



## FAQs – INVESTING IN MEXICAN REAL ESTATE

*June 5, 2005*

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## FAQs – INVESTING IN MEXICAN REAL ESTATE®

This compilation of frequently asked questions, “FAQs”, are taken from those that the Procopio<sup>1</sup> International Practice Group lawyers commonly receive. Additional questions will likely be added in the future. Please check our publications web page at: <http://www.procopio.com/news-room/articles/> for updates.

The answers to these “FAQs” are designed to help the reader have a better understanding of the legal and tax issues associated with the purchase, use and eventual sale of Mexican real estate. Its summary nature means that it should not and can not be used as a substitute for specific legal or tax advice for a particular transaction.<sup>2</sup>

- **How can I take a title to Mexican real estate in the coastal zone?**

A non-Mexican citizen cannot own a fee simple title of Mexican real estate in the coastal zone or along the international borders. This zone is commonly known as the “prohibited zone” (50 kilometers along the coast and 100 kilometers along the international borders). A U.S. or Canadian investor can generally acquire ownership of Mexican real estate through a Mexican company (e.g., a *Sociedad Anónima* (“SA”) or *Sociedad de Responsabilidad Limitada* (“SRL”)) provided the real estate is commercially rented and not for personal use. The SA or SRL can own the Mexican real estate in these circumstances and there are generally no restrictions as to the citizenship or residence of its owners and managers. Personal use of Mexican real estate (i.e. for residential purposes) can be acquired through a Mexican trust (*fideicomiso*) where the U.S. or Canadian investor is both the settlor of the funds used to purchase the real estate and a beneficiary of the *fideicomiso* owning the property.

- **What is a Mexican *fideicomiso*?**

A Mexican *fideicomiso* is a civil law type of trust. Mexican foreign investment law allows U.S. or Canadian individual investors (and other non-Mexican citizens) to acquire beneficial interest in personal-use Mexican real estate within the “prohibited zone” (see above) through a *fideicomiso*. These special type of *fideicomisos* are commonly known as “*fideicomisos en zona prohibida*” (i.e., *fideicomisos* for the prohibited zone), “residential *fideicomisos*”, “real estate trusts” or “Mexican Residential Trusts” (“MRTs”). As an overview, it is worth identifying the common terminology of U.S. (and Canadian) trusts contrasted with Mexican *fideicomisos*/ trusts in summary form below:

Common Law (U.S. & Canadian) Terms	Mexican Terms (“Equivalent”)
<b>Trust</b>	<b><i>Fideicomiso</i></b>
<b>Settlor, Grantor or Trustor</b>	<b><i>Fideicomitente</i></b>
<b>Beneficiary</b>	<b><i>Beneficiario, Fideicomisario</i></b>
<b>Trustee, Fiduciary</b>	<b><i>Fiduciario</i></b>

In a typical purchase and sale transaction, a new *fideicomiso* is typically created where the *fideicomitente* is a Mexican seller (an individual or an entity). The buyer (non-Mexican individual or entity) in such case, will be the *fideicomisario*. In the case of property that is held by the seller through an existing *fideicomiso* (e.g., where the seller is a non-Mexican citizen) then the purchase and sale transaction is commonly structured as an assignment of beneficiary rights (*cesión de derechos de fideicomisario*) from seller to buyer. An MRT is typically an irrevocable trust and the beneficiary is generally considered the owner for tax and other purposes.

*Fideicomisarios* (i.e., beneficiaries) usually are granted all rights of equitable ownership (such as the right to use, enjoy, rent, modify, encumber, etc.), while the trustee only maintains legal title to the property. Under Mexican law, the trustee of a *fideicomiso* must always be a Mexican authorized financial institution (e.g., a Mexican Bank). Various U.S. and

<sup>1</sup> Procopio’s International Practice Group includes five Mexican licensed attorneys, all of whom are also licensed in California. It has developed specific and unique legal and tax expertise as to cross border corporate structuring and tax planning of U.S. investments in Mexican Real Estate. Procopio’s International Practice Group’s series of articles are of special interest to current and future investors in Mexican real estate. If you require more information about Procopio’s International Practice Group please contact our International Partners: Patrick W. Martin ([pwm@procopio.com](mailto:pwm@procopio.com)) and Enrique Hernandez ([eh@procopio.com](mailto:eh@procopio.com)).

