

**CONFORMED COPY**

**LOAN NUMBER 7126-ME**

# **Loan Agreement**

**(Tax Reform Adjustment Loan)**

**between**

**UNITED MEXICAN STATES**

**and**

**INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT**

**Dated September 30, 2002**

**LOAN AGREEMENT**

AGREEMENT, dated September 30, 2002, between the UNITED MEXICAN STATES (the Borrower) represented by its signatory on page 10 of this Agreement and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Borrower is a signatory of the *Articles of Agreement of the International Bank for Reconstruction and Development* (the international treaty by which the Bank was created), which *Articles of Agreement* contain, *inter alia*, general provisions relating to loans extended by the Bank;

(B) the Bank has received from the Borrower a letter, dated May 14, 2002, describing a program of actions, objectives and policies designed to achieve structural adjustment of the Borrower's economy (hereinafter called the Fiscal Program), which Fiscal Program includes a description of tax reforms that consist of actions designed to, *inter alia*, increase federal tax revenue, improve the efficiency of federal tax collection by reducing the distortions in federal tax incentives, establish an equitable federal tax burden on individuals with similar income levels and simplify the administration of federal taxes as set forth in the paragraphs entitled "Tax Policy" and "Tax Administration" under Section II of said letter (hereinafter called the Tax Policy Component), declaring the Borrower's commitment to the execution of the Tax Policy Component and requesting assistance from the Bank in support of the Tax Policy Component during the execution thereof;

(C) the Borrower has carried out the measures and taken the actions described in Schedule 2 to this Agreement to the satisfaction of the Bank and has maintained a macroeconomic policy framework satisfactory to the Bank; and

(D) on the basis, *inter alia*, of the foregoing, the Bank has decided in support of the Tax Policy Component to provide such assistance to the Borrower by making the loan provided for in Article II of this Agreement (the Loan) as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

## ARTICLE I

### General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Loan and Guarantee Agreements for Fixed-Spread Loans” of the Bank dated September 1, 1999, with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

- (a) Section 2.01, paragraph 41, is modified to read:

“ ‘Project’ means the program, referred to in the Preamble to the Loan Agreement, in support of which the Loan is made.”;

- (b) Section 3.08 is modified to read:

“Each withdrawal of an amount of the Loan from the Loan Account shall be made in the Loan Currency of such amount. If the Loan Currency is not the currency of the deposit account specified in Section 2.02 of the Loan Agreement, the Bank, at the request and acting as an agent of the Borrower, shall purchase with the Loan Currency withdrawn from the Loan Account the currency of such deposit account as shall be required to deposit the withdrawn amount into such deposit account.”;

- (c) Section 5.01 is modified to read:

“The Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in accordance with the provisions of the Loan Agreement and of these General Conditions.”;

- (d) The last sentence of Section 5.03 is deleted;

- (e) Section 9.07 (c) is modified to read:

“(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the program referred to in the Preamble to the Loan Agreement, the performance by the Borrower and the Bank of their respective

obligations under the Loan Agreement and the accomplishment of the purposes of the Loan.”; and

(f) Section 9.05 is deleted and Sections 9.06, 9.07 (as modified above), 9.08 and 9.09 are renumbered, respectively, Sections 9.05, 9.06, 9.07 and 9.08.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Deposit Account” means the account referred to in Section 2.02 (b) of this Agreement;

(b) “Federal Budget 2002” means the Borrower’s annual budget for the year 2002 (*Presupuesto de Egresos de la Federación para el Ejercicio Fiscal 2002*), duly approved by the Chamber of Deputies (*Cámara de Diputados*) of the Borrower’s Congress, and published in the Borrower’s Official Gazette (*Diario Oficial de la Federación*) and entered into effect on January 1, 2002, pursuant to the provisions of Article 74 (IV) of the Borrower’s Constitution;

(c) “Fiscal Deficit” means the difference between federal public sector revenues and federal public sector expenditures as set forth in the Federal Budget 2002;

(d) “Fiscal Year” means the Borrower’s fiscal year commencing on January 1 and ending on December 31;

(e) “Gross Domestic Product” means the total value of goods produced and services provided within the Borrower’s territory during a given Fiscal Year;

(f) “Income Tax Law” means *Ley del Impuesto Sobre la Renta* of the Borrower published in the Borrower’s Official Gazette (*Diario Oficial de la Federación*) and entered into effect on January 1, 2002;

(g) “NAFIN” means *Nacional Financiera S.N.C.*, a Mexican development bank serving as the Borrower’s financial agent for purposes of the Loan;

(h) “NAFIN Contract” means the contract referred to in Section 3.03 (a) of this Agreement; and

(i) “SHCP” means the Borrower’s Secretariat of Finance and Public Credit.

