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Investment Funds

Mexico

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Contents

1. Investment Funds Market Overview	p.3	3. Retail Funds	p.8
1.1 State of the Investment Funds Market	p.3	3.1 Retail Fund Formation	p.8
2. Alternative Investment Funds	p.3	3.2 Fund Investment	p.9
2.1 Fund Formation	p.3	3.3 Retail Funds Regulatory Environment	p.9
2.2 Fund Investment	p.4	3.4 Operational Requirements for Retail Funds	p.9
2.3 Regulatory Environment	p.4	3.5 Retail Fund Finance	p.10
2.4 Operational Requirements for Alternative Investment Funds	p.5	3.6 Retail Fund Tax Regime	p.10
2.5 Alternative Investment Funds: Fund Finance Market	p.5	4. Legal, Regulatory or Tax Changes	p.10
2.6 Alternative Funds Tax Regime	p.5	4.1 Recent Developments and Proposals for Reform	p.10

1. Investment Funds Market Overview

1.1 State of the Investment Funds Market

The alternative fund industry has been actively growing over the past 20 years in Mexico. Although an incipient market compared to more developed jurisdictions, the number of local general partners (GPs) and investors has been steadily growing over the years. Government regulation (including regulation allowing the Mexican pension funds to invest in certain types of funds) has helped the growth of the industry and, in recent years, the government has been an important participant and supporter of the private equity industry, investing in more than 85 funds.

Additionally, Mexico is the second largest economy in Latin America and is one of the world's most globalised countries, with 12 free trade agreements spanning 46 countries.

Private Equity and Venture Capital

The private equity industry and the venture capital sector in Mexico continue to grow and mature. The internationalisation of both funding sources and investment by domestic GPs suggests that Mexico is playing an increasingly influential role in financial and economic growth, at both the regional and global levels.

Local managers generally use Mexican jurisdiction for the formation of alternative investment funds, although Ontario and Quebec limited partnerships are also used, depending on the type of investors targeted and the type of investment fund. Some international fund managers have also used Mexican jurisdiction to raise their local funds.

Retail Funds

Retail funds in Mexico are regulated and supervised and accessed by every type of investors. This investment instrument is very popular and there are over 600 retail funds authorised to operate in Mexico. The purpose of the retail funds includes, among others, giving small and medium-sized investors access to the stock market (as retail funds always invest in public securities), offering a wide range of investment options for savers, strengthening the stock market by facilitating the presence of a larger number of participants and channelling investors' resources to participate in financing the country's productive sector.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Alternative investment funds can be divided into private funds and listed funds. These funds are generally structured as Mexican trusts, either the private equity investment trust or *Fideico-*

miso de Inversión de Capital Privado (FICAP), which has certain tax benefits aimed at incentivising private equity investors, or the Mexican passive income, tax transparent trust.

Mexican trusts are not considered legal entities in Mexico, trusts are contracts and therefore offer a lot of flexibility regarding fund structuring. Investor's interests in the private funds are generally documented as beneficiary rights but can also be documented through notes such as the ones issued by the listed funds, although such notes are placed privately under Mexican safe-harbour securities rules.

Private funds in Mexico are usually managed by a GP or manager; listed funds are required to have a manager.

2.1.2 Common Process for Setting up Investment Funds

Investment funds are generally structured as Mexican trusts, the process starts with the investment memo or PPM and the drafting of the trust agreement. These funds are always managed by a manager or GP and the scope of this management is generally documented through a service agreement between the trustee of the trust and the GP. The trust agreement is always negotiated with the trustee and, depending on the type of fund being raised, with key investors. Unlisted private funds are not required to be registered or get any authorisations.

Listed funds require the trustee of these funds to make a filing for the authorisation of the notes they issue to be offered publicly before the National Banking and Securities Commission of Mexico (CNBV) and before the relevant Mexican stock exchange regarding the listing process. The issuance process of this type of listed fund generally takes between six and 12 months and the notes are generally placed with institutional investors (mainly Mexican pension funds).