<sup>2</sup> This simplification means that many details associated with the tax consequences of these transactions cannot be discussed in this article. See, Martin & Hernandez-Pulido, *How Do you Say “FIRPTA” In Spanish? A Comparative International Tax Analysis for Foreign Investors of U.S. & Mexican Real Estate*. The most recent version of this article can be viewed at <http://www.procopio.com/publications/pdfs/FIRPTA.pdf>.

Canadian banks have Mexican authorized bank subsidiaries that provide trustee services in Mexico.

The trustee will usually transfer title to the property in *fideicomiso* to any capable person as the beneficiary so instructs. Mexican trustee's will generally not receive and manage funds on behalf of the beneficiaries nor will they take on active management or investment activities of the property. Their "role" within the MRT arrangement is generally limited to holding legal title to the property for the benefit of the *fideicomisarios*.

Under current law, a MRT can be setup for an original 50 year term which may be renewed for additional 50 year periods.

- **What is the "Calvo Clause" and why must I agree to it when investing in Mexican real estate?**

Mexican law requires that non-Mexican investors stipulate to not invoke the protection of their own governments in the case of a dispute as to their investment. The penalty for contravening this stipulation is the loss of their property interest in favor of Mexico. The clause that is inserted in the bylaws of Mexican entities that have or may have foreign investors or in *fideicomisos* with non-Mexican beneficiaries is known as the "Calvo Clause". Formation of Mexican companies and MRTs require a permit from the Mexican Ministry of Foreign Affairs (*Secretaría de Relaciones Exteriores* or SRE). These permits are issued subject to the effective adoption of the Calvo Clause in the formation documents.

The Calvo Clause is sometimes also known as the Barren Clause, and is named after Argentinean jurist Carlos Calvo. Many Latin American countries have adopted a Calvo type clause in their foreign investment legislation.

- **I am confused about the benefits of title insurance regarding a purchase of Mexican real estate?**

Mexican title insurance policies and the entry of U.S. title insurance companies are relatively new and hence have caused much confusion in the marketplace. The principle purpose of title insurance is to help ensure the title's quality as well as provide an indemnity contract should a third party claim superior title or bring a claim against the Mexican real property.

- **If I am not financing the purchase of the Mexican real estate, why should I consider purchasing title insurance?**

Title insurance is generally only as good as the company insuring and reinsuring title and the terms of the title insurance policy. There are benefits of title insurance which are discussed below.

- **What are the benefits of Mexican title insurance?**

The indemnity right granted under most policies, help protect a purchaser and owner of Mexican real estate in accordance with the terms of each particular title insurance contract. In addition, Mexican title insurance companies (e.g., those which are operated through publicly traded companies in the U.S.) generally require an independent due diligence analysis of any particular property before they will issue any title insurance policy. Typically, the title history undergoes a separate examination by the issuing company with local Mexican counsel required to issue a legal opinion regarding the status of title. Additionally, one of the most significant benefits of title insurance can be the legal defense that would typically be available under the policy to hire and work with local Mexican counsel to defend a legal claim against title (even a frivolous claim). Some title insurance companies also enable the insured to bring a claim against their U.S. affiliate title insurance company and not exclusively against the Mexican title insurance company.

- **How much coverage will I have from my Mexican title insurance policy?**

A title insurance policy generally only provides insurance up to the amount of the policy (e.g., a US\$ 1million policy is generally limited to a total coverage amount of US\$1 million). This is true, even if the value of the Mexican property significantly increases over time due to appreciation and/or improvements to the property.

