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# **MEXICO. THE IMPACT OF RECENT REFORMS ON THE ECONOMY**

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Ernesto Velarde-Danache, Mexican Notary Public and Attorney licensed only in Mexico, was admitted to practice in 1982. He holds an LL.M from the University of Cambridge, of Cambridge, England.

Ernesto has spoken about doing business in Mexico in many different countries such as the United States, Canada, Italy, France, Portugal, England, Spain, India, Mexico, the Republic of Ireland, Switzerland, Netherlands, China, Singapore and Korea.

He has helped more than 300 companies start business in Mexico.



# WHAT IS CURRENTLY THE LEGAL FRAMEWORK FOR INVESTING IN MEXICO?



- **HAS EXECUTED FREE TRADE AGREEMENTS WITH MORE THAN 45 COUNTRIES, IT IS NOW THE FREE TRADE LEADER IN THE WORLD.**

- **NAFTA (1994) WITH THE USA AND CANADA.**
- **THIS TREATY HAS BEEN INSTRUMENTAL IN INCREASING MEXICO'S EXPORTS BY 80% TO THE WORLD**
- **THE ONE WITH THE EUROPEAN UNION. WITH JAPAN, ISRAEL, SOUTH AMERICA AND OTHER COUNTRIES.**
- **AS A RESULT PRODUCTS MANUFACTURED IN MEXICO ARE IMPORTED INTO OTHER COUNTRIES WITH REDUCED OR NO TARIFFS**



# **SOME COUNTRIES THAT HAVE INCREASED THEIR INVESTMENT IN MEXICO:**

- GERMANY
- JAPAN
- BELGIUM
- SLOVAKIA
- KOREA
- TAIWAN
- LUXEMBOURG
- FRANCE
- CHINA



# **SUBSTANTIAL REFORMS TO MEXICAN LEGAL SYSTEM**

## **GENERAL INFORMATION**

- **THEIR BUREAUCRACY. RED TAPE AND TRAMITOLOGY DRAMATICALLY REDUCED.**
- **MEXICO AND MOST OF ITS 32 STATES HAVE SYSTEMATICALLY MODERNIZED THEIR LEGAL SYSTEM**
- **EDUCATION.** MODERNIZED THE SYSTEM. BETTER TEACHERS. IMPROVED TEACHING PROGRAMS. LESS CORRUPTED LEADERS.
- **TELECOMUNICATIONS.** REMOVAL OF RESTRICTIONS FOR THE PARTICIPATION OF FOREIGN INVESTORS
- **ENERGY.** MODIFICATION TO THE ENERGY SECTOR TO OPEN UP INVESTMENT IN PEMEX AND CFE
- **FEDERAL LABOR LAW.** THE VERY EXCITING AND LONG AWAITED REFORM.

# **WHAT ARE THE MAIN ASPECTS OR THE HIGHLIGHTS OF THE LABOR REFORM THAT MAKE MEXICO A MORE COMPETITIVE PLAYER IN THE WORLD ARENA?**

- **FIRST TIME IT IS REFORMED IN 42 YEARS**
- **THE CONCEPT OF OUTSOURCING IS NOW REGULATED**
- **ABILITY TO HIRE FOR A TRIAL PERIOD, SEASONAL, INITIAL TRAINING**
- **AGREEMENT FOR AN INDEFINITE PERIOD OF TIME, FOR ONE, THREE AND FOR UP TO SIX MONTHS**
- **CAP OF ONE YEAR FOR BACK SALARIES**
- **CONTRACTING WORK AND PAYING BY THE HOUR**
- **NEW CAUSES OF DISCRIMINATION LIKE SEXUAL ORIENTATION, SOCIAL CONDITION, AGE, MARITAL STATUS, PREGNANCY ARE INCORPORATED.**

# **MEXICO TAX REFORM HIGHLIGHTS (BECAME EFFECTIVE ON JANUARY 1, 2014)**

## **THE PAYMENT OF VAT ON ALL TEMPORARY IMPORTATIONS:**

- **FIXED VAT RATE OF 16% TO BE IMPOSED ON TEMPORARY IMPORTATIONS DESTINED TO THE MAQUILADORA INDUSTRY.**
- **VAT ON TEMPORARY IMPORTATIONS WILL BE DUE AT THE TIME PERFORMING THE TEMPORARY IMPORTATION.**
- **INCORPORATED ARTICLE 28-A INTO THE VAT LAW**