As with the private funds, these listed funds are always documented by a trust agreement, a management or services agreement and a prospectus. Depending on the type of fund, co-investment agreements between the GP and the issuing trust are common to document the co-investment commitment of the GP. Regarding cost, listed funds are considerably more expensive than other alternative investment funds due to the filing process and the participants in the issuance of the notes of such fund (ie, auditors, underwriters, etc).

2.1.3 Limited Liability of Investors

Investors investing through Mexican trusts do not have statutory limited liability. These investors in general are protected from negligence and fraud from the trustee or the manager through indemnity clauses and the fact that the trustee of the trust will be liable to any third party for any investment made up to the amount of the trust estate.

2.1.4 Disclosure Requirements

Private funds are not specifically regulated in Mexico and there are no disclosure requirements to investors in Mexico, although PPMs and periodic reporting are customary. As to listed funds, Mexican regulations require disclosure levels to investors comparable to those of public companies and, therefore, a prospectus approved by the CNBV needs to be published before the public offer of the securities issued by these funds in addition to periodic reporting.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

With regard to private funds, the predominant investors would be high net worth individuals, family offices or other international funds or asset managers. Regarding listed funds, the main investors are the Mexican Pension Funds or AFORES.

2.2.2 Legal Structures Used by Fund Managers

Managers of Mexican funds are usually set-up as Mexican limited liability companies.

When the fund is structured as an Ontario or Quebec limited partnership, the GP vehicle is generally a limited liability vehicle.

2.2.3 Restrictions on Investors

Most recent listed funds are restricted to qualified and institutional investors. Some non-listed funds structured to issue securities through private placements are also restricted to qualified and institutional investors to comply with Mexican safe-harbour securities rules. Other non-regulated funds are not required to have a specific type of investor, although it is a common practice to focus fund raising efforts in sophisticated investors that understand the risks involved.

2.3 Regulatory Environment

2.3.1 Regulatory Regime for Alternative Funds

Private funds are unregulated in Mexico. Mexican trustees (mainly Mexican banks), however, are subject to strict supervision and regulation regarding their trust settlement and administration. Additionally, listed funds are subject to securities regulation in their capacity as note issuers.

As to managers that wish to create an investment fund that will invest in listed securities (eg, a hedge fund), a registration process as an investment adviser before the CNBV would be required. The registration process of financial advisers is not cumbersome and can be obtained in a short period of time.

2.3.2 Requirements for Non-local Service Providers

Service providers of funds in Mexico (local or non-local) are not regulated entities and do not require any type of regulatory authorisation, registration or licence. Regarding listed funds,

some service providers, such as auditors and appraisers, are required to comply with certain securities rules and regulations.

2.3.3 Local Regulatory Requirements for Non-local Managers

Managers of funds in Mexico are not regulated entities and do not require any type of authorisation or licence. Managers of listed funds (local or non-local) are subject to some regulatory requirements consisting mainly of disclosure and reporting to investors of such listed funds. Certain types of listed funds in addition require managers to comply with certain minimum track record.

2.3.4 Regulatory Approval Process

Listed funds are subject to CNBV approval for the public offering of notes. This approval can take between six and 12 months, depending on the pipeline of funds that have initiated the filing process, the type of fund and market conditions.

2.3.5 Rules Concerning Marketing of Alternative Funds

As to listed funds, marketing regulation is the one applicable to any public issuers in the Mexican market, which in general provides for the market to have all available information at the same time and forbidding the solicitation using information which is not already publicly available to every prospective investor.

2.3.6 Marketing of Alternative Funds

This firm generally advises funds to avoid public solicitation (marketing to undetermined persons) of investors, even if they are not issuing securities, and to abide by the safe harbour rules for private placements of securities which allow private placement of securities to qualified and institutional investors.

