

## Mexican Private Equity Trusts

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Over the last years, encouraging investment in private equity vehicles has become a very useful and advantageous tool throughout Latin America to draw foreign and local investors into such countries.

To promote private equity investment in Mexico, as of year 2006 a special regime was included in the Mexican tax legislation in order for investors (both Mexican and foreign) to participate in Mexican companies which should not be listed as of the moment the investment is made, even though they may be listed afterwards (Mexican target entities). This regime is not intended to develop any specific activity, thus Mexican target entities may belong to any kind of industry.

Recently, several Mexican and foreign real estate and infrastructure investment funds have been very active setting up structures through which funds are raised amongst the investment public at large and further contributed into Mexican target entities. Due to recent changes made in Mexican pension and retirement funds regulation, these pension funds (commonly known as Mexican *AFORES*) have become the most attractive investors participating in these kind of investment structures; nonetheless, these investments are open to any kind of investors.

Under this regime, investments shall be made through Mexican incorporated trusts (Mexican *Fideicomisos*) through which funds raised from investors via the acquisition of certificates issued by such trusts are contributed as equity or debt into the Mexican target entities. The trustee of such trusts shall be an authorized Mexican financial institution.

These private equity investment trusts are commonly known as FICAPS (*Fideicomisos de Inversión en Capital de Riesgo*). To raise the funds from investors, FICAPS issue certificates that could be either publicly placed through the Mexican Stock Exchange or be privately issued. FICAPS are relieved from complying with certain management and tax payment obligations that otherwise would be obliged to comply with (i.e. advance tax payments).

The main feature of the FICAPS is that investors participating in these kind of trusts might receive income in the form of dividends, capital gains and interest payments, and would be subject to a transparent regime for tax purposes that allow them to be treated as if they had obtained such income from carrying out a direct investment in a Mexican target entity.

Trustees of FICAPS are obliged to keep record of the different types of income generated by the investments made on an individual basis per certificate holder. The trustee shall register the individual contributions and distributions made by and to each certificate holder as well, respectively.

The tax regime that should be applied to each kind of investor participating in this kind of vehicle will depend on each investor's particular nature, as the tax treatment may differ if the investor is a foreign resident, a Mexican entity or a Mexican individual, or a Mexican or foreign pension and retirement fund.

For instance, Mexican *AFORES*, which are exempt from Mexican income tax on dividends, capital gains and interest payments received will remain tax exempt on these kinds of income even though they obtain such income from the investments held in Mexican target entities through the FICAPS.

Since this is a tax transparent regime, it is provided that the Mexican target entities making payments to the FICAPS should not withhold income tax since the corresponding withholding is made by the trustee of the FICAP.

In the case of a public issuance of certificates, neither the Mexican target entities nor the trustee of the FICAP may withhold any taxes, but rather the financial intermediary through which the certificates are placed should be required to carry out such tax withholdings, as such intermediary knows the nature of the investors participating in the vehicle.

### Requirements to Qualify as FICAP

FICAPS are subject to compliance with several requirements in order to qualify under Mexican tax provisions.

1) FICAPS shall invest at least 80% of their net worth in stock issued by Mexican target entities, which shall be held at least for a 2 year term, and may be able to grant loans to such entities as well. If such shares are sold before the 2 year term elapses, the FICAP would have to comply with certain tax obligations in respect of the income obtained through such vehicle as of the following year at the level of the trust.

2) The 20% or less that is not invested in stock issued by Mexican target entities or granted as loans to such entities shall be invested in securities issued by the Mexican federal government or in Mexican debt mutual funds. Such 80/20 threshold shall be achieved by the end of the fourth year of operations of the trust and if not, the trust would not be considered as a FICAP.

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3) Mexican target entities in which FICAPS may invest shall not be listed as of the moment the investment is to be made, even though they may be listed afterwards. The trustee of the FICAP shall also be involved in the Mexican target entities' board of directors in order to assure the entities development.

4) The duration of the FICAPS shall not exceed 10 years and at least 80% of the income derived from the investments held shall be distributed on a net basis by the end of each year. Once the 10-year term has elapsed, the FICAP would have to comply with certain tax obligations in respect of the income obtained through such vehicle as of the following year at the level of the trust.

Failure to comply with some of these requirements would cause the FICAP to be treated as a "business trust" for Mexican tax purposes being obliged to fulfill certain tax obligations such as making advance tax

payments on behalf of the investors for any income obtained from the Mexican target entities.

Derived from the above, due to its special characteristics, the FICAP regime represents an attractive, flexible and tax efficient alternative contained in the Mexican tax provisions for any kind of investors, either Mexican or foreign, aiming to invest in infrastructure and/or private equity investments within Mexico.

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