- **TAX CREDIT APPLICABLE AGAINST 100% OF THE VAT LIABILITY ARISING FROM THE IMPORTATION MADE BY COMPANIES THAT BECOME CERTIFIED BY THE MEXICAN TAX AUTHORITIES (“SAT”).**
- **THIS NEW PROVISION WILL BECOME EFFECTIVE ONE YEAR AFTER THE PUBLICATION BY THE SAT OF THE CERTIFICATION RULES.**

## **VAT ON SALES BETWEEN NON-RESIDENTS:**

- **SALES BETWEEN NON-RESIDENTS OF GOODS THAT ARE TRANSFERRED IN MEXICO BETWEEN MAQUILADORA COMPANIES WILL CONTINUE TO BE EXEMPTED FROM VAT**
- **ARTICLE 9-IX OF THE VAT LAW PROVIDED THAT THE GOODS REMAIN UNDER THE TEMPORARY IMPORTATION REGIME.**

# **MAQUILA OPERATION FOR INCOME TAX PURPOSES.**

**A) THE RETURN OF GOODS ABROAD CAN ALSO BE MADE THROUGH VIRTUAL OPERATIONS, IN ORDER TO AVOID THE NEED FOR PHYSICAL EXPORTS ON GOODS THAT ARE PART OF A SUPPLY CHAIN STRUCTURE IN MEXICO;**

**B) DESIGN AND PRODUCT DEVELOPMENT ACTIVITIES WILL CONTINUE TO BE CONSIDERED AS TRANSFORMATION ACTIVITIES FOR PURPOSES OF QUALIFYING AS MAQUILADORA OPERATIONS;**

**C) IT WAS CLARIFIED THAT THE TRANSFORMATION AND REPAIR OPERATIONS CAN BE COMPLEMENTED WITH THE USE OF MACHINERY AND EQUIPMENT OWNED BY THE MAQUILADORA COMPANY OR A THIRD PARTY NON-RESIDENT**

**D) SHELTER COMPANIES - THE TERM UNDER WHICH THE FOREIGN RESIDENT CONTRACTING WITH THE SHELTER COMPANY WOULD NOT CONSTITUTE A PERMANENT ESTABLISHMENT IN MEXICO WAS EXTENDED TO 4 YEARS.**

- **STANDARDIZING THE BORDER VAT RATE WITH THE REST OF THE COUNTRY FOR A VAT RATE OF 16% NATIONWIDE (CURRENTLY 11% WITHIN THE BORDER REGION).**
- **BENEFITS OF THE TREATIES WITH MEXICO TO AVOID DOUBLE TAXATION.**



# **TAX REFORM – PAYMENTS TO EMPLOYEES**

- SALARY PAYMENTS OVER \$2,000 PESOS MUST BE MADE BY ELECTRONIC TRANSFER/DEPOSIT OR NOMINATIVE CHECK (EXCEPT WHEN MADE IN TOWNS WITHOUT BANKS).
- EMPLOYERS WILL NEED TO COLLECT ELECTRONIC INVOICES FOR SALARY PAYMENTS.
- EMPLOYERS WILL ONLY BE ALLOWED TO DEDUCT UP TO 47 PERCENT (OR UP TO 53 PERCENT IN LIMITED CASES) OF THE PAYMENTS MADE TO EMPLOYEES THAT ARE NOT TAXABLE TO EMPLOYEES.

