, without being required to make interim income tax payments;<sup>5</sup>
- Portfolio Companies will 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 share capital of a Portfolio Company is 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 without applying the optional regime established in the Tax Regulations. Likewise, 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 respective 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 when the Fibra E trust acquires the first share of such entity. Otherwise, all of the monetary assets of the Portfolio Company will be deemed to be distributed to its shareholders as if it were a capital reimbursement.

### Tax Treatment Applicable to Fibra E Trusts

The financial institution or broker dealer that acts as trustee of the Fibra E must determine the taxable income for the respective fiscal year and provide the information that the Tax Regulations establish in respect of the income received to the institution for the deposit of securities that the Energy Notes have on deposit, which in turn, should provide such information to the financial institution holding and administering the Energy Notes, so that the institution may withhold the income tax of the Holders that corresponds to the taxable income distributed (except with regard to Holders that are exempt from income tax on income distributed) in accordance with Article 188 of the ITL. In order to determine its taxable income, the trustee must consider the portion of taxable income for the fiscal year for each Portfolio Company, in the proportion that corresponds to such Portfolio Company's share capital as of the last day of the fiscal year, as well as the deduction of

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<sup>5</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, among others.

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deferred expenses arising from the acquisition of the assets dedicated to the Permitted Activities and operating expenses deductible from the trust itself.

The trustee is not required to make interim income tax payments on income obtained from the Fibra E trust.

### Tax Regime Applicable to Holders

Holders are subject to income tax on income received through the Fibra E trust, as follows:

- Holders resident in Mexico or resident abroad with permanent establishment in Mexico must declare the taxable income distributed to them and shall be entitled to credit the tax withheld against their income tax liability. Income distributed to individuals resident in Mexico is considered income from business activities and the withholding is considered to be an interim payment;
- Foreign-resident Holders without permanent establishment in Mexico are not required to register with the Federal Taxpayer Registry (RFC) and the withholding of such income tax shall be deemed as a definitive payment. They are also not obligated to comply with formal requirements relating to the creation of a permanent establishment in Mexico;
- Holders who are natural persons or foreign residents without permanent establishment in Mexico are exempt from income tax in respect of the gains obtained in the sale of Energy Notes provided that such sale is made in the stock market.

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