2.3.7 Investor Protection Rules

As mentioned, most recently listed funds are restricted to qualified and institutional investors and some non-listed funds structured to issue securities through private placements are also restricted to qualified and institutional investors.

Listed funds have reporting and disclosure requirements applicable to any listed securities issuers.

2.3.8 Approach of the Regulator

The department of the CNBV in charge of the approval of the issuances of listed funds is, in general, very co-operative and business driven, it is always open to discuss regulatory and filing process matters, as well as new structures. The CNBV is in general a very professional organisation.

2.4 Operational Requirements for Alternative Investment Funds

Private non-listed funds are governed by their Mexican trust agreement or by the constitutional documents of the limited partnership. Therefore, such funds' operational requirements and corporate governance are freely set forth by the sponsor or GP of the fund (generally following market practice).

As to listed funds, from a tax perspective they are structured as FICAPs or passive income Mexican trusts that publicly issue and list:

- equity development notes (*certificados bursátiles fiduciarios de desarrollo* or CKDs), which funds are required to be invested in Mexican projects;
- real estate development certificates (*certificados bursátiles fiduciarios inmobiliarios* or FIBRAs), which funds shall be invested in income-generating real estate portfolios (similar to the US REIT);
- investment project certificates (*certificados bursátiles fiduciarios de proyectos de inversión* or CERPIs), which funds are required to be invested in projects in Mexico or abroad (depending in the investment scope of the fund); or
- energy and infrastructure investment certificates (FIBRA-E, also known as the “Mexican MLP”), which funds must be invested in long-term Mexican qualified energy, electricity and infrastructure projects.

These listed funds are managed by a GP and may require investment committee, technical committee or noteholder meetings to approve investments and divestments. Day to day operations of the fund are generally carried out by the GPs in accordance with their respective management agreements. Auditing of the fund and valuation services of the fund's portfolio are also common, as well as required for listed funds.

2.5 Alternative Investment Funds: Fund Finance Market

As private funds are not regulated, they can access financing at the fund level without any regulatory restriction. Listed funds are also allowed to access financing with some regulatory restrictions (generally caps).

Practical issues may arise regarding the possibility of granting collateral to the lender, depending on the investment structure of the fund.

Listed funds are in general allowed to obtain financing provided they abide by regulation, requiring them to have a minimal asset to loan ratio depending on the type of fund.

Tax

From a tax perspective, it should be considered that Mexican tax laws include thin capitalisation rules which may limit the deduction of interest payable to non-resident investors. Furthermore, Mexican resident companies face additional restrictions for the deduction of interest as new BEPS-inspired limitations have been introduced to the domestic tax legislation as further detailed below.

Assets

When their financing is secured, funds normally secure their financing with real assets (mortgages or pledges) or with cash flows (via a security trust) of the fund or of the vehicles in which they have invested.

Trusts

Funds structured as trusts generally require “corporate authorisations” (authorisations of governing bodies of the trust). These authorisations may become complex for listed funds if a bondholder meeting is required for their approval, as the call for this meeting takes, in general, at least a couple of weeks.

2.6 Alternative Funds Tax Regime

Mexican tax laws and regulations include specific tax regimes for certain types of funds but not for all types of funds available, thus, in the absence of a specific tax regime (which is sometimes established in the form of a tax incentive), the general rules applicable to Mexican trusts shall govern the tax implications applicable to the participants in a fund, whether they are privately held or listed.

General Regime

Funds created subject to Mexican jurisdiction are typically structured so that they can be treated as tax transparent. Thus, the income is directly attributable to investors and will be subject to the individual tax regime applicable to each of them. In the case of listed funds the financial institutions involved in the structure may be required to withhold taxes which will be considered paid on behalf of the investors (and Mexican residents will then be entitled to credit these payments when determining their annual income tax liability).