- **Is Mexican title insurance worth the cost?**

This is a decision that can only be made by each investor. However, many sophisticated real estate developers have found that a detailed legal review of their property and offering title insurance to their clients through a reputable U.S. title insurance company is a must when helping their clients purchase Mexican real estate.

- **What does title insurance cover (and what is not covered) regarding Mexican real estate?**

Importantly, not all title insurance policies are equal. Title insurance policies and the company which is responsible for coverage of a Mexican real property are structured differently depending upon the title insurance contract and the company. Also, each policy carries with it express exclusions from coverage. For example, if a policy excludes unrecorded

taxes (which is standard practice in the industry), then any unrecorded taxes claim against the real property will not be covered by the policy.

- **Can I always get Mexican title insurance to cover my investment?**

Not all Mexican properties are insurable. Some title insurance companies will not insure certain properties. For instance, ejido properties are not generally insurable, and once a former ejido property has been privatized, most title insurance companies require a certificate from the National Agrarian Registry evidencing that the property is no longer subject to an ejido regime, minutes from the ejido governing body that reflect authorization to privatize the property with the signature of all ejido members, seller's affidavit regarding no liens or encumbrances on the property, certified survey and surveyor's affidavit of the property. Properties with claims filed against them are also generally not insurable. It is possible that a particular property might be insurable at a particular point in time, but later not be insurable due to changed circumstances.

- **Is there such a thing as a standard residential purchase and sale contract for Mexican real estate (such as the California Residential Purchase Agreement and Joint Escrow Instructions)?**

Currently, there are no standard residential purchase and sale agreements which have been developed that are commonly used in the real estate industry. The purchase and sale agreement is one of, if not the most, crucial contractual agreement related to the purchase or sale of any Mexican real estate and should be carefully drafted and understood by both the buyer and seller. Many sophisticated real estate developers and development projects have developed comprehensive residential purchase and sale agreements to help facilitate the purchase and closing of Mexican real estate.

Special care has to be taken when signing any type of offer, letter of intent, memorandum of understanding, or other type of communication regarding a potential sale or purchase of Mexican real property. It is often the case that an enforceable binding contract may be formed under Mexican law, even if not intended.

- **What is the *Catastro* and why is it important to me regarding Mexican real estate?**

The Municipal Property Office (*Catastro*) deals primarily with technical aspects of real property, such as measurements, tax codes, mergers of parcels, subdivisions, property taxes, etc. The *Catastro* is often confused with the Municipal Public Registry of Property and Commerce (*Registro Publico de la Propiedad y Comercio*), which is a Municipal agency that registers property deeds and reflects titles of ownership.

The purpose of the *Catastro* agency is to provide the government and individuals with accurate descriptions and information about the existing real estate in Mexico, specifically about the applicable urban development planning. The *Catastro* does not by itself constitute proof of ownership for a specific property. Rather, it may only provide an indication of ownership.

It is important not to assume that a title is duly registered just because it has a municipal tax code number and is filed at the *Catastro* agency, or in the surveyor's office, under any name. This is a technical matter and has little to do with legal ownership of the property. Title should be registered in the Municipal Public Registry of Property and Commerce (*Registro Publico de la Propiedad y Comercio*).

- **How is the State Public Registry of Property and Commerce (*Registro Publico de la Propiedad y Comercio*) different from the *Catastro* and what is its function?**

The Municipal Public Registry of Property and Commerce (MPRPC) is the public entity in charge of making public, i.e. to third parties, the legal acts that require public notification for them to have full legal effect vis-à-vis the parties that were not directly involved in a particular transaction or act. This includes real estate transactions. Filings before this registry are particularly relevant for real property as Mexican law provides that any transfer of real estate will be effective vis-à-vis third parties after the corresponding transaction has been duly recorded. For this purpose, Mexican law provides that any transfer of real property must be formalized before a public notary attorney, (i) obtain a "no-lien certificate" from the MPRPC and then, once the certificate has been obtained and the corresponding transaction has been executed between the parties, (ii) file before the MPRPC registry the corresponding preliminary notice publicizing the transaction and (iii) file the definitive deed. There are important timing requirements for these filings, which will determine at what point in time the real property transaction will be effective vis-à-vis third parties.

