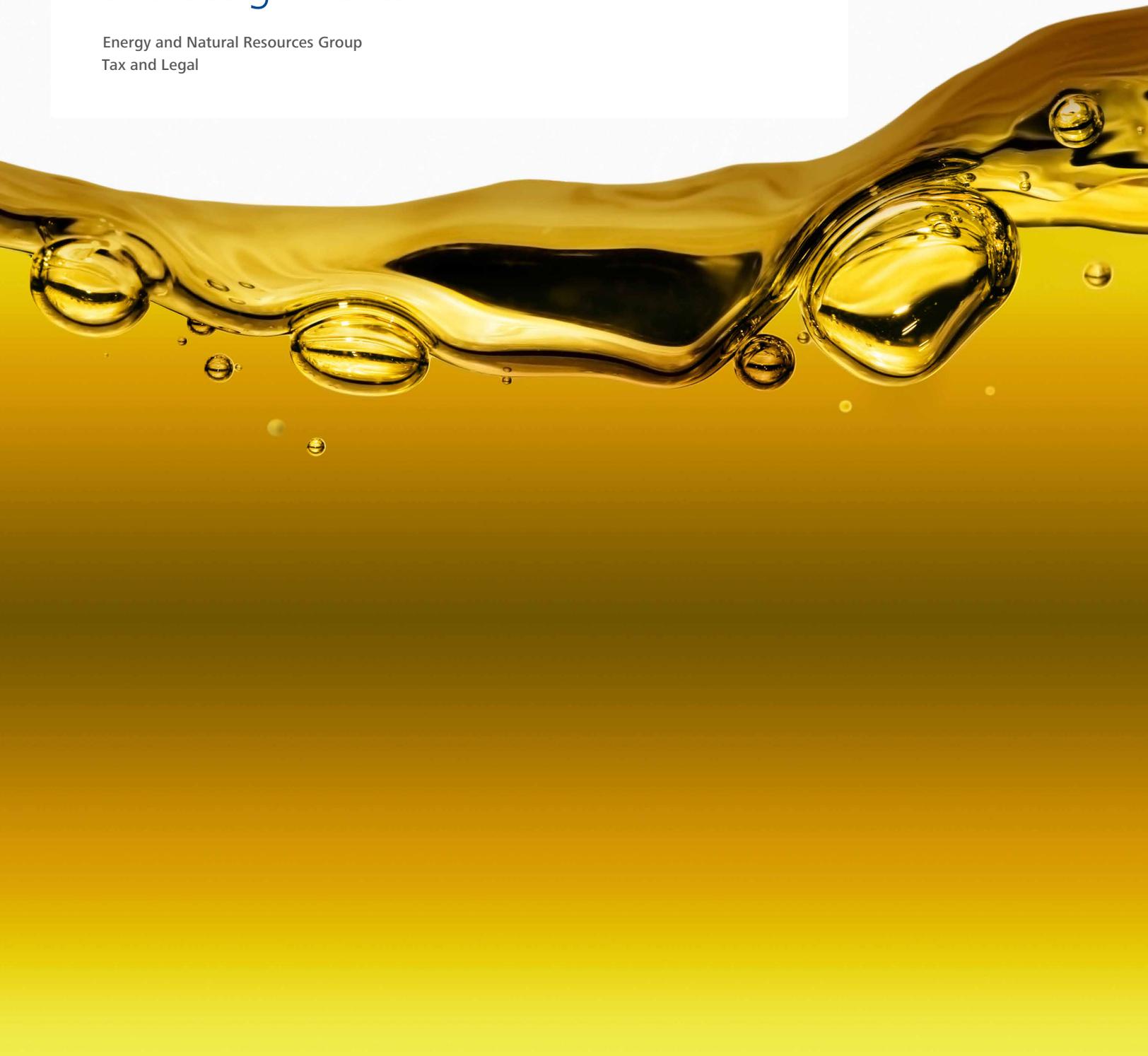




Mexican Government issues rules on costs, expenses and investments; procurement and audit of hydrocarbon exploration and production contracts and assignments

Energy and Natural Resources Group
Tax and Legal



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Background

On 6 March 2015 the Finance Ministry issued a decree containing guidelines and definitions on the elaboration and submission of reports related to costs, expenses and investments associated with the exploration and production contracts and assignments outlined in the Hydrocarbon Revenue Law. The guidelines also include rules on the registry in the accounting books, cost recovery and deductibility.

Moreover, guidelines on the procurement of goods and services in contracts and assignments are further explained. The process for the tax audit as well as the financial audit requirements are included, as well as the rules for updating the royalties and rights

The rules aim to incorporate a number of topics, some of which were included in the contract model for production sharing issued as part of the bidding process published on 11 December 2014.

Booking, recovery and deductibility of expenses

Functional Currency: It is asserted that the Contractor and the Assignee shall keep their accounts in accordance with the provisions of the Mexican Federal Tax Code and Financial Reporting Standards in Mexico (Mexican FRS), in Spanish and in Mexican Pesos, regardless of the functional currency or their reporting currency.

