PRESS RELEASE

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THE COMPREHENSIVE PUBLIC FINANCE REFORM PACKAGE WAS APPROVED BY CONGRESS

- **THE PACKAGE OF INITIATIVES THAT CONSTITUTES THE COMPREHENSIVE PUBLIC FINANCE REFORM, PRESENTED BY THE EXECUTIVE ON JUNE 20th 2007, WAS APPROVED TODAY BY CONGRESS**

- **SINCE THE INITIATIVES WERE SUBMITTED TO CONGRESS, THE LEGISLATIVE BRANCH CARRIED OUT AN EXHAUSTIVE PROCESS OF ANALYSIS, INCLUDING MEETINGS WITH REPRESENTATIVES OF THE DIFFERENT ECONOMIC, SOCIAL AND ACADEMIC SECTORS OF THE COUNTRY WHICH, WITH THEIR PROPOSALS, CONTRIBUTED TO MODIFY AND ENRICH THE INITIATIVES. THE MAIN MODIFICATIONS THAT WERE APPROVED ARE DESCRIBED FURTHER ON.**

- **THE REFORM IS ESTIMATED TO YIELD REVENUES OF AROUND PS. 120.0 BILLION IN 2008, AN AMOUNT EQUIVALENT TO 1.3 PERCENT OF GDP.**

- **ACCORDING TO THE DISTRIBUTION OF FEDERAL INCOME BETWEEN FEDERAL ENTITIES AND THE FEDERATION THAT IS ESTABLISHED IN THE FISCAL COORDINATION LAW, CLOSE TO 30% OF THE RESOURCES OBTAINED FROM THE REFORM WILL BE ALLOCATED TO FEDERAL ENTITIES AND 70% TO THE FEDERATION, WITHOUT INCORPORATING THE RECOURCES FROM THE SALES ON GASOLINE TAXES.**

- **THE RESOURCES OBTAINED FROM THE REFORM WILL BE ALLOCATED TO SOCIAL EXPENDITURES AND INFRASTRUCTURE INVESTMENT, AT THE SAME TIME THAT THEY WILL STRENGHTEN THE PUBLIC FINANCES OF THE THREE LEVELS OF GOVERNMENT AND WILL REDUCE THE GOVERNMENT'S DEPENDANCE ON OIL REVENUES. THIS WILL RESULT IN HIGHER ECONOMIC GROWTH AND JOB CREATION.**

- **THE MODIFICATIONS PROPOSED BY LEGISLATORS TO THE FISCAL REGIME OF PEMEX WERE APPROVED.**

- **THE APPROVAL OF THE PUBLIC FINANCE REFORM SHOWS THAT, THROUGH A FRUITFUL DIALOGUE AND RESPONSIBLE NEGOTIATION, THE EXECUTIVE AND LEGISLATIVE BRANCHES CAN REACH THE REQUIRED CONCENSUS IN ORDER TO GUARANTEE A MORE PROIMISING FUTURE FOR ALL MEXICANS.**

The main modifications to the proposal are describes in what follows, classifying them according to the four pillars of the Public Finance Reform. Such pillars are:

1. Tax administration: to facilitate compliance with tax obligations, and strengthening measures to reduce tax elusion and evasion.

2. Public spending: to establish an institutional structure that guarantees result-oriented spending, making it more efficient and transparent at the three levels of government, and promoting its productivity and austerity.

3. Fiscal Federalism: to provide states and municipalities with better instruments and incentives in order to establish a relationship of co-responsibility between the three orders of government.

4. Public revenues: to set the base for a tax system that allows the substitution of oil revenues with more stable sources of income by implementing neutral schemes that promote investment, job creation and economic growth.

Tax Administration

1) Tax on cash deposits

- The denomination of the of tax is modified from the tax on informality to tax on cash deposits.
- The Law of the Tax on Deposits will take effect on July 1st 2008, instead of January 1st 2008.
- The level of monthly deposits beyond which the tax starts to be charged was increased. The tax of 2% will be applied on the amount of cash deposits that exceed the cumulative monthly amount of Ps. 25,000, compared with the previous amount of Ps. 20,000. Worth noting is that an individual with a monthly income of Ps. 25,000.00 would belong in the highest income decile.
- The law clarifies that remittances made through electronic transfers or checking orders do not constitute cash deposits and therefore are not subject to the tax. During 2006 and the observed period of 2007, 98.4 percent of remittances were received by these means of payment.
- The tax can be credited, first, against income tax; then against retained income tax; and subsequently against any other federal contributions. Finally, if such contributions were not enough, the taxpayer can request the

reimbursement of the tax. This will guarantee that the formal sector of the economy is not affected.