Mexican resident companies are subject to a general 30% income tax rate on their net tax result for the year, which is determined by subtracting all authorised deductions from the aggregate taxable income of the year (both income and deductions are generally considered on an accrual basis). Mexican tax laws do not establish any reduced capital gains tax rate for Mexican resident companies.

However, Mexican resident individuals are subject to progressive income tax rates, where a 35% rate applies to the higher bracket. While the income attributable to Mexican individuals is regulated under separate chapters of the law and subject to specific rules depending on its nature, upon filing the annual tax return, the applicable bracket is determined by combining all taxable income.

Non-resident investors are typically subject to withholding taxes at rates that will vary depending on the nature of the income realised through the fund, as well as their country of residency for tax purposes. Withholding tax rates under Mexican legislation range between 4.9% and 35% (the law also establishes a 40% withholding tax rate that will seldom apply), but they will generally be reduced under an applicable tax treaty.

Capital gains

The only exception to the general regime described above for Mexican resident individuals relates to capital gains from the sale of publicly traded shares (and other similar income) which are subject to a reduced 10% tax and, thus, they are reported separately from other items of income. Also, it should be considered that dividends distributed to Mexican resident individuals are subject to an additional 10% dividend tax, in addition to the income tax determined in the manner mentioned above.

In the case of non-resident investors, Mexican tax laws provide that capital gains from the sale of publicly traded shares (and other similar income) are subject to a reduced 10% tax; however, investors who are residents of tax treaty countries may be subject to an exemption provided that certain requirements are met.

Benefits under tax treaties

It should be noted that the application of tax treaty benefits is subject to providing a valid certificate of residency issued by the competent tax authority of the country of residence of the investor, and in certain cases to fulfilling additional requirements which vary depending on the type of income realised by the non-resident investor. By way of example, benefits related to the sale of shares may require that a Mexican resident representative be appointed, and that a report issued by a Mexican certified public accountant be filed by the latter.

Passive income Mexican trusts

Investors participating in a passive income Mexican trust should directly recognise the income generated through the trust as if they had received it directly, irrespective of whether the fund actually distributes it or not. Accordingly, investors may be subject to tax in terms of the Mexican tax laws (as adjusted based on any applicable tax treaty) irrespective of whether they receive a distribution, which needs to be considered when structuring a fund.

Mexican investors (including the manager or GP) will be subject to ordinary tax rates (as mentioned above, there is no specific carried interest regime), whereas non-resident investors will be subject to withholding tax rates ranging between 4.9% and 35% (although generally reduced under an applicable tax treaty, where withholding on interest is generally capped at 10% or 15% depending on the country; capital gains may be subject to an exemption for minority participations or to a reduced 10% withholding tax on the gain, depending on the country; and dividends will generally be subject to a maximum 10% tax).

As previously stated, the application of the benefits provided under any relevant tax treaties is subject to certain formal conditions, including the filing of certificates of residency and/or reports issued by a local certified public accountant, and in some cases the appointment of a Mexican resident representative. Considering the transparency of the passive income Mexican trust, these requirements would need to be complied with for each investor (as opposed to doing centralised filings at the trust level), which requires significant co-ordination between investors and the manager of the fund so as to timely comply with all relevant conditions and effectively obtain any relevant tax treaty benefits.

Foreign law funds

Where funds are created subject to foreign law, such as the limited partnerships subject to Ontario or Quebec law that are common in the context of private equity or venture capital funds, they are also typically structured so that they can be treated as transparent from a Mexican tax perspective. Thus, the income is directly attributable to investors and will be subject to the individual tax regime applicable to each of them as described before, including the need to comply with individual requirements for each investor seeking to avail themselves of any tax treaty benefit.

In this case, investors would also directly recognise the income generated through the foreign vehicle as if they had received it directly, irrespective of whether the fund actually distributes it or not. Accordingly, upon structuring a fund that uses a foreign vehicle it should also be considered that investors may be subject to tax in terms of the Mexican tax laws (as adjusted based on any applicable tax treaty) irrespective of whether they receive a distribution.