- **CONTRIBUTIONS TO SOCIAL SECURITY AND OTHER SOCIAL SAFETY OR WELFARE PROGRAMS WILL NO LONGER BE DEDUCTIBLE.**
- **FOOD VOUCHERS WILL BE DEDUCTIBLE ONLY IF THEY ARE DELIVERED THROUGH ELECTRONIC PAYMENTS DULY AUTHORIZED BY THE TAX ADMINISTRATION SERVICE (SAT).**
- **THE CHANGES ELIMINATE THE CURRENT FORMULA TO CALCULATE THE PROFITS TO DETERMINE PTU.**
- **NOW THE PROFIT FOR PTU PURPOSES WILL BE THE SAME AS THE TAXABLE PROFITS WITH SLIGHT VARIATIONS, INCLUDING NO DEDUCTION OF THE PTU BUT 100 PERCENT DEDUCTION OF ALL THE PAYMENTS MADE TO THE EMPLOYEES THAT WERE NOT TAXABLE TO THE EMPLOYEES.**

- **THE CHANGES CREATE AN UNEMPLOYMENT INSURANCE THAT WILL BE FUNDED BY CONTRIBUTIONS MADE BY EMPLOYERS AND EMPLOYEES.**
- **TAX PAYERS THAT HIRE EMPLOYEES OVER 65 YEARS OLD WILL RECEIVE A TAX CREDIT EQUAL TO 25 PERCENT OF THE SALARY PAID TO EMPLOYEES OVER 65.**



# ENERGY REFORM

**BILL ADOPTED BY A NARROW MARGIN ON DECEMBER 12, 2013 AND WHICH TOOK EFFECT ON JANUARY 1ST, 2014.**

- PEMEX WILL BE CONVERTED INTO A PUBLIC “PRODUCTIVE COMPANY”
- TO SUMMARIZE, THE REFORM ADDRESSES THREE KEY ASPECTS AS FOLLOWS:





- **AUTHORIZING PRIVATE INVESTMENT FOR EXPLORATION AND EXTRACTION OF HYDROCARBONS UNDER CONTRACTS (I.E., PRODUCTION SHARING AGREEMENT) WITH THE FEDERAL GOVERNMENT, AS FURTHER EXPOSED.**
- **AUTHORIZING OIL PROCESSING AND REFINING BY PRIVATE COMPANIES AS WELL AS GAS PROCESSING, OIL AND OIL DERIVATIVES TRANSPORTATION, STORAGE AND DISTRIBUTION.**
- **AUTHORIZING PRIVATE INVESTMENT FOR ELECTRICITY GENERATION, COMMERCIALIZATION, TRANSMISSION AND DISTRIBUTION UNDER CONTRACT WITH CFE.**

# CONSTITUTIONAL ENERGY REFORM

- THE MOST RELEVANT ASPECTS OF THE REFORM TO THE ARTICLES 27 AND 28 OF THE CONSTITUTION REGARDING THE POSSIBILITY OF SEVERAL COMPANIES COULD INVEST AND OPERATE IN THE NATIONAL ENERGY INDUSTRY.
- THE REFORM ESTABLISHES THAT THE NATION IS ENTITLED TO PERFORM OIL AND OTHER HYDROCARBONS EXPLORATION AND EXPLOITATION ACTIVITIES THROUGH ALLOCATIONS TO PRODUCTIVE COMPANIES OF THE STATE OR THROUGH CONTRACTS WITH THESE OR WITH PRIVATE COMPANIES.

# CONTRACTUAL MODEL

FOUR DIFFERENT CONTRACTUAL ARRANGEMENTS HAVE BEEN INTRODUCED:

- **SERVICE CONTRACTS** - CASH CONSIDERATIONS.
- **PROFIT SHARING CONTRACTS** – COMPENSATION BASED ON A PERCENTAGES OF THE PROFIT.
- **PRODUCTION SHARING CONTRACTS** – WITH A COMPENSATION BASED ON A PERCENTAGE OF PRODUCTION.
- **LICENSE CONTRACTS** - THE ONEROUS TRANSMISSION OF HYDROCARBONS, ONCE THESE HAVE BEEN EXTRACTED FROM UNDERGROUND

# INSTITUTIONAL DESIGN

- CNH BECOMES THE NEW KEY PLAYER IN THE MEXICAN OIL & GAS INDUSTRY BEING THE NEW AWARDING AUTHORITY FOR PRIVATE COMPANIES AS WELL AS FOR PEMEX
- THE REFORM ALSO BROUGHT A SUBSTANTIAL MODIFICATION WITH REGARD TO THE COUNTERPARTY SINCE EACH CONTRACT SHOULD BE SIGNED WITH THE FEDERAL STATE AND NO LONGER WITH PEMEX