- **Are Mexican real estate brokers regulated like in the U.S.?**

The Mexican real estate sales and broker community is not a regulated profession in Mexico like in most states in the United States. They also are not required to maintain a separate and regulated trust account as is the case in most of the states in the United States. It is almost never advisable to make a non-refundable deposit with any real estate sales

broker, agent, the seller of the real estate, or a Mexican attorney, until after the buyer understands the Mexican real property which is being purchased and the terms and conditions under which it is being purchased.

- **Why can I not locate a Mexican escrow company to hold deposit funds and take the proceeds for the purchase of the Mexican real estate? Are Mexican escrows regulated?**

There is no such thing as an escrow under Mexican law. It is not a regulated industry in Mexico and largely does not exist as it is understood in the U.S. It is not uncommon, and sometimes is advisable, for U.S. escrows to be used for the purchase and sale of Mexican real estate, to enable the parties to have the funds placed with a third party who is not interested in the closing of the Mexican real estate transaction.

- **What is the typical closing time required for my purchase of Mexican real estate?**

Closings can be quite time consuming relative to the U.S. A well managed real estate development project can sometimes enable the buyer to close within 60-90 days, but more often a closing will require several months.

- **Are there typical encumbrances under Mexican law that I should be concerned about regarding my proposed purchase of Mexican real estate?**

There are a host of potential Mexican encumbrances and liens that should be addressed by any investor of Mexican real estate. These include, but are not limited to, tax liens, mortgage encumbrances, and other creditors liens and encumbrances. These encumbrances may, but are not necessarily always recorded in the MPRPC.

- **Does Mexico have different types of deeds (e.g., Warranty Deed, Grant Deed, Quitclaim Deed)?**

No. Mexico does not provide the same type of title and implied warranties of each of the above deeds used in different jurisdictions in the U.S. It is important for buyers of Mexican real estate to obtain the greatest contractual rights (including rights associated with any Mexican deed) to help protect them as part of any real estate transaction.

Although Mexico does not have equivalent U.S. type real estate deeds, a purchase and sale in Mexico can be carried out in two forms, *ad corpus* or *ad mesuram*. In an *ad corpus* purchase and sale, there is a fixed predetermined price that does not guarantee a specific area of the property; conversely an *ad mesuram* purchase and sale guarantees a specific area and in the event there is an excess or shortage in such area the price is adjusted accordingly.

- **Can I take a title of the Mexican real property as *joint tenants*, *tenants in common* or as *community property*?**

Mexico does not recognize the same type of real estate ownership as exists in the U.S., such as joint tenants, tenants in common or community property. If individual investors were married in the U.S. or Canada, and reside in those countries, their ownership rights in Mexican real estate will be partially determined by Mexican law and the applicable law of residency. For instance, a California resident couple who have lived all of their lives in California (without a prenuptial or postnuptial agreement) will likely have community property rights associated with their Mexican real estate investment (assuming community property funds are used to purchase the property), while Mexican law will provide no particular acknowledgement or benefit if the Mexican *fideicomiso* or title reflects only one of the spouses as owner/beneficiary. This is just one example of many where there can be a conflict in law regarding the rights involved with Mexican real estate.

Even though there are no exact equivalents for all of U.S. real estate ownership forms in Mexico, Mexican law does recognize a type of "tenancy in common" which is known as *co-propiedad*.

- **I am a U.S. citizen. I was told that if I sell Mexican real estate owned by a Mexican *fideicomiso*, or through a Mexican company (e.g., an SA or an SRL), that there is no U.S. income tax since the property is located outside of the U.S. Is this true? If Mexican income tax is paid on the sale, does U.S. tax also apply?**

U.S. citizens, resident aliens and lawful permanent residents (i.e., green card holders) are subject to U.S. income tax on their worldwide income. A sale of Mexican real estate by a Mexican *fideicomiso* will generate U.S. taxation on the gain recognized and realized by applying U.S. tax principles. Any Mexican income tax paid from the sale may be available for a credit against the U.S. income tax, reducing the total U.S. tax burden on a "dollar-for-dollar" basis.

