



SHCP

SECRETARÍA DE HACIENDA  
Y CRÉDITO PÚBLICO

# ECONOMIC CONDITIONS RELATED TO THE FISCAL TERMS

DECEMBER, 2014

# FISCAL ELEMENTS

## INTRODUCTION

### Overview

- The fiscal elements for the Contract and for the bidding round were designed to allow the State to capture the oil rent.

### Elements defined in the Law:

Corporate income tax	30%
Contractual payment during the exploratory phase	First 60 months: 1,150 pesos x km <sup>2</sup> , 2,750 pesos x km <sup>2</sup> afterwards
Exploration & production activities tax	1,500 pesos x km <sup>2</sup> during exploration, 6,000 pesos x km <sup>2</sup> during extraction
Basic royalties	Variable formula that depends on prices
Ring-fencing: at the level of the E&P industry for Corporate income tax, and at the contract level for contractual payments.	

### Elements defined on the Bidding Rules:

Cost-recovery limit	Up to 60% of income, per period
Adjustment Mechanism	Defined formula

### Element to be defined during the Bidding:

State participation share of production	
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# FISCAL ELEMENTS

## BIDDING MECHANISM

### First-Price Sealed-Bid Auction

- Clear, transparent & simple award mechanism.
- It's the most common mechanism used around the world:
  - Angola, Brazil, Canada, United States, Indonesia, Nigeria, Peru and Venezuela, among others.

### Bidding Mechanism

- Bidders will produce a sealed envelope for each and every block, specifying their offer or otherwise declining.
- All envelopes will be delivered at the beginning of the auction. Once delivered, the offers shall not be modified.
- The winner will be named during the event, although the Ruling will be formalized at a later date.

# FISCAL ELEMENTS

## BIDDING VARIABLES

### Bidding Variables

- The bidding variables will be:
  - The State share of production.
  - Additional investment, over the minimum investment commitment for each Area.
- The award is done following objective criteria based on a predefined formula.
- The winner will be the bidder with the highest weighted value on the economic proposal (V), calculated as follows:

$$V = 0.90 * \text{State Share} + 0.10 * \text{Additional Investment}$$

#### Tiebreakers

1. Cash payment, and
2. Coin flip.

#### Reserve Prices

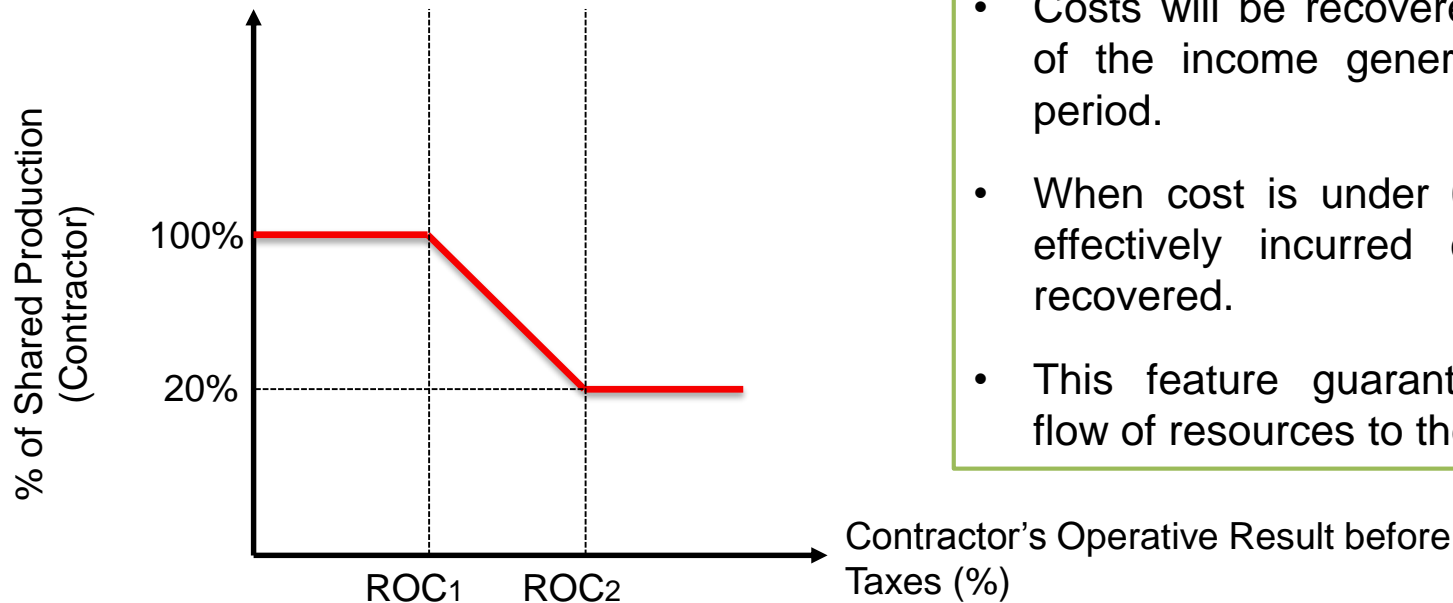
- The minimum reserve price will be established in advance.

# PRODUCTION SHARING CONTRACTS

## FISCAL REGIME – ADJUSTMENT MECHANISM

### Adjustment Mechanism

- The Contract includes the formula for the Adjustment mechanism.
- The formula is continuous to avoid distortions.



### Cost Recovery Limit

- Costs will be recovered, up to 60% of the income generated on each period.
- When cost is under 60%, only the effectively incurred costs will be recovered.
- This feature guarantees an early flow of resources to the State.

# PRODUCTION SHARING CONTRACTS

## FISCAL REGIME – OTHER PROVISIONS

### Controls for the determination of recoverable costs

- Accounting rules for registering costs, expenses and investments.
- Cost concepts which are recoverable are established (already provided in the Law).
- In order to recognize recoverable costs, they must:
  - Be supported by CNH-approved exploration & development plans.
  - Reflect market conditions.
- External audits to guarantee compliance with financial information norms.
- Audits by SHCP, SAT & CNH.

### Procurement Guidelines

- Established to guarantee market prices in the procurement of goods & services by the contractor, following OCDE Transfer Pricing guidelines.
- Expenses above 20 million dollars require through bidding processes.

### Interaction with the Mexican Oil Fund

- Rules, dates and terms to receive and review the information related to contractual payments calculation and settlement.
- Information records will be established using electronic systems and electronic signature.