- Payments made in cash by individuals and firms to repay loans granted by financial institutions will not be subject to the tax up to the amount of the loan.
- Acquisitions using cash of teller checks will be considered cash deposits.
- Deposits made to accounts of societies that operate investment funds are regulated specifically. It is established that cash deposits made to the aforementioned accounts will be considered to correspond to the final beneficiaries of such deposits.

2) Miscellaneous fiscal amendments affecting the Federal Fiscal Code

- The majority of the proposals to strengthen auditing and control procedures were approved. In particular, shared responsibility is established in the case of a firm leaving its fiscal address without the corresponding notice; fines to advisors and service providers are increased; tax payers are given the opportunity to know all the documentation provided by any administrative authority; it is established that when tax payers do not exhibit the required documentation during the tax authority's visit but they present it as a proof in a later defense, the authority can make a new visit, and proposals in the penal sphere are suppressed, with the exception of the one related to fiscal fraud in cases of money laundering.

Public spending

Worth mentioning are the following modifications to the Federal Executive proposals:

1) Political Constitution of the Mexican United States. It is necessary to clarify that the following changes to the Constitution have been approved by the lower house of Congress but have yet to be approved by the Senate. Once the process has finished at the Federal Level, it would continue if local legislatures approve the modifications.

   - The reform will allow approving outlays for the whole life of those investment projects defined in the Federation Expenditures Budget, leading to important savings in the projects.

- Proposed modifications regarding the adjustment in dates to present the Public Account and the Report of Results of the Superior Audit of the Federation with the aim to present prompt results to society.
- The House of Representatives will conclude the revision of the Public Account no later than April 30th of the following year after its presentation. Also, the proposal to give Congress the faculty to establish uniform governmental accounting principles for the three orders of government was approved.
- The House of Representatives will have the attribution of evaluating financial management results as part of the revision process of Public Account.
- The surveillance functions of the House of Representatives were strengthened through diverse changes, among which are the following:
  - ✓ The Superior Audit of the Federation will be able to make audits on the fulfillment of objectives in the federal programs.
  - ✓ Direct surveillance is established over federal resources used by any entity, individual, private or public firm, and those transferred to trusts, mandates, funds or any other legal act.
  - ✓ Shareable revenues are excluded from the direct surveillance by the Superior Audit of the Federation in order to not violate the autonomy of the Federal Entities.

2) Federal Law of Budget and Fiscal Responsibility

- Instead of establishing the National Council of Evaluation of Public Policies proposed by the Executive branch, general principles will be established which will be the basis of the performance evaluations made by all existing public institutions that have this function.
- The Federal Executive will have to establish a savings goal of up to 20% of the operating and administrative expenditure of the Federal Government, which will have to be fulfilled before the term of the administration. A minimum annual savings goal of 5% in the years to come will be established.
- Programs of austerity for government-owned companies will be established. In these, the goals will be based on international standards of operating expenses, when it is feasible, including expenditures on human resources. The companies will have to inform their savings goals.
- Government ministries and publicly-owned enterprises will establish -in an investment plan with short, medium and long-term projects- their

investment needs using criteria on socio-economic returns, and their impact on poverty reduction and regional development. In addition, methodology will be developed in order to establish an ordering of the projects so they are evaluated and prioritized for their approval and completion.

- The reform promotes greater competition in government acquisitions, which will lead to important savings and a more efficient acquisition process of goods and services by the public sector.
- Regarding personal services, the creation of jobs and new hiring by the Federal Government will be conditioned to the previous funding of all future obligations (inherent expenses such as taxes, contributions to social security, insurance premiums, among others).
- A gender perspective is introduced in the evaluations of government programs in which it is feasible to distinguish between beneficiaries.