In addition to the U.S. tax consequences, there are generally also Mexican income taxes generated from the sale or transfer of the Mexican real estate interest held in the Mexican *fideicomiso* or Mexican company, SA, SRL, etc. Persons dealing with Mexican real estate are also subject to Mexican taxation because any real estate interest is Mexican source

income under Mexican tax law. Mexico has a one tier corporate tax system or integrated corporate tax where there is no tax on dividends paid from previously taxed earnings. This is distinct from the U.S. taxation system of “C” corporations.

The corporate income tax rate in Mexico is currently 28 percent and the highest marginal tax rate for individuals is 28 percent. Income tax in Mexico is determined and paid on an annual basis with monthly provisional payments that are credited against the final yearly tax. Mexico has a withholding tax regime applicable to foreign sellers upon the sale of the Mexican real estate. This withholding tax rate is generally 25 percent of the gross income and is generally NOT reduced under applicable tax treaties, such as the ones in force with both the U.S. and Canada.

There is a special rule of Article 13 of the U.S.-Mexico Income Tax Treaty, which has caused much confusion in the marketplace. In short, a U.S. seller of stock of a U.S. entity which is the owner of Mexican real estate may be able to avoid Mexican income tax on the sale of the “shares”. However, this usually only causes worse tax problems for the buyer – since he or she will not receive tax basis in the underlying real estate (neither for Mexican or U.S. tax purposes in most cases). The effect - the buyer ends up paying the Mexican tax of the seller. Plus, the seller, as a U.S. person, must pay U.S. tax on the sale without any foreign tax credit to off-set the tax. This is especially relevant in light of a U.S. District Court case where a U.S. judge recently ruled that a sale of “stock” of a U.S. company, as beneficiary of a Mexican real estate trust (*fideicomiso*) was taxable in Mexico.<sup>3</sup> This situation requires careful planning by the U.S. investor to avoid unexpected double taxation.

- **Are there any U.S. or Mexican tax risks or downsides if I purchase the shares of a Mexican company that itself is the owner of Mexican real estate?**

There are many risks. The purchase of stock of a Mexican company can have significant future U.S. and Mexican income tax costs. A U.S. purchaser (whether an individual, a trust or a company) will generally only obtain tax basis in the shares and not the underlying real estate. This means that upon the Mexican company’s sale of the real estate, the taxable gain (both in Mexico and indirectly in the U.S.) will be greater than if the purchase of the real estate was made directly. Additionally, by purchasing the shares of the company, you will be assuming (at least indirectly) all of the liabilities and obligations of the Mexican company (e.g., labor claims, past taxes, contractual obligations, etc.). An important aspect of the corporate régime in Mexico is that liabilities of the shareholders are limited to the amount of paid-in capital contributed to the company. No “piercing the corporate veil” or “alter ego” regime exists. Shareholders are generally only responsible for company debts, including tax contingencies, up to the capital contribution they make and only if the patrimony of the company itself is not sufficient to satisfy those claims.

When investing in real estate through a structure that involves ownership of a Mexican company, one important aspect that must be taken into consideration is that under Mexican law, the employees of such company are entitled to a certain percentage of the annual profits (e.g., 10%) generated by the Mexican company. In general terms, the amount of the employees’ profit sharing is equal to a percentage of the net profits of the company that is determined by a joint committee made up by labor and governmental representatives.

