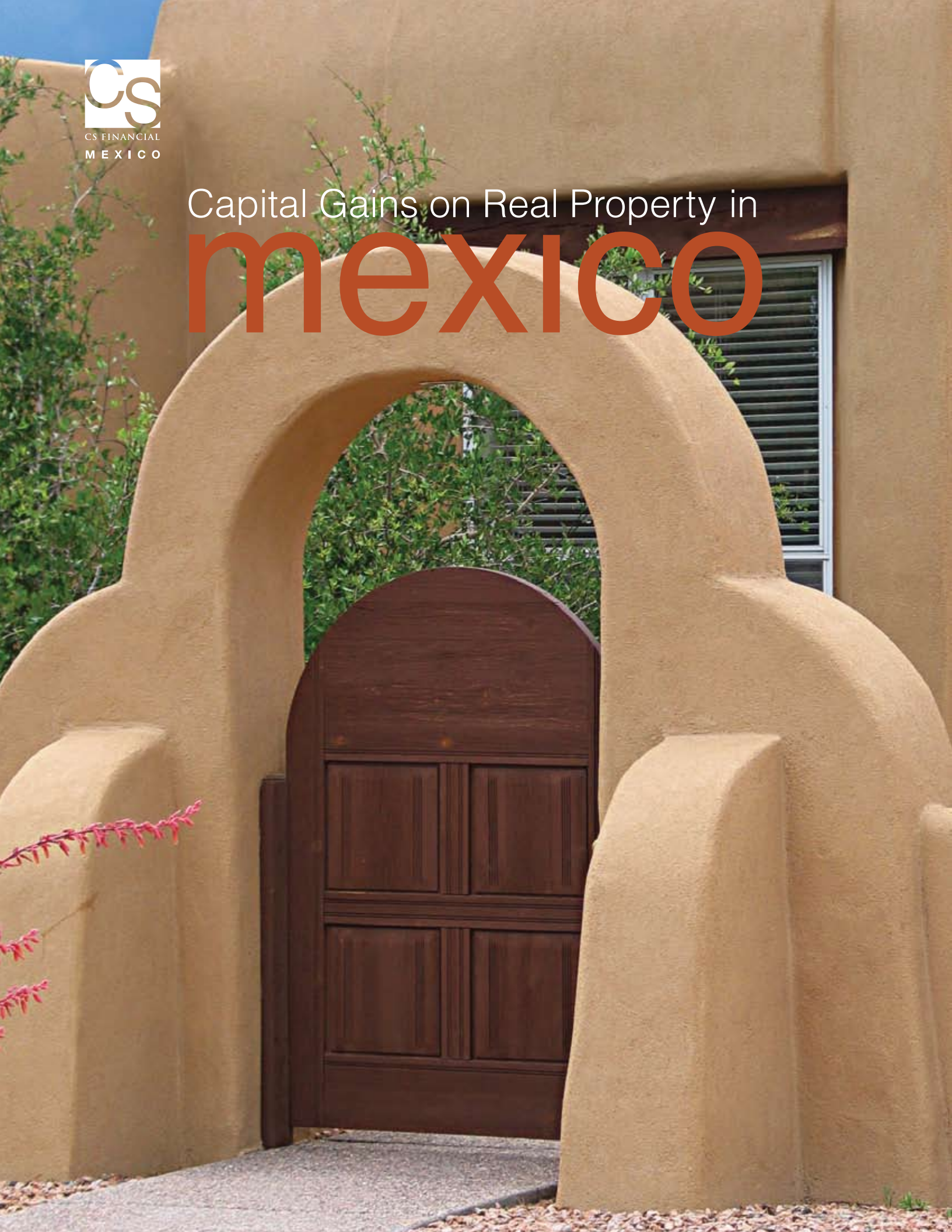




Capital Gains on Real Property in **mexico**



The purpose of this article is to provide the reader with an overview/guideline pertaining to the applicable laws/rules for capital gains tax liability at the time of sale of real estate in Mexico. The article has been structured with headings pertaining to the most important issues presented in this particular matter.

general concepts of applicable capital gains tax laws



The Mexican tax code provides that capital gains tax is owed on the profit when a party sells his/her home or property. By law, the seller has two general options when it comes to capital gains and can use whichever is the lesser of the two options:

Option 1: The seller pays a percentage of his/her net profit derived from the sale. The tax code provides for different percentages depending on the sale year, but one can currently assume a capital gains tax rate of 34%. A variety of deductions are available when using this option, and a seller should discuss these in further detail with a specialist.

Option 2: The seller pays a flat 25% of the gross sales amount with no deductions.

Although a 34% capital gains tax may seem high, the Mexican tax code does have several laws and procedures that will assist the purchaser in maximizing his/her cost basis, thereby reducing his/her net profit, and in turn lowering the capital gains tax exposure. The purchaser should understand these laws prior to the time of purchase, not at the time of sale, and thus should consult a specialist in the field prior to the time of purchase.

never assume the seller's capital gains liability

The first step in calculating the applicable capital gains tax liability is to subtract from the sales price of the property the recorded value provided in the transfer deed at the time of purchase. In the past, parties recorded values lower than the actual purchase price for two major reasons:

1. in an effort to save money on the 2% acquisition tax; and,
2. as it assisted the seller in the amount of capital gains to be paid from his/her sale.

The purchaser should never record a lower value than that actually paid for the property. Doