Commentary on Tax Issues of the Mexican Energy Reform

By Roberto Arena and Fernando Camarena

The Energy Reform resulting from the December 2013 amendment to the Mexican Constitution and that allows the participation of the private sector in the oil and gas market, once again changed the paradigm of the energy industry in Mexico. This is probably the most important reform to the industry since the 1938 expropriation by President Lázaro Cardenas.

The Mexican tax system was not designed to tax private companies engaged in the exploration and extraction of hydrocarbons. Since the principle that hydrocarbons obtained from Mexican soil are owned by the Mexican State remains, there was the need to create a regime requiring companies to make payments from revenue coming from the exploration and extraction of hydrocarbons. In addition, the onerous tax regime applicable to Pemex was in urgent need to be replaced with one that affords Pemex, now a State Productive Company, with the more flexible taxation applicable to the private sector.

THE HYDROCARBONS REVENUE LAW

To upgrade the Mexican tax regime and to address the issues previously described, on Aug. 11, 2014, the Hydrocarbons Revenue Law was published. Among other things, this new Law sets forth the rules under which the private sector and the State Productive Companies make payments to the Mexican federal government (conducted through the newly-formed Mexican Petroleum Fund) derived from revenues associated with contracts or assignments. These assignments shall only be granted to Pemex or other State Productive Companies. In general terms, holders of the new contracts allowed by the Energy Reform (exploration and production, license, profit-sharing, production-sharing and service contracts), shall be required to pay the following types of payments to the government (payments may be different depending on the contract): (i) a signing bonus; (ii) a contractual quota for the exploratory phase; (iii) royalties; and (iv) a payment consisting of a percentage of the contract value of hydrocarbons produced. Assignment holders are also required to make other type of payments to the government.

CHANGES IN TAX REGIME

In addition to the aforementioned payments, contract holders are subject to the general corporate income tax which is applicable to companies at a rate of 30 percent. Dividends paid to Mexican individuals and nonresident shareholders are subject to an additional income tax withholding of 10 percent. The Hydrocarbons Revenue Law includes some changes to the general income tax regime such as the establishment of different deduction schedules for certain type of investments, and in certain cases contract holders engaged in deep-water activities can apply their tax loss carry forward for 15 years instead of applying the standard 10-year rule. This new Law also includes a broader definition of what activities constitute a permanent establishment. With respect to value-added tax, there are no cash flow disadvantages, since the Hydrocarbons Revenue Law provides that payments to be made by contract holders to the Mexican State shall be subject to a 0 percent value-added tax rate.

Due to the novelty of these rules, it is still to be seen how certain aspects will be construed by the Mexican tax authorities and courts.

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