- **The seller of the Mexican real property wants to record a lower value than the actual purchase price I am willing to pay. Is this permitted under the law? If so, are there any future tax risks or liabilities for me from structuring the transaction in this fashion?**

This is an ugly tradition that has existed in much of the Mexican real estate market for some decades. This can be a tax fraud, whereby both the seller and the buyer can be liable under Mexican tax law. This is not advisable for many reasons. The economic impact to the buyer, who accommodates the seller’s reduction and false recordation of the purchase and sales price, is that he will likely be paying the seller’s Mexican income tax upon the future sale of the real estate. In other words, if the purchase price is US\$1,000, but only a \$500 amount is recorded, the \$500 gain which is not taxed to the seller will be taxed to the buyer when he sells the property in the future. The Mexican real estate marketplace is rapidly changing in this respect as the Mexican government authorities are becoming more sophisticated and aggressive regarding ways to detect these types of transactions.

- **What States within the United Mexican States have income taxes and how do they apply to my proposed purchase of Mexican real estate?**

None of the thirty-one Mexican States have their own separate income taxation system (which is not tied to the federal government’s income tax regime). This means that there are not separate Mexican State income taxes on the rental or sale of Mexican real estate.

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<sup>3</sup> *Randolph D. Gale, et al, v. Alan G. Carnrite, et al.* United States District Court, Southern District of Texas, Houston Division, May 2007. The U.S. federal court concluded, as a matter of law (i.e., Mexican law) that the “stock” sale was subject to Mexican income taxation, irrespective of the U.S. tax consequences of the transfer.

- **Do I have to file Mexican income tax returns as a U.S. investor in Mexican coastal real estate if I rent the properties? Can I obtain a foreign tax credit in the U.S. for Mexican income taxes paid?**

Yes. Generally, you will have a Mexican income tax filing requirement for rental income generated from Mexican rental property. If the owner of the property is a Mexican *fideicomiso*, you might be able to obtain a foreign tax credit in the U.S. for the Mexican income taxes paid. However, if the owner is a Mexican company (such as an SA or SRL), you as an individual shareholder might not be able to obtain a foreign tax credit, which could eventually burden the rental income with double taxation. If the owner of the Mexican real estate is a Mexican entity that may be structured as a “pass through” entity for U.S. tax purposes (like a *Sociedad de Responsabilidad Limitada* – SRL), you as an individual owner may be able to obtain a foreign tax credit and avoid double taxation from the rental income if the proper procedures are taken.

- **I have a friend or family member who wants to invest in my Mexican real estate which is currently held in a Mexican *fideicomiso*. Can I not just transfer a beneficiary interest in the Mexican *fideicomiso* free from U.S. and Mexican taxes?**

As mentioned above, an MRT is generally an irrevocable trust where the beneficiary is treated as the “owner” for Mexican and U.S. tax purposes (when the beneficiary is also the grantor). Accordingly, the transfer of a beneficiary interest in *fideicomiso* held real estate is generally treated under both Mexican and U.S. tax law as if the property itself is being transferred. Mexican tax law provides for withholding mechanisms to ensure the proper payment of Mexican taxes upon transfers of ownership interest in Mexican real estate.

The most common tax withholding procedure is for the Mexican Notary who handles the transfer of the beneficiary interest to act as a withholding agent. Generally, a Notary will not authorize the transfer if sufficient funds are not delivered to her or him to cover the applicable tax liability arising from the transaction. Under Mexican trust and civil law, the transfer of a beneficiary interest in a MRT is required to be formalized before a Notary Public. Failure to do so may render the transfer null.

- **I was told that Mexican tax law provides for an annual adjustment for inflation of the tax basis of the Mexican real estate owned by a Mexican *fideicomiso*, or through a Mexican company (e.g., an SA or an SRL), thereby reducing the taxable gain from the sale. How does this work? Does this also reduce the taxable gain for U.S. tax purposes?**

Mexican tax law does indeed provide for an annual adjustment for inflation of the tax basis of the Mexican real estate (unlike the U.S. tax law which does not provide for any inflation adjustments). In short, an annual inflation adjustment is made according to the government published inflation rates. This enables the seller to have a lower taxable gain upon the sale of the real estate. For instance, if the original/historical price for a piece of Mexican real estate was US\$1,000, and the annual inflation rate was 7%, the new tax basis after one year would be \$1,070, and so forth and so on. This inflation adjustment reduces the Mexican taxable gain. However, these inflation adjustments have no impact when calculating the U.S. taxable gain. In this example, the U.S. seller will have a tax basis of US\$1,000 when calculating the U.S. taxable gain, even though over time he or she might have a Mexican tax basis of \$3,500 (with annual inflation adjustments over time).