## ARTICLE II

### The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount equal to three hundred three million and forty thousand Dollars (\$303,040,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.09 of this Agreement.

Section 2.02. (a) Subject to the provisions of paragraphs (b) and (c) of this Section, the Borrower shall be entitled to withdraw the amount of \$300,009,600 from the Loan Account in support of the Program.

(b) The Borrower shall open, prior to furnishing to the Bank the first request for withdrawal from the Loan Account, and thereafter maintain in *Banco de México*, a deposit account in Dollars on terms and conditions satisfactory to the Bank. Except with respect to the front-end fee referred to in Section 2.04 of this Agreement, all withdrawals from the Loan Account shall be deposited by the Bank into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Loan shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Bank shall have determined at any time that any proceeds of the Loan shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Bank: (i) deposit into the Deposit Account an amount equal to the amount of said payment; or (ii) if the Bank shall so request, refund such amount to the Bank. Amounts refunded to the Bank upon such request shall be credited to the Loan Account for cancellation.

(d) No withdrawals shall be made from the Loan Account unless the Bank shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement and based on evidence - satisfactory to the Bank - that the macroeconomic policy framework of the Borrower is satisfactory to the Bank. If, after said exchange of views, the Bank is not so satisfied, the Bank may give notice to the Borrower to that effect and, if within ninety (90) days after such notice, the Borrower shall not have taken steps satisfactory to the Bank in respect of its macroeconomic policy framework, then the Bank may, by notice to the Borrower, cancel the unwithdrawn amount of the Loan or any part thereof.

(e) No withdrawals shall be made from the Loan Account if an action has been taken or a policy has been adopted to reverse any action or measure under the Tax Policy Component (including any action or measure set forth in Schedule 2 to this

Agreement) in a manner that would, in the opinion of the Bank, adversely affect the achievement of the objectives of the Tax Policy Component. If such an action or policy is taken, the Bank may give notice to the Borrower to that effect and, if within ninety (90) days after such notice, the Borrower shall not have taken steps satisfactory to the Bank in respect of such action or policy, then the Bank may, by notice to the Borrower, cancel the unwithdrawn amount of the Loan or any part thereof.

Section 2.03. The Closing Date shall be June 30, 2003 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a fee in an amount equal to one percent (1%) of the amount of the Loan. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of said fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge on the principal amount of the Loan not withdrawn from time to time, at a rate equal to: (i) eighty five one-hundredths of one per cent (0.85%) per annum from the date on which such charge commences to accrue in accordance with the provisions of Section 3.02 of the General Conditions to, but not including the fourth anniversary of, such date; and (ii) seventy five one-hundredths of one per cent (0.75%) per annum thereafter.

Section 2.06. The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, in respect of each Interest Period at the Variable Rate; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the Borrower shall, during the Conversion Period, pay interest on such amount in accordance with the relevant provisions of Article IV of the General Conditions.

Section 2.07. Interest and commitment charges shall be payable semiannually in arrears on May 15 and November 15 in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in full on May 15, 2012.

Section 2.09. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management:

- (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency;

- (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan from a Variable Rate to a Fixed Rate, or vice versa; and
- (iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Variable Rate.

(b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a "Conversion", as defined in Section 2.01(7) of the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

Section 2.10. Without limitation upon the provisions of paragraph (a) of Section 2.09 of this Agreement and unless otherwise notified by the Borrower to the Bank in accordance with the provisions of the Conversion Guidelines, the interest rate basis applicable to the aggregate principal amount of the Loan withdrawn during each Interest Period shall be changed from the initial Variable Rate to a Fixed Rate for the full maturity of such amount in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

Section 2.11. The *Director de Financiamientos Internacionales* of Nacional Financiera S.N.C., and any person whom he or she shall designate in writing, are designated as representatives of the Borrower for the purposes of taking any action required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions.

### **ARTICLE III**

#### **Particular Covenants**

Section 3.01. The Borrower shall exchange views with the Bank on any proposed action to be taken during and after the disbursement of the Loan which would have the effect of materially reversing the objectives of the Tax Policy Component, or any measure or action taken under the Tax Policy Component (including any action or measure specified in Schedule 2 to this Agreement).

Section 3.02. Upon the Bank's request, the Borrower shall - through NAFIN:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(b) furnish to the Bank as soon as available, but in any case not later than four months after the date of the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(c) furnish to the Bank such other information concerning the Deposit Account and the audit thereof as the Bank shall have reasonably requested.