# INSTITUTIONAL DESIGN

- THE CNH IS IN CHARGE OF TWO MAJOR DUTIES:
  - IDENTIFY AND AUTHORIZE WHICH FIELDS PEMEX MAY EXPLOIT AND WHO MAY ACCOMPANY PEMEX IN THEIR DEVELOPMENT, IF PEMEX SO DECIDES (ROUND ZERO);
  - DETERMINE WHETHER OR NOT A FIELD SHOULD BE OPENED TO PUBLIC BIDDING, THE AWARDING AND MANAGEMENT OF THE ALLOCATED FIELDS (ROUND ONE AND ONWARDS);

# ROUND ZERO

- THE REFORM ALLOWS TO PEMEX TO SELECT AND SUBMIT TO THE CNH'S APPROVAL THE EXPLORATORY FIELDS OF ITS INTEREST.
- CNH WOULD THEN GRANT PEMEX EXPLOITATION TITLES (*ASIGNACIONES*)
- THE FOLLOWING MAIN OPTIONS ARE AVAILABLE TO PEMEX:
  - ✓ TO REQUEST THE MIGRATION OF ITS EXPLOITATION TITLES INTO OIL & GAS CONTRACTS IN WHICH PEMEX WOULD BE PART TO A CONSORTIUM WITH A PRIVATE OPERATOR.
  - ✓ TO REQUEST EXPLOITATION TITLES WITHOUT MIGRATION INTO OIL & GAS CONTRACTS.

**PEMEX CAN EITHER CONTINUE USING TRADITIONAL SERVICE CONTRACTS OR ENTER INTO INTERNATIONALLY-BASED OIL & GAS CONTRACTS CONDUCTING ITS OWN BID ROUNDS.**

## **ROUND ZERO**

- **PEMEX HAS THE RIGHT TO MIGRATE ITS EXPLOITATION TITLES AT ANY TIME WITH THE CNH'S APPROVAL.**
- **THE CNH MIGHT ALSO DECIDE TO MAKE THE PARTICIPATION OF PEMEX MANDATORY.**
- **PEMEX WILL ALSO BE REQUIRED TO MEET THE HIGHEST TECHNICAL AND FINANCIAL REQUIREMENTS FOR EXPLORATION FIELDS.**
- **CNH HAS THE RIGHT TO REVOKE**



# ROUND ONE & ONWARDS

- THE CNH'S ASSIGNMENT DECISION AFTER THE ROUND ZERO WILL CLEARLY GIVE WAY TO THE PORTFOLIO OF FIELDS LEFT FOR THE FOLLOWING ROUNDS.
- ROUND ONE WILL NOT INCLUDE ALL FIELDS, BUT PROBABLY, THE MOST SIGNIFICANT ONES IN TERMS OF PROSPECTIVE RESOURCES.
- THE BIDDING MAY BE ORGANIZED EITHER AS:
  - ❖ OPEN INTERNATIONAL BIDDING PROCESS,
  - ❖ CLOSED INVITATION TO TENDER; OR
  - ❖ EXCEPTIONALLY THROUGH DIRECT AWARDING.



# CONCLUSION

ENERGY	LABOR	TAX
<p><b>THE INTRODUCTION OF FOREIGN CAPITAL AND ENTERPRISE SHOULD SHAKE UP A SERIOUSLY UNDERPERFORMING SECTOR THAT COULD GREATLY RAISES MEXICO'S PRODUCTION OF OIL AND NATURAL GAS.</b></p>	<p><b>LABOR REFORM SEEKS TO MODERNIZE MEXICO'S LABOR LAW.</b></p> <p><b>MEXICO BECOMES MORE COMPETITIVE FOR FOREIGN INVESTMENT</b></p>	<p><b>THIS REFORM PROVIDE SIGNIFICANT SUPPORT AND POSITIVE IMPACT TO MEXICO'S ECONOMY S.</b></p>

# CONCLUSION

- **THIS YEAR MOODY'S UPGRADED MEXICO'S SOVEREIGN RATING TO "A3" FROM "BAA1" WITH A STABLE OUTLOOK .**
- **MEXICO BECAME ONLY THE SECOND COUNTRY IN LATIN AMERICA TO EARN A COVETED "A" GRADE SOVEREIGN RATING.**



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