- **How does Mexico's value added tax ("IVA") apply to my Mexican rental property? Can I obtain a foreign tax credit in the U.S. for Mexican value added taxes paid?**

The IVA is a consumption tax levied against most all goods and services (including rentals, services, etc.). It applies to any individual or entity that performs certain types of activities in Mexico, which include the renting of real estate, including time sharing. The IVA generally consists of a 15% surcharge upon the ordinary retail price of the activity performed, i.e. such a percentage upon the rental price of the real estate property. In the Baja California peninsula, and along the Mexican international border region, the IVA rate is generally reduced to 10%. However, lease and sale of commercial real estate is generally taxed at 15%.

Residential leases are generally exempt. However, if the leased property is furnished, IVA would likely be applicable.

IVA is collected through a credit system. The seller, service provider or owner of rental property is burdened with collecting IVA from his or her customers or tenants. IVA paid on inputs may be deducted from the collected amount and any balance is then forwarded to the Mexican government. If IVA paid on inputs exceeds IVA collected, a refund might be available for the difference. By application of this procedure, the burden of tax is transferred by each economic agent until it reaches the final consumer who becomes the actual taxpayer of the IVA.

Providers of exempt goods and services (such as residential leases) may not apply the credit system, and thus the tax paid on inputs becomes a final tax for them as if they were the final consumers of such inputs (goods and services). This scenario is especially relevant for U.S. renters of Mexican residential real estate because the IVA paid on inputs necessary

for the rental activity (e.g., cleaning supplies, property management services, etc.) will not be recovered (through crediting or refund) and will not qualify for a foreign tax credit under U.S. tax law. In this scenario, IVA paid on inputs should be considered as a cost which may qualify as a deduction against the U.S. tax liability of the landlord.

- **Are there any U.S. information reporting requirements with respect to a U.S. investor's ownership of Mexican real estate?**

Yes. The particular information reporting requirement(s) will depend on the structure through which title to the property is held (*fideicomiso* vs. Mexican entity) and other facts and circumstances. The U.S. informational reporting requirements apply in addition to calculations of taxable income. They specifically apply to Mexican real estate owned by Mexican companies – SAs, SRLs and entities such as *fideicomisos*, etc. U.S. tax law allows the IRS to assess severe monetary penalties for failure to timely comply with the required information reporting requirements.

- **I am a U.S. citizen, lawful permanent resident or other permanent domicile of the U.S. Does the U.S. gift and estate tax regime apply to gift transfers (or transfers at death) of the Mexican real estate owned by a Mexican *fideicomiso*, an SA or an SRL?**

Yes. The U.S. estate and gift tax regime applies to the worldwide assets of a U.S. citizen, lawful permanent resident (e.g., green card holder) or an alien that is domiciled in the U.S. A gift transfer of a beneficial interest in a Mexican *fideicomiso* will likely be subject to the U.S. gift tax, unless the transfer qualifies for an exemption under the gift tax rules (e.g., a gratuitous transfer of property between two U.S. citizen spouses). Similarly, a gift of shares in an SA or ownership interest in an SRL will generally be subject to the U.S. gift tax subject to applicable exclusions (e.g., the annual exclusion amounts of \$12,000 and the lifetime exclusion amount of US\$ 1 million).

Similarly, if a U.S. citizen or U.S. domiciled alien dies with an ownership interest in a Mexican *fideicomiso* or Mexican company, the value of that Mexican real property interest will likely be subject to U.S. estate and/or generation skipping transfer taxes.

