Tax Flash 13/2014

Draft bill of secondary laws in energy matters

On April 30, 2014 the Executive Branch sent to the Senate the bills comprising the proposed secondary laws in energy matters, and requested the Senate to send to the Lower House the respective tax bills in the oil and gas and electricity sector.

The package includes 21 laws, divided into nine blocks, of which nine are new and 12 will be amended:

1. Hydrocarbons Law*
2. Foreign Investment Law
3. Mining Law
4. Law on Public-Private Associations
5. Electricity Industry Law*
6. Geothermal Energy Law*
7. Law on National Waters
8. Law of the National Agency of Industrial Security and Law Environmental Protection of the Hydrocarbons sector*
9. Law of Petróleos Mexicanos*
10. Law of Comisión Federal de Electricidad*
11. Federal Law of State Owned Companies
12. Law of Public-Sector Acquisitions,
Leases and Services
13. Law of Public Works and Related Services
14. Law of Coordinated Regulatory Agencies in Energy Matters*
15. Law of the Federal Public Administration
16. Law of Hydrocarbons Revenues*
17. Federal Charges Law
18. Tax Coordination Law
19. Mexican Petroleum Fund for Stabilization and Development*
20. Federal Law of Treasury Budget and Responsibility
21. General Law on Public Deb

Following is a summary of some proposed topics we consider relevant:

- Pemex and Comisión Federal de Electricidad will cease to be decentralized public agencies wholly-owned by the State.

- They will have budgetary and management autonomy. This means that they will have a special regime in terms of the budget, debt, contracting, assets and remuneration, and will have a new tax regime in line with international standards.

- The State will still be the owner, but will no longer be involved in the direct operation of the companies.

- The tax bill consists of two new laws: the Law on Hydrocarbons Revenues and the new Mexican Petroleum Fund for Stabilization and Development.
- The tax package also includes changes in existing laws: The Federal Law of Treasury Budget and Responsibility, the General Law on Public Debt, the Federal Charges Law and the Tax Coordination Law.

- The bill proposes a reduction in the current tax burden of Petróleos Mexicanos, resulting in profits which can be reinvested in the company.

- Recognition of its real production costs will encourage correct decision-making regarding the medium and long-term projects in which Pemex invests.

- Under the new regime, all the expenses incurred by Pemex to explore and extract hydrocarbons will be recognized.

- The total tax burden will be reduced from the current 79% to less than 65% on average.

- It is hoped that when all Pemex's costs are recognized and the tax burden is reduced, it will be able to generate greater profits.

- The bills proposed by the National Congress *establish the possibility of declaring a dividend* to be determined based on frank discussions between the Pemex Board of Directors and the National Congress. Such discussion will respond to the needs and investment options of Pemex, through the alternative uses of resources based on public spending.

- Given the size of the changes in PEMEX's tax regime and the importance of its current contribution to public finances, an orderly transition is proposed to gradually introduce this tax regime over a 10 year period.

- Pemex's new tax regime will also apply to any contracts executed with private parties. The intention is that the tax structure of any Pemex contracts and assignments will be similar to and competitive with those of independent third parties. In other words Pemex will not be at a competitive disadvantage compared to private sector participants.

- The most notable characteristics of the new tax regime applicable to contracts, including shared profits and shared production contracts, are as follows:

  - A minimum contractual fee would be established to guarantee that the State receives a minimum level of revenues, regardless of the stage of development and profitability of the projects.

  - Operators would be given incentives to minimize costs and produce on a sustained basis, thus maximizing petroleum income for the Nation.

  - The tax regime proposed for the new petroleum contract is highly progressive, ensuring that the State will keep a greater percentage of revenues in those cases where prices of hydrocarbons increase or deposits are discovered which are more profitable and larger than originally expected.

Finally, the tax regime of the Comisión Federal de Electricidad will change significantly. Until today it applies a regime which involves collecting a percentage of the value of the company's assets each year, regardless of the result obtained in terms of profits. The bill proposes replacing this regime to treat it as a public company in Mexico which would pay the respective income tax like any other taxpayer.

We invite you to consult the full content of the draft bills of secondary laws in energy matters, by clicking on the following link: **http://www.presidencia.gob.mx/reformaenergetica/#!leyes-secundarias**

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