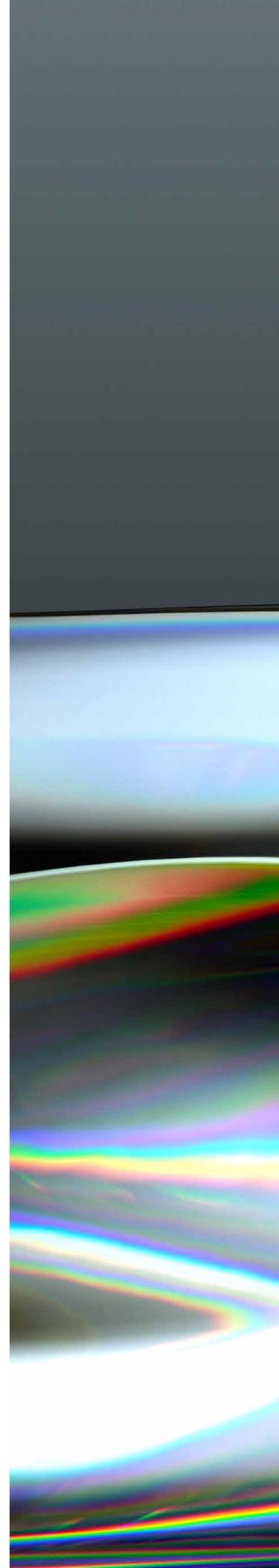
Operating account: Among the relevant topics, it is clarified that the Contractor or the Assignee shall record the costs, expenses and investments at historic value (i.e. without adjustment for inflation) by category of activity, sub-activity and task; and shall be identified according to Mexican FRS and allocated, to the well, site, field or contractual area, in that specific order.

Information Registry System: Contractors and Assignees shall maintain a financial and accounting reporting system that allows the electronic transfer of the information, documentation and accounting records included in the operating account to the Mexican Petroleum Fund (FMP).

Information and documentation requirements: Documentation of costs, expenses and investments shall include Internet digital tax receipts (CFDI), import documentation (pedimentos), contracts and payment evidence (wire transfers and bank checks.) Other requirements include compliance with general tax rules on deductibility. With respect to payments from abandonment reserve trusts, Contractors are additionally required to provide the trust contract, quarterly records of trust funding and forecast of total abandonment costs. Assignees are required to provide the accounting registry of the reserves for the abandonment account.

Currency conversion: If the costs, expenses and investments incurred are denominated in U.S. dollars, the applicable exchange rate is the one published by the Bank of Mexico (central bank) on the previous trading day to the transaction date. The peso equivalent of a foreign currency other than the U.S. dollar is computed by converting the foreign currency to U.S. dollars, using a monthly conversion table also published by the Bank of Mexico, and then applying the peso conversion.

Eligible costs, expenses and investments: Those that are strictly indispensable to perform hydrocarbon exploration and extraction activities during the term of the Contract or Assignment and that comply with the guidelines.



Non-eligible costs, expenses and investments:

Include those that are not strictly indispensable or that are not inherent to the Contract; are not in compliance with the guidelines and are incurred prior (after) the Contract's starting (termination) date; are incurred after the measurement point; do not have documentation support; are not registered in the operating account or are not included in the budget approved by the National Hydrocarbon Commission,

Recoverable (deductible) costs and investments:

Eligible costs, expenses and investments are recoverable in the Contract (or deductible for purposes of profit sharing) as long as they comply with the guidelines and are effectively paid. Operating costs and expenses shall be considered first and then investments. Cost recovery in favor of the Contractor shall be paid once production is obtained. There will be no cash advances on recoverable costs. In case of Assignments, deductions of costs and investments are allowed only if the Assignment title is current.

Non-recoverable (deductible) costs and investments:

The non-recoverable costs and expenses (non-deductible in case of Assignments) include non-eligible costs, expenses and investments; financial costs, rights of way, donations, penalties for non-compliance with regulations; long-term incentives to staff; technology payments to related parties (unless they comply with transfer pricing provisions); commissions; any payment above market value; the conditioning or transporting of hydrocarbons after the measuring point, the price of hydrocarbons will be adjusted in accordance with the Contract, in order that these prices reflect the market value at the Hydrocarbon Measurement Point; lobbying; among others.

Transfer pricing: Transfer pricing studies are mandatory to comply with the arm's length principle.

Fixed assets: Rules are incorporated for the sale of assets, and their recovery, lease or transfer from other contracts.

Procurement and supply of services

Procurement and supply of services: In order to comply with the principles of transparency, economy and efficiency, the guidelines state comprehensive rules on the procedures for procurement of services and purchase of goods. The specific procedure for the assignment to related parties is described in detail and varies according to the U.S. dollar value of the transaction and whether the supplier is a related party of the Contractor or Assignee.

Audit

External Audit process: As part of the obligations of the contractor, its financial statements (reviewed by an external auditor on an annual basis) and its transfer pricing studies shall be delivered to the tax authorities no later than 15 July of the following year at the contractor's expense. The audit costs shall be considered a recoverable cost.

Tax audit: The guidelines provide the general process for a tax audit similar to the current rules for a federal tax audit, subject to International Audit Standards.

Indexation

Indexation of royalties and rights: In a similar manner to that presented in the model contracts, the guidelines outline the procedures for the indexation of royalties and rights

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