- **I thought my Mexican *fideicomiso* will allow me to defer any U.S. estate taxes upon my death until my spouse also dies?**

It is rare to find any Mexican *fideicomiso* instrument which contemplates U.S. estate taxes between U.S. spouses and anticipates the application of these taxes for the Mexican real estate interest. Accordingly, each investor should contemplate and understand the best structure for their particular family to avoid and defer U.S. gift, estate and generation skipping transfer taxes to the extent legally possible.

Special care should be given to the succession provisions under each Mexican *fideicomiso*, as sometimes they may require a Mexican probate judge decree to recognize substitute beneficiaries upon death of the principal beneficiary. A testamentary designation of the beneficiary interest under a Mexican *fideicomiso* in a U.S. trust (with “pour over” provisions) might require a lengthy and sometimes expensive probate process to implement. Structuring alternatives are available to prevent this scenario.

- **Will a U.S. probate proceeding and/or a U.S. court order be required to transfer the rights in the Mexican *fideicomiso* to me and my siblings upon the death of my parents (who are the beneficiaries of the Mexican *fideicomiso*)?**

Unfortunately, ill-planned Mexican real estate investments can cause and require significant future legal work and legal proceedings to the heirs associated with the Mexican real estate upon the death of the U.S. beneficiary(s) of the Mexican *fideicomiso*. For instance, a U.S. probate court might be required to grant an order under an ancillary probate proceeding in the U.S., to transfer Mexican real estate held in a *fideicomiso* if successor beneficiaries are not named in the *fideicomiso* instrument. The Mexican trustee will generally never designate successor beneficiaries, which are merely identified in a U.S. will, without a probate proceeding and a U.S. court order (which must then be recognized under Mexican law).

- **Can I name my U.S. family living trust as a successor beneficiary of the Mexican real estate that is held in a Mexican *fideicomiso*? Why does the Mexican notary attorney not respect the terms set forth in my family revocable trust formed under the laws of a particular state within the U.S.?**

It is possible to minimize (or at least defer) U.S. estate taxes if the ultimate beneficiary of the Mexican real estate is a U.S. family living trust. Unfortunately, if this is not done correctly, a Mexican notary attorney or Mexican court may not respect the terms or existence of the U.S. family living trust.

- **Can I calculate my U.S. tax liability by applying U.S. long term capital gains rates to the gain from the sale of Mexican real estate owned by a Mexican *fideicomiso*, or through a Mexican company (e.g., an SA or an SRL)?**

The exact structure a U.S. or Canadian citizen or resident uses for his or her Mexican real estate investments is crucial. The tax consequences of future rental income or a future sale can be wildly different depending upon the type of legal structure implemented. A Mexican *fideicomiso*, for instance, is taxed very differently from an SA to a U.S. individual investor. The SA must be treated as a “C” corporation and is subject to double taxation by disallowing a foreign tax credit for the tax paid in Mexico by the SA upon its sale of the Mexican real estate. The Mexican tax liability of the SA would generally be calculated by applying the flat Mexican corporate income tax rate of 28%. Accordingly, preferential U.S. long term capital gains rates are not generally available upon the sale of Mexican real estate owned through an SA.

Ownership of Mexican real estate through a Mexican *fideicomiso* may provide access to the preferential long term capital gains rates in the U.S. Furthermore, a direct foreign tax credit to offset the U.S. tax liability may also be available for the Mexican income taxes paid.

An SRL structure may also enable the U.S. individual investor to obtain long term capital gains treatment and avoid double taxation if properly structured.

- **Does state income tax apply (e.g., California, Illinois, New York, etc.) if I sell Mexican real estate owned by a Mexican *fideicomiso*, or through a Mexican company (e.g., an SA or an SRL)?**

Residents of states within the U.S. must analyze their particular state’s income tax laws. California residents, for example, are subject to California income taxation on their worldwide income. Any Mexican income tax paid from the sale by a California resident is not eligible for a credit against California income taxes. Although, to the extent they qualify for a foreign tax credit for U.S. federal tax purposes, they may qualify for a deduction against the applicable California income tax liability.