Section 3.03. (a) The Borrower, through SHCP, shall enter into a contract (*Contrato de Mandato*) with NAFIN, satisfactory to the Bank, whereby:

(i) NAFIN agrees to act as financial agent of the Borrower with regard to the Loan, meaning that, *inter alia*, NAFIN agrees to represent the Borrower vis-à-vis the Bank for purposes of submitting Loan withdrawal applications to the Bank in form and substance sufficient to justify disbursement by the Bank to the Borrower of Loan proceeds, agrees to maintain and operate the Deposit Account in compliance with the terms of this Agreement and agrees to ensure that the obligations set forth in Section 3.02 of this Agreement are complied with; and

(ii) the Borrower agrees that, through SHCP, the Borrower shall cooperate fully with NAFIN to ensure that NAFIN is able to comply with all of NAFIN's obligations referred to in paragraph (a) of this Section.

(b) The Borrower shall exercise its rights and carry out its obligations under the NAFIN Contract in such a manner as to protect the interests of the Bank and to accomplish the purposes of the Loan. Except as the Bank may otherwise agree, the Borrower shall not amend or fail to enforce any provision of the NAFIN Contract. In case of any conflict between the terms of the NAFIN Contract and those of this Agreement, the terms of this Agreement shall prevail.



## **ARTICLE IV**

### **Additional Event of Suspension**

Section 4.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Fiscal Program, or a significant part thereof, will be carried out.

## **ARTICLE V**

### **Effective Date; Termination**

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Loan Agreement within the meaning of Section 12.01(c) of the General Conditions, namely that the NAFIN Contract has been entered into by the Borrower and NAFIN.

Section 5.02. The following is specified as an additional matter, within the meaning of Section 12.02 (c) of the General Conditions, to be included in the opinion or opinions to be furnished to the Bank, namely, that the Borrower (in its legal opinion) and NAFIN (in a separate legal opinion satisfactory to the Bank, issued by NAFIN counsel acceptable to the Bank), indicate that the NAFIN Contract has been duly authorized or ratified by, and executed and delivered on behalf of, the Borrower and NAFIN and is legally binding upon the Borrower and NAFIN in accordance with the NAFIN Contract's terms.

Section 5.03. The date December 30, 2002 is hereby specified for the purposes of Section 12.04 of the General Conditions.

## **ARTICLE VI**

### **Representative of the Borrower; Addresses**

Section 6.01. Except as provided in Section 2.11 of this Agreement, the *Director General de Crédito Público* of the SHCP of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Dirección General de Crédito Público  
Secretaría de Hacienda y Crédito Público  
Palacio Nacional (piso 3), oficina 3010  
Colonia Centro  
06000 México, D.F.  
México

Telex:

Facsimile:

1777313-SHOCME

011-52-5-228-1156

For the Bank:

International Bank for  
Reconstruction and Development  
1818 H Street, N.W.  
Washington, D.C. 20433  
United States of America

Cable address:

Telex:

Facsimile:

INTBAFRAD  
Washington, D.C.

248423 (MCI) or  
64145 (MCI)

(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

UNITED MEXICAN STATES

By /s/ Francisco Gil Díaz  
Authorized Representative  
Secretariat of Finance and Public Credit

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

By /s/ James D. Wolfensohn  
Authorized Representative

## SCHEDULE 1

### Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Loan shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112		Alcoholic beverages
121		Tobacco, unmanufactured, tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitutes)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked

718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;

5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term "environmentally hazardous goods" means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party);

6. expenditures: (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories; or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and

7. expenditures under a contract in respect of which the Bank determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation.

## SCHEDULE 2

### Actions Referred to in Recital (C) of the Preamble to this Agreement

1. The Federal Budget 2002 forecasts an overall Fiscal Deficit of 0.65 percent of the Gross Domestic Product for Fiscal Year 2002, as said Gross Domestic Product is estimated in the *Criterios Generales de Política Económica 2002*, published by the *Secretaría de Hacienda y Crédito Público* (the Borrower's Secretariat of Finance and Public Credit) in November 2001.

2. The Federal Budget 2002 has increased for Fiscal Year 2002 the programmable expenditures (*gastos programables*) for education, health, social safety nets, and economic infrastructure by at least 0.8 percentage points of the Gross Domestic Product with respect to Fiscal Year 2001. For purposes of this paragraph, "economic infrastructure" means roads and facilities for the generation, transmission, transformation and distribution of electricity.

