

The Purchase of Real Property by Foreigners in Mexico

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Foreign purchasers of real estate in Mexico must comply with formalities set-out by the Mexican Constitution, laws, and tradition of Civil Law. It is essential that foreigners who purchase property in Mexico comply with these formalities. Failure to do so can subject investors to fines, penalties, or even the loss of their investments.

The Mexican property title system is not as developed as it is in the home countries of many foreign investors. Title searches can be inaccurate or unreliable, and there are no “private title plants” to back it up. Public property registries in most Mexican states are not computerized and can be susceptible to corruption or human error. Additionally, the title insurance industry in Mexico is underdeveloped and can be costly, or unavailable.

Foreign buyers of real estate in Mexico should be aware of potential conflicts of interests among all the parties involved in a real estate transaction: brokers, co-brokers, seller, and seller’s attorneys, buyer and buyer’s attorney, notary public, closing agents, escrow agents and title insurance companies. Brokers, for example, are usually compensated by the seller, in the form of a percentage of the sale price of the property, and thus, they have a vested interest in fixing a very high sales price, and closing as soon as possible, regardless of the security of the transaction. Additionally, if a deal is stalled or terminated neither the broker nor the seller gets paid. This often results in sellers and brokers discouraging buyers from getting their own legal counsel--despite the fact that this is usually in the buyer’s best interest--because this can delay or undermine the sale. This is particularly true if the buyer’s attorney exposes hidden legal difficulties regarding the sale.

Due to the above situation, foreign purchasers of real estate in Mexico are advised to obtain qualified, independent Mexican legal counsel, in order to secure their transactions and protect their individual interests.

Constitutional Restrictions

The Mexican State has ownership of the Nation’s land and water (*See Article 27 of the Mexican Constitution*). However, the Mexican State is also granted the power to transfer ownership of such property to private individuals. This creates private property.

Constitutionally, foreigners may, in most circumstances, purchase property in Mexico provided that they vow, before the Secretariat of Foreign Affairs, to be considered Mexican nationals regarding such property and refrain from invoking the protection of their home governments if controversy arises. If the foreigner violates this agreement all rights to his property will revert to the Nation. This constitutional provision is known as the “Calvo Clause” and is effective in many Latin American countries.

Additionally, foreigners are forbidden to acquire direct ownership of Mexican property located in the “Restricted Zone”. (*See Article 27 of the Mexican Constitution*)

Acquiring Property in Mexico’s Restricted Zone

Mexico's "Restricted Zone" includes all land and water located within 100 kilometers of any border and 50 kilometers of any sea. Foreigners are prohibited from acquiring *direct* title over real property in the Restricted Zone.

However, foreigners are allowed to acquire *indirect* title to real property in the Restricted Zone in two ways. (*See Mexico's Foreign Investment Law*):

1. Via a Mexican corporation (which can be owned and operated by foreigners) provided that the corporation's property is not for residential purposes; and
2. Via a land trust (*fideicomiso*) using a Mexican bank as trustee.

Via a Mexican Corporation

If the property to be acquired in Restricted Zone is not intended for residential purposes, a foreigner may obtain title by establishing a Mexican corporation. Some considerations when acquiring property in this way are the following:

- A Mexican corporation is treated as a "Mexican Person" under Mexican Law, even if its shareholders, members, and officers are foreigners. Thus, a Mexican corporation can acquire *direct ownership* over Restricted Zone property (including legal and beneficial title).
- Creating and maintaining a Mexican corporation to acquire Restricted Zone property is more costly than acquiring such property through a trust. Unless the buyer's mid-long term goal is to develop, lease or in any other way use his/her Restricted Zone property for commercial purposes, acquisition through a trust is likely easier and less costly.
- A Mexican corporation created to acquire Restricted Zone property must include the "Clavo Clause" in its Articles of Incorporation.

Via a Mexican Land Trust

The method for foreigners to acquire beneficial ownership of Restricted Zone property in Mexico for residential purposes is through a Mexican land trust. This is a three-party contract in which the seller (trustee/*fideicomitente*) irrevocably transfers to a bank (as trustee/*fiduciario*) title to real property. The bank, in its fiduciary capacity as trustee, holds legal title over the property but confers beneficial title to the foreign buyer (the beneficiary/*fideicomisario*) so that he can use and enjoy the property.

The specific terms and conditions of a Mexican land trust agreement will vary from bank to bank. However, the most common provisions are as follows:

- To create a Mexican land trust a permit must be obtained from the Secretariat of Foreign Affairs
- The trust may be in-force for 50 years. It can be renewed for another 50 years at the request of any beneficiary.
- So long as the beneficiary's use and enjoyment of the property is lawful, the bank cannot restrict it
- The bank cannot sell, securitize, or otherwise encumber the property without the express, written consent of the beneficiary. .

- The beneficiary may sell his beneficial interest in the property to another foreigner.
- The beneficiary may transfer the title (legal and beneficial) outright to a Mexican citizen. This will extinguish the trust.
- To rent the property to third parties the beneficiary must obtain authorization from the Secretariat of Foreign Affairs.
- There can be more than one beneficiary under a trust. If there are multiple beneficiaries each will be a co-beneficiary in the property (unless otherwise established). Co-beneficiaries must jointly consent to any transactions relating to the trust or property.
- It is possible to designate secondary beneficiaries. Secondary beneficiaries are usually family members who will only become beneficiaries under the trust after the principal beneficiaries have passed away (unless otherwise established).
- Secondary beneficiaries designated in the trust will prevail over contrary designations in the principal beneficiary's will.