Transparency in foreign law funds

Considering that one of the main reasons to use certain foreign vehicles (such as the aforementioned limited partnerships created pursuant to Ontario or Quebec law) has been the possibility to treat them as transparent for Mexican tax purposes, it is particularly relevant to consider that a new set of provisions

dealing with the transparency of non-Mexican vehicles have entered into force as of 1 January 2021.

Under such new provisions, non-Mexican vehicles that are treated as transparent under foreign tax laws will in general be viewed as opaque for Mexican tax purposes, unless the vehicle and its participants (including the investors and the manager) qualify for the exception for “private equity funds” that was also enacted as part of the tax reform in the form of a tax incentive, and which is intended to maintain the full tax transparency that is frequently sought by private equity funds.

In this regard it should be noted that certain portions of the drafting of such exceptional regime are ambiguous, and thus the GPs or managers of this type of funds will be required to carefully define whether their funds are effectively eligible for the tax transparency under this exception. Although it is expected that regulations be issued to clarify certain aspects of the regime and the related requirements, no such regulations have been issued as of the date of preparation of this document.

FICAP Trusts

While the regime applicable to FICAP trusts is technically established as a tax incentive, in essence, the related rules establish a series of requirements that generally mimic the characteristics of a private equity fund, the compliance of which ensures that the trust be considered transparent in general terms.

Specifically, the rules applicable to FICAP trusts assume that the purpose of the fund is to acquire equity participations in promoted companies and fund them via loans, and thus the trustee is required to maintain registries of the items of income that may derive from such kind of participation in the promoted companies. Also, the rules establish that the shares acquired in the promoted companies be maintained for at least two years prior to their disposition.

The main difference with the full transparency (of a passive income trust) is that where the fund is structured as a FICAP trust, investors will be subject to taxes only upon receiving a distribution, which results in a more convenient treatment since taxes will only be payable when investors actually receive a distribution from the fund. Given that FICAP trusts are also transparent, the same tax rates as previously mentioned would apply. Therefore, assuming that the objectives of the fund allow for the compliance of the requirements that are relevant to the FICAP regime, this treatment may be more convenient for the investors.

Since the FICAP trust is also a tax transparent vehicle, pursuant to Mexican tax laws, the application of any tax treaty benefits that may be available to the investors participating therein would be subject to the same requirements mentioned above.

While the requirements would also need to be complied with for each investor, the fact that the income tax withholding corresponding to the latter is triggered at the time the FICAP trust makes a distribution is certainly useful from a co-ordination and logistics perspective.

FIBRAs

As previously referred, FIBRAs are similar to the real estate investment trusts (REITs) that exist in the United States. In essence, the rules applicable to these funds establish that FIBRAs should own income-generating real estate (or finance the construction or acquisition of income-generating real estate).

Specifically, it is established that FIBRAs should be formed as Mexican trusts whose purpose shall be to invest in real estate and use such properties for leasing (for at least four years); alternatively, FIBRAs may also acquire the right to receive income from leasing of Mexican real estate from the owner of the real estate, and to grant financing for such activities.

In order to achieve such objectives, at least 70% of the trust estate should be comprised of the real estate properties and/or the collection rights described above; the remainder of its estate (ie, up to 30% of the trust estate) may only be invested in publicly traded government bonds or in shares issued by debt mutual funds.

The FIBRA trust is not required to make any periodic advance income tax payments, which represents an advantage over the ordinary tax regime from a cash flow perspective. Also, it is required to distribute to investors at least 95% of the net taxable earnings obtained, at least once a year (following the end of the tax year); upon doing so, the broker-dealers should apply a 30% withholding tax to the investors except in the case of tax-exempt certificate holders (such as Mexican pension funds, or non-resident pension funds who are tax-exempt on their country of residence).