Fiscal Federalism

1) Fiscal Coordination Law

- The proposed changes to the formulae of the Shareable Revenue Fund (Fondo General de Participaciones) and the Municipal Development Fund (Fondo de Fomento Municipal) were approved. The creation of the Fiscalization Fund (Fondo de Fiscalización), constituted using the funds from the Contingency Reserve and the Rights Coordination Fund, was approved in order to reward economic activity and tax collection efforts.
- The amendment to the distribution rules of the Fund of Contributions for the Strengthening of Federal Entities (FAFEF) was approved.
- The distribution formula of the Contributions Fund for Basic and Normal Education (FAEB) was adjusted. Specifically, state education expenditure is now included as a variable in the distribution in order to reflect the effort states make in order to strengthen their basic education systems.
- Two compensation funds for federal entities were created:
  - ✓ the Hydrocarbon Extraction Fund (0.46% of the ordinary right on hydrocarbons paid by PEMEX) for Federal Entities where oil is extracted, and

- ✓ the Compensation Fund for the ten Federal Entities with the lowest non-mining and non-oil related GDP per capita. This will be financed with close to 20% of the new gasoline sales tax. The objective of the Fund is to promote a more balanced regional development, allocating resources to the entities with the highest needs.

2) Federal Excise Tax Law (IEPS in Spanish)

- Taking into account that the constitutional reform initiative to allow Federal Entities to establish a local sales tax on goods that are liable to pay the federal excise tax (IEPS) was not approved, Congress incorporated a federal sales tax on diesel and gasoline with the following characteristics:
  - ✓ The resources will be allocated in their entirety to Federal Entities.
  - ✓ A part of the tax will be distributed among the Federal Entities as a function of the fuel consumption that takes place in their territory (close to 80%) and the rest of the resources will go to the previously mentioned Compensation Fund.
  - ✓ This tax will be transitory and will be suspended if the constitutional reform is approved and any state incorporates the local sales tax.
  - ✓ The resources received by the Federal Entities and their municipalities will be destined to roads, rural, urban, hydraulic, basic and sanitary infrastructure as well as environmental programs.
  - ✓ The fees are: Magna Sin gasoline with 36 cents per liter, Premium UBA gasoline with 43.92 cents per liter, and diesel with 29.88 cents per liter.
  - ✓ The fees will be applied gradually during 18 months through the following increases: Magna Sin gasoline 2 cents per liter; Premium UBA gasoline, 2.44 cents per liter, and diesel 1.66 cents per liter, in addition to the adjustment rhythm in the prices of these goods that is currently in place.

3) The date for the elimination of the Law of the Tax on the Property and Use of Vehicles was forwarded to the first of January 2012, or before if Federal Entities establish this tax at the local level.

Tributary System

1) Unique Rate Corporate Tax (IETU)

- The name of the "unique rate corporate contribution" proposed by the Executive was changed to "unique rate corporate tax".
- A more paced transition and a lower final rate were established. The rates that will be applied are 16.5% for the 2008 fiscal year, 17% for 2009 and 17.5% from 2010 onwards.
- At the same time, a transitory regime is incorporated to give an adequate treatment to previous investments by tax payers.
  - ✓ New investments made from September 1st to December 31st 2007 will be deductible in the following 3 fiscal years in equal shares.
  - ✓ For investments in fixed assets, deferred expenses and charges, a tax credit against the IETU is established at a rate of 5% during the following 10 fiscal years starting 2008 will be granted. This will be equivalent to 50% of the fiscal value of the existing investments as of December 31st 2007 that were acquired before August 31st 2007, and the preceding 10 fiscal years.
- The Executive will have to evaluate the appropriate legal instrument through which the value of inventories as of December 31st 2007 will be recognized, as well as the recognition of the losses pending amortization in which the tax payer incurred during the fiscal years from 2005 to 2007 by applying the immediate deduction of the investments in income tax payments.
- A single fiscal credit will be granted that will replace the credits to retained income tax and employment tax credit (CAE), in order to simplify the compensation system due to the non-deductibility of salaries, as well as to avoid that these could represent a higher cost than the salary deduction. A fiscal credit for the social security contributions by employers is also granted.
- Fiduciary entities through which individuals carry out activities that are liable to pay the unique rate corporate tax can credit against the tax their payments of wages and the social security contributions by employers.
- Non-onerous and not-for-profit donations will be deductible up to 7% of the fiscal profit or cumulative income, in the case of firms and individuals,

respectively, corresponding to the immediately preceding fiscal year in which the deduction takes place.

- Income received by individuals corresponding to the primary sector will be exempt up to an amount of 40 and 20 minimum wages for the individual or partner of a firm, without exceeding 200 minimum wages, as long as they are registered in the Federal Tax Payer Registry (RFC). In the case of those not registered, they will have a temporary exemption as long as they subscribe within the time limits and complying with the requirements established by the Tax Administration Authorities.
- The suspension and tax pardon of the payment on the IETU is allowed in case of bankruptcy procedures, under certain conditions.
- The treatment proposed in the iniciative for the accidental acts undertaken by an individual is eliminated, making unnecessary the exemption on sales of the residence and used furniture of an individual.