Due Diligence

Whether using a Mexican land trust or a Mexican corporation to acquire property in Mexico's Restricted Zone, a foreign buyer is advised to undertake an independent "due diligence" prior to any purchase. This due diligence investigation should attempt to ensure that the seller has good and marketable title to the property. This investigation should also try to make sure that the property is not affected by a variety of "unpleasant surprises". Some of the most common of these surprises include the following:

- Liability for environmental contamination. (Under Mexican law buyers may be liable for violations that occurred before acquiring the property)
- Boundary disputes, easements on the property or invasions of land (squatters)
- Zoning, building or use of land restrictions
- Liens or encumbrances on the property
- Hidden defects in land or buildings
- Lack of federal, local, or state permits or authorizations necessary for use or development of the property
- Disputes over title of the property (including claims by government, agrarian landholders [*ejidatarios*], claims of adverse possession, or other such colorable title claims)

Additional Concerns: Title, Down Payments, and Conditional Purchase Agreements

Regardless of whether the buyer intends to use a Mexican corporation or a Mexican land trust to acquire his property, he is advised to obtain from the seller copies of the existing property title (in the form of a public deed) and a Certificate of Clean Title. Additionally, it may be advisable to investigate the chain-of-title to ensure that the seller is able to convey the title lawfully. A common way for the purchaser to retain the sole option to purchase the property while conducting due diligence on the title and property is to enter into a conditional purchase agreement prior to the final sale.

Under a conditional purchase agreement the purchaser will make a down payment of the property and will obligate himself to pay the remaining purchase price when the seller meets certain conditions. These conditions will usually include the following:

- Performing cadastral appraisal (always) and commercial appraisal (only when needed) by an authorized appraiser. These appraisals are valid for 90 calendar days and can be extended for 15 additional calendar days.
- Providing certificate of clean title.
- Providing certificate of no debt of property tax payment.
- Preparing the deed of sale within a specified period of time, and getting a written confirmation from the notary public that the title is ready to be transferred.
- Proper zoning, land use specifications, and municipal blueprints.
- Existence of all applicable permits, licenses, and concessions.
- If title insurance is desirable, then the sale shall be conditioned to obtaining a title commitment from a title insurance company, assuring that the title is insurable.

When these conditions have been met the buyer must pay the balance of the sale price (or lose his deposit) and the purchase/sale is formalized. If the conditions are not met the deal is voided and the buyer is refunded his deposit. (Before signing or making deposits or down payments under a conditional purchase agreement the buyer should have the agreement reviewed by independent legal counsel.)

Formalities

After deciding which method to use to acquire property in Mexico's Restricted Zone and conducting due diligence on that property there are several formalities that must be complied with in order to finalize the transaction and make it binding on the buyer, the seller, and third parties. These formalities include the following:

- Transferring title to the property (by executing the trust or purchase and sale agreement) before a public notary. The notary will issue a Public Deed that will formalize the sale, and attest to the nature and legality of the transaction, the status of the parties, and the authenticity and validity of the signatures.
- Recording the transaction in the public registry of the jurisdiction where the property is located. (This can be performed by the notary or the attorneys).
- Paying all applicable taxes and fees.

Tax Concerns

Both the seller and the buyer are potentially liable for taxes on the purchase and sale of property in Mexico.

All parties to a real estate transaction in Mexico (especially the seller) are advised to seek advice from a Mexican tax specialist.

Income Tax (Capital Gains Tax)

At the discretion of the seller, the sale of property located in Mexico is subject to the following taxation:

- A 25% tax on gross income (the sale price); or
- A 32% tax on the net capital gain of the sale (this includes inflation adjustments). The capital gain is the difference between the amount of original acquisition price and the amount declared as the sales price or value of the transaction, less related legitimate expenses (such expenses may include capital improvements, bank appraisal fee for establishment of the trust, notary fees, registry recording fees, the transfer tax and real estate agent commissions provided that receipts in the name of seller are provided)

The public notary is responsible for calculating the capital gains tax and including it in the public deed. The notary must also collect the income tax owed and remit it to the Secretariat of Finance (*Hacienda*) within 15 days of the execution of the deed.

These income taxes apply regardless of whether a Mexican land trust is used or the property is purchased outright by a Mexican corporation.

The obligation to pay the income tax may be avoided by proving to the government that the property being subject to the acquisition is the seller's primary residence in Mexico. However, there are certain requirements necessary in order to prove such residence, which include, but are not limited to the following: possession of an FM3 Mexican visa, presence in Mexico for more than 183 days in one calendar year and presence in the property to be transferred for at least 6 months (as long as the power or water receipt is in the name of the seller).

Since the income tax is very high, sellers may attempt to decrease the amount to be paid by declaring a lower sales price of the property instead of the true purchase price in the public deed facilitating the transaction and therefore, to reduce their tax liability to the sales price declared in the public deed. However, potential purchasers should note that in the future, when they wish to sell their properties, the income tax will be calculated on the basis of the purchase price declared in the respective public deed and therefore, their tax liability will be increased accordingly (provided that the 32% tax on the net capital gain of the sale is used).

Real Estate Acquisition Tax

Individuals or corporations acquiring property in Mexico (including land and structures) are subject to a real estate acquisition tax. This tax varies between 2% and 3.7% of the value of the property. This tax applies regardless of whether a Mexican land trust is used or the property is purchased outright by a Mexican corporation.

Value Added Tax

Value Added Tax (VAT) must be paid by the purchaser of commercially zoned structures or buildings. This tax is at a rate of 15% (10% in the Border Zone, which includes all of the Baja California Peninsula) over the value of the purchased structures. (This usually included taxes, interest, fees, or other expenses)