Additionally, subject to certain requirements the owners of the real estate properties contributed to the trust may also benefit from a deferral in the recognition of the gain realised upon the transfer of the real estate to the FIBRA trust.

FIBRA-Es

The FIBRA-E trust was established in 2015 as a means to incentivise investments in energy (hydrocarbons and electricity) and infrastructure projects; it is inspired in the Master Limited Partnership (MLP) that exists in the United States.

Pursuant to the Mexican tax laws and regulations, FIBRA-E trusts are required to invest in the capital of Mexican resident companies who carry out the permitted activities within the

industries referred above. Upon receiving an investment from a FIBRA-E trust, the promoted companies will become transparent for income tax purposes which effectively results in the elimination of the monthly advance income tax payments and the annual tax payments at such level. Instead, the taxable profits generated by the promoted entities shall be considered by the FIBRA-E trust (in the proportion of its participation) in order to calculate a combined tax result that is then distributed amongst the certificate holders. Tax losses generated by a promoted company cannot be used to offset income generated by other promoted companies, and thus they may only be carried forward by the company that generates them.

The investors in the FIBRA-E will recognise the distribution of the net taxable profits as business income, as if they had directly generated it; broker-dealers distributing such taxable profits shall apply a 30% withholding tax to the investors except in the case of specific tax-exempt certificate holders (Mexican pension funds). Accordingly, the structure effectively eliminates the dividend withholding tax that would have otherwise applied to the Mexican individuals and to the non-resident investors upon receiving a dividend distribution from a promoted company.

Mexican resident individuals and non-resident investors will be exempt from income tax payment on any gains realised from the sale of the certificates issued by a FIBRA-E, provided such sale takes place through an authorised stock exchange.

3. Retail Funds

3.1 Retail Fund Formation

3.1.1 Retail Fund Structures

Retail funds (*fondos de inversión*) are statutorily regulated in Mexico and must be structured as public corporations that publicly issue and list shares, which proceeds are used to invest in a previously determined portfolio of trading securities.

The retail fund takes the form of a Mexican corporation (*sociedad anónima*) that issues shares. Investors in retail funds, are usually small or medium-sized investors, who contribute their money in order to acquire listed shares of the retail fund representing a proportional part of the investment portfolio of the fund.

Retail funds must adopt one of the following types as per its type of investment:

- equity (of private companies);
- debt;
- listed shares; or
- limited purpose.

Regarding the conditions for the acquisition and sell of their shares, they shall establish one of the following modalities: open, which are those who have the obligation to repurchase the shares representing their capital or amortise them with investment securities; or closed, which are those who are prohibited from repurchasing shares representing their capital and amortise shares with investment securities.

3.1.2 Common Process for Setting up Investment Funds

The setting-up process involves incorporating the vehicle and the IPO process before the CNVB and before the relevant Mexican stock exchange regarding the listing process. These funds are managed by a fund operator which requires a licence from the CNBV.

The listing process involves the preparation of a prospectus that will determine the type of trading securities in which the retail fund will invest, restrictions (or time constraints) on the sale of the shares of the retail fund by investors, etc.

The listing process is not cumbersome and may take a few months to obtain the CNBV authorisation.

3.1.3 Limited Liability of Retail Fund Investors

As the retail fund is structured as a Mexican corporation, the investors on its shares are protected by statutory limited liability provisions applicable to the shareholders of the *sociedad anónima*.

3.1.4 Disclosure Requirements

Retail funds are subject to statutory and regulatory disclosure requirements as issuers of public securities.

Among others, the disclosure requirements include providing investors the prospectus of the retail fund, information on the investment risk of the retail fund, the historical performance of each class and series of shares and the level of indebtedness derived from the operating characteristics of the securities subject to investment that make up the portfolios of retail funds and weekly and monthly reports with the composition of the portfolios.