2) Miscellaneous fiscal amendments on taxes

- The proposal to integrate the tax and the fiscal subsidy into one unique fee for the income tax (ISR) for individuals was approved. Likewise, income obtained by large investors, individuals or foreign residents as a result of selling stocks in the stock exchange will be taxed if they imply a transaction involving 10% or more of the stock of a given firm.
- The excise tax (IEPS) on gambling and lotteries was approved.
- The proposal to tax spray paints was eliminated.
- The abrogation of the Asset Tax (IMPAC) was approved.

The Fiscal Regime of PEMEX

- Even though the modification to the fiscal regime of PEMEX was not a component of the Public Finance Reform, it was included after a proposal by the legislators. The proposal is focused on strengthening PEMEX and diminishing its tax burden so the company has higher resources for investment. Moreover, additional resources are allocated to research and development of technology in the sector.
- The rate on the ordinary fee on hydrocarbons is reduced from 79% at the moment to 74% in 2008; 73.5% in 2009; 73% in 2010; 72.5% in 2011 and 71.5% from 2012 onwards.

- The limits related to deductions by concepts of cost, expenditures and investments related to the extraction of crude oil and natural gas are maintained.
- The reduction that PEMEX obtains on payment of the ordinary fee on hydrocarbons will be channeled to investment expenditure, in accordance to what is established in the Federation's Expenditure Budget.
- PEMEX and its subsidiary agencies will carry out a program to increase their operational efficiency during the period from January 1st 2008 to December 31st 2012, after the approval by the Secretariat of Energy.
- In order to maintain the income of the federal entities unaffected, the rates that are applied to the ordinary fee on hydrocarbons in order to determine the federal shareable tax collection are modified.
- The rate on the fee for scientific and technological research on energy is raised from 0.05% at the moment to 0.15% in 2008; 0.30% in 2009; 0.40% in 2010; 0.50% in 2011 and 0.65% from 2012. The resources will be channeled through CONACYT funds, according to the Law of Science and Technology.
- A unique fee on hydrocarbons is established to promote the reopening of oil fields that were abandoned or were in the process of abandonment, but which still have productive potential. The additional resources that PEMEX Exploration and Production receives from the exploitation of these fields will be allocated to an Investment fund for Exploration and Production, after discounting expenditures and the unique fee on hydrocarbons.

Reform Resources

The Public Finance Reform is expected to generate additional revenue of Ps. 120.0 billion, equivalent to 1.1% of GDP. The new taxes will generate Ps. 114.7 billion and the new efficiency measures for tax collection will increase revenues by Ps. 21.0 billion. The elimination of the asset tax (IMPAC), as well as the increased gasoline deductions in the income tax (ISR), will reduce the additional revenue by Ps. 15.8 billion.

Revenues from the Public Finance Reform, 2008		
	Billions	% GDP
Total (I-II)	**120.0**	**1.1**
I. Additional Revenues	135.8	1.3
1. IETU	110.6	1.1
2. Tax on Deposits	2.9	0.0
3. Lotteries and Gambling	1.2	0.0
4. Tax Collection Efficiency	21.0	0.2
II. Revenue Reduction	15.8	0.2
1. IMPAC	15.7	0.1
2. Gasoline deduction in income tax	0.1	0.0

Allocation of resources obtained from the Public Finance Reform

According to the distribution of federal revenue between the Federal Entities and the Federation that is established in the Fiscal Coordination Law, close to 30% of the resources obtained from the Public Finance Reform will be allocated to the Federal Entities and 70% to the Federation. Additionally, Federal Entities will receive close to Ps. 12.2 billion arising from the federal tax on final sales of gasoline and diesel.

Allocation of resources obtained from the Public Finance Reform, 2008		
	Ps. Bill.	% GDP
Total	**132.2**	**1.3**
Federation	82.8	0.8
Federal Entities	49.5	0.5
Participations	26.8	0.3
Shared Revenues	8.6	0.1
Hydrocarbon Extraction Fund	1.8	0.0
States Gasoline	12.2	0.1

The Federal Government's resources from the Reform have to be distributed to maintain a balanced budget, while attending the priorities and strategies established in the National Development Plan such as fostering investment, increases in human capital and the promotion of growth in productivity and employment. To accomplish these objectives, the proposed allocation of the resources obtained form the Public Finance Reform is the following:

Proposed allocation of resources from the Public Finance Reform		
	Ps. Bill.	Structure %
Total	**82.8**	**100.0**
I. Competitiveness and job creation	**63.4**	**76.6**
1. Infrastructure	55.7	67.3
Transport and communications	17.1	20.6
Water	8.4	10.2
Energy	30.2	36.5
2. Lower electricity tariffs	7.7	9.3
II. Human development	**19.4**	**23.4**
3. Medical infrastructure	3.7	4.5
4. Strengthening of IMSS	4.2	5.1
5. Support to the least-developed municipalities	3.1	3.8
6. Public Security in Municipalities	3.7	4.5
7. Secondary and higher education coverage	4.6	5.5

Medium Term Perspectives

- The Public Finance Reform is expected to improve economic growth perspectives, mainly through its positive effect in investment. First, the greater physical infrastructure derived from public investment will increase the productivity of production factors and will reduce the costs of doing business in the economy. Second, the tributary scheme is more favorable for investment, by allowing immediate tax deductibility through the IETU (Unique Rate Corporate Tax). Third, through consolidating healthy public finances in the medium term, lower interest rates and country sovereign risk will be observed. Finally, the confidence effect derived from the fact that Mexicans are able to undertake the reforms that Mexico needs in order to improve future economic prospects.

- These factors are expected to result in a gradual increase in the pontential growth rate of GDP by around 0.5 percentage points. An increase of 0.2 percent in the growth rate for 2008 is expected, with an additional increase of 0.3 additional percentage points in subsequent years.

- With respect to public finances, budgetary revenues will increase from 22.8 percent of the GDP in 2007 to an average of 24.2 percent from 2008 to

2012. This is mainly due to two factors: i) efficiency gains of 20 basis points of GDP derived from improvements in tax administration, accumulating an increase equivalent to 1 percent of GDP in 2012, and ii) the collection from IETU will increase from 1.1 to 1.2 percent of GDP between 2008 and 2012. This will compensate the expected decline in oil revenues.

Revenues obtained from the Public Finance Reform, 2008-2012

CONCEPT	% of GDP				
	2008	2009	2010	2011	2012
TOTAL (1+2+3-4)	**1.1**	**1.4**	**1.7**	**1.9**	**2.1**
1. IETU [1/]	1.1	1.1	1.2	1.2	1.2
2. Deposit Tax	0.0	0.1	0.1	0.1	0.1
3. Collection Efficiency	0.2	0.4	0.6	0.8	1.0
3.1 In Income Tax	0.1	0.3	0.4	0.5	0.7
3.2 In VAT	0.1	0.1	0.2	0.3	0.3
4. Asset Tax (IMPAC)	0.1	0.2	0.2	0.2	0.2

1/ IETU rate: 2008, 16.5%; 2009, 17% and form 2010 onward, 17.5%.

- The higher economic growth derived from the Public Finance Reform will reduce public spending pressures by an average of 0.2 percentage points of GDP each year with respect to an inertial scenario. It is anticipated that the proposals to promote austerity will reduce spending pressures by close to 5 percent of the administrative expenses of the Federal Public Sector, reaching a maximum of 20 percent by 2012.

- Higher revenues and economic growth, as well as the austerity measures, will allow the Public Sector to maintain a balanced budget. In this way, financial costs would be reduced, allowing additional increases in programmable expenditures. This, together with the higher revenues from the Reform would translate into a higher availability of resources for social development and infrastructure.

- By fulfilling the balanced budget goal, the net debt of Federal Public Sector would be reduced from 20.5 to 15.6 percent of the GDP between 2007 and 2012. By maintaining the public sector borrowing requirements (PSBR) at 2.0 percent of the GDP during 2009-2013, the historical balance of the PSBR would diminish from 36.0 to 34.6 percent of GDP in the period from 2007 to 2012.

Public Finance Evolution, 2008-2012					
	(% of GDP)				
CONCEPTS	2008	2009	2010	2011	2012
Economic Balance	0.0	0.0	0.0	0.0	0.0
Public Sector Net Debt	19.4	18.5	17.5	16.5	15.6
PSBR	2.0	2.0	2.0	2.0	2.0
PSBR Historical Balance	35.7	35.4	35.1	34.8	34.6

- By strengthening the sustainability of public finances, the fiscal burden of future generations is diminished. In addition, a smaller absorption of financial resources by the Public Sector will increase the availability of resources for the private sector, leading to higher private investment. The previous elements will lead to an improvement in economic perspectives through higher rates of economic growth in the years to come, leading to better standards of living for all Mexicans.