3. The Income Tax Law:

(a) (i) eliminates the special cash-flow tax regime (which regime consisted of registering the income in cash and deducting from said income the expenditures in cash, and deducting investments in a single year at a rate of 100%) for those taxpayers referred to in Article 79 of the Income Tax Law; and (ii) substitutes said regime with a cash-basis regime, which regime consists of registering the income in cash and deducting from said income: (A) the expenditures that are paid in cash (i.e, labor, utilities, rental and raw material costs as mentioned in Articles 123 through 126 of the Income Tax Law); and (B) the cost of investments in fixed-assets through the application of either the straight-line depreciation method or the immediate tax deduction method as defined in paragraph (c) below for purposes of eliminating the deduction of: (1) the cost of investments in financial assets; and (2) excess estimates of the cost of investments in fixed-assets;

(b) substitutes the inflation adjustment regime with a simplified mechanism for determining the cumulative and deductible inflation applicable to financial assets and liabilities, as provided in Articles 46 through 48 of the Income Tax Law;

(c) introduces an immediate tax deduction method, which method consists of the deduction of the net present value of the future straight-line capital depreciation discounted at the annual rate of 6% for taxpayers which are legal entities and individuals carrying out business and professional activities, with respect to new fixed assets investments outside the metropolitan areas of Monterrey, Guadalajara and Mexico City, or anywhere within the Borrower's territory, provided that - in the latter case - the production activity of said taxpayers is labor intensive, uses clean technologies with

respect to the emission of pollutants and does not require significant use of water, as provided in Articles 220 and 221 of the Income Tax Law;

(d) establishes a limit on tax deductions by legal entities with respect to fringe benefits (*gastos de previsión social*) paid to non-union workers (*empleados de confianza*) as referred to in Article 31-XII of the Income Tax Law, which limit consists of the lower of 10% of the taxable income of each of said workers or an amount equivalent to the annual minimum wage for said workers;

(e) (i) eliminates the reduced tax rate for reinvested profits; (ii) eliminates the 5% withholding tax rate for dividends; (iii) unifies the tax rates applicable for legal entities and individuals at 35% for Fiscal Year 2002; and (iv) provides for the gradual reduction of said tax rates to 32% by Fiscal Year 2005, as referred to in Articles 10 and LXXXII Transitory (*Transitorio*) of the Income Tax Law;

(f) gradually phases out the tax reduction percentage for the publishing industry by Fiscal Year 2006, as provided in Article LXVII Transitory (*Transitorio*) of the Income Tax Law;

(g) expands the taxable income base of individuals to include: (i) the real interest (*intereses reales* – which interest is defined as the amount of said interest which exceeds the adjusted inflation as determined in accordance with the mechanism set forth in Article 159 of the Income Tax Law) earned on bonds issued by the Borrower or legal entities, as referred to in said Article; (ii) dividends and profits as provided in Article 165 of the Income Tax Law; and (iii) capital gains on stock with the exceptions contemplated in Article 109-XXVI of the Income Tax Law;

(h) (i) reduces the Borrower's income tax subsidy (*crédito al salario*) by up to 3% of each employer's payroll; and (ii) creates an option for employers to either: (A) pay a new 3% tax applicable to the entire employer's payroll; or (B) absorb as a cost the income tax subsidy of up to 3% of the entire employer's payroll (calculated as set forth in the Income Tax Law);

(i) reduces the number of tax rate brackets for individuals and harmonizes the maximum rate applied to said individuals with the tax rate referred to in paragraph (e) (iii) above; and

(j) simplifies the tax regime of the individuals who carry out business activities (*actividades empresariales*) as follows: (i) individuals who only sell goods or render services to the general public (other than those individuals who fall within the exception referred to in Article 137, paragraph 4, of the Income Tax Law) whose annual gross revenues in the previous Fiscal Year resulting from the carrying out of said activities and interest earned do not exceed \$1,500,000 Mexican Pesos, may pay a one percent (1%) presumptive tax on said gross revenue (Articles 137 through 140 of the Income Tax Law); (ii) individuals who carry out business activities exclusively and

whose annual gross revenues in the previous Fiscal Year do not exceed \$4,000,000 Mexican Pesos (Articles 134 through 136 of the Income Tax Law) may calculate their taxable income on a cash-basis regime and deduct from their annual gross revenue the expenditures in cash (as mentioned in paragraph (a) (i) above); and (iii) individuals who carry out business and professional activities whose annual gross revenue in the previous Fiscal Year exceeds \$4,000,000 Mexican Pesos (Articles 120 through 133 of the Income Tax Law) may calculate their taxable income on a cash-basis regime and deduct from their annual gross revenue the cost of their fixed-assets investments through the application of either the straight-line depreciation method or the immediate tax deduction method as defined in paragraph (c) above).