They also have to reveal to the investors all information considered as relevant, such as:

- merger, spin-off, dissolution or liquidation agreements; the beginning of the liquidation process; the revocation of the authorisation granted by the CNBV to incorporate and operate as retail fund;
- the resolutions of the board of directors that approve changes in the corporate purpose, category, type or modality of

- the investment, rating, reference, index, investment regime, holding limits per shareholder, and repurchase schemes;
- modifications of the rating, if any, made by a rating institution of values;
- the hiring of loans or financing equal or higher than five percent of the assets of the retail fund; and
- any other event that affects the financial situation of the retail fund, among many others.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Retail funds are open to any type of investor. Retail funds are one of the most relied upon forms of investment among Mexican individuals.

3.2.2 Legal Structures Used by Fund Managers

Fund operators are usually limited liability corporations.

3.2.3 Restrictions on Investors

As retail fund shares are acquired through the stock exchange, there are no restrictions as to the type of investors that may invest on the shares of retail funds.

3.3 Retail Funds Regulatory Environment

3.3.1 Retail Funds Regulatory Regime

As mentioned, retail funds and their managers or fund operators are statutorily regulated and supervised by the CNBV. Investments by the retail funds are limited to the portfolio of assets approved by the CNBV in the respective prospectus of the retail fund.

3.3.2 Requirements for Non-local Service Providers

Service providers such as custodians used by retail funds must be Mexican entities.

3.3.3 Local Regulatory Requirements for Non-local Managers

Managers of retail funds must be Mexican entities.

3.3.4 Regulatory Approval Process

The managers of retail funds in Mexico are required to set up an SPV (to act as fund operator) and to get a licence for this SPV, which will be subject to regulation and supervision of the CNBV. Authorisation to act as a retail fund operator is burdensome and requires considerable investment in systems and human resources that must comply with the requirements set forth by the CNBV.

The listing process of the retail fund is not cumbersome and may take a few months to obtain the CNBV authorisation.

3.3.5 Rules Concerning Marketing of Retail Funds

Marketing regulation applicable to retail funds is the one applicable to any public issuers in the Mexican market, which in general provides for the market to have all available information at the same time and forbidding the solicitation using information which is not already publicly available to everyone.

Retail funds are not be able to hire share distribution services in an exclusive manner with a company or distributing entity, creating a cap on the commissions in the distribution of such shares for the benefit of its investors. By determining specific requirements to access the funds' different series of shares, discriminatory practices are eliminated and access for small investors to investment in funds is facilitated.

3.3.6 Marketing of Retail Funds

Retail funds can be marketed to the general public, so long as the solicitation rules applicable to public offers of securities are abided by.

3.3.7 Investor Protection Rules

Mexican regulations require disclosure levels to investors comparable to those of public companies and therefore a prospectus approved by the CNBV needs to be published before the public offer of the securities issued by these funds. Retail funds are open to any type of investor and the fund managers or operators are required to provide periodical information on the portfolio of securities and the value or price of each retail fund share.

3.3.8 Approach of the Regulator

The filing process in Mexico is very transparent. The CNBV is very approachable and very open to discuss new transactions and structures, it is in general, a very professional organisation. Face-to-face meetings to discuss relevant subjects are possible.

3.4 Operational Requirements for Retail Funds

Retail funds and their managers are supervised and must operate within the frame of its prospectus. Retail funds operate through securities brokers (supervised and licensed financial entities) that act as custodians of the assets of the retail fund. The fund operator acts as the manager of the fund and provides instructions as to the composition of the investment portfolio. The fund operator shall also liquidate or sell the assets of the securities portfolio in order for the retail fund to repurchase the shares from investors.

The fund operators are required to comply with regulation applicable to transactions on the stock exchange, valuation and pricing of the assets and shares of the retail fund, etc.

3.5 Retail Fund Finance

Retail funds are also allowed to access financing with some regulatory restrictions. In general, retail funds are allowed to obtain financing as long as they comply with a minimal asset-to-loan ratio depending on the type of fund.

3.6 Retail Fund Tax Regime

Fondos de Inversión

Irrespective of the categories that may exist from a regulatory perspective, Mexican tax laws and regulations establish specific tax regimes for two classes of retail funds (*fondos de inversión*): debt-related funds (who can only invest in debt securities); and equity-related funds (who can invest in shares and other securities, in addition to debt instruments).

The aforementioned classes of retail funds are considered tax exempt under the Mexican tax laws and the income generated through them is attributed to the investors, who are subject to tax on this income (although the retail funds may be required to withhold taxes, that can then be used by investors as a credit against their own annual income tax liability). Thus, the regime applicable to retail funds achieves some sort of tax transparency.

In order to achieve such transparency, funds (and especially equity funds) are required to maintain very detailed records on the various income streams they realise, which are then apportioned per share on a daily basis so that the income can be correctly allocated to the investors considering their period of ownership of the publicly traded shares issued by such funds.

The financial institutions involved in the structure of the retail funds may also be required to withhold taxes in respect of certain items of income, which will be considered paid on behalf of the investors and Mexican residents will then be entitled to credit these payments when determining their annual income tax liability.

Exchange Traded Funds

Domestic exchange traded funds (ETFs) are subject to specific tax regulations that include the requirements for a fund to qualify as such, and the specific tax regime applicable to the fund itself and to the investors thereof.

Such regulations require that the fund be created as a Mexican trust who should use a Mexican bank or a broker-dealer as trustee, and whose purpose should be to acquire and manage publicly traded shares and certificates issued by FIBRAs with the objective of tracking an index (equity ETFs), or to acquire and manage publicly traded bonds issued by the Mexican government or by Mexican companies so as to track debt or foreign exchange indices (debt ETFs).

Equity ETFs are subject to a hybrid tax regime, where the investors are directly liable for the taxes triggered upon the sale of the certificates by mirroring the treatment that would have applied from directly owning the underlying shares or FIBRA certificates, whereas the fund is subject to income tax at the 30% corporate rate on the income arising from investing the resources they are allowed to maintain in cash (which cannot exceed 3% of the trust estate and which may give rise to interest, gains from securities lending and gains from the foreign exchange derivatives that funds are allowed to enter into).

Sale of certificates

Regarding the sale of the certificates, Mexican resident corporations are subject to the corporate income tax rate; in the case of Mexican resident individuals, the gains from the sale of the certificates shall be apportioned considering the underlying assets, as they will be subject to the reduced 10% income tax rate in the proportion of the trust estate represented by shares, and an exemption may apply in the proportion of the gain related to the ownership of FIBRA certificates. Gains shall also be apportioned in the case of non-resident certificate holders, who will be subject to the reduced 10% income tax withholding in the proportion of share ownership (although residents of treaty countries may benefit from an exemption, subject to certain conditions) and to an exemption in the proportion attributable to FIBRA certificates.

Conversely, debt ETFs are essentially treated as transparent vehicles and thus they are not subject to tax in Mexico. The interest income (or the foreign exchange gains) realised by such funds is attributable to the holders of the certificates, and the trustee shall distribute the interest within three days following the receipt thereof. In turn, the broker dealers acting as manager or custodians of the certificates issued by the debt ETFs shall apply the withholding tax at the rate applicable to the specific certificate holder, depending on whether they are Mexican residents or non-residents.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

As previously mentioned, funds structured through certain qualifying non-Mexican transparent vehicles (such as limited partnerships created under Ontario or Quebec law) may no longer be treated as transparent for Mexican tax purposes under the rules that entered into force in 2021, unless they qualify for the “private equity funds” exception.

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Given the ambiguity in certain portions of the wording used to create such exception that results in effectively maintaining the full transparency that is frequently sought by private equity funds, special attention should be given to any administrative rules that may be published by the tax authorities that may clarify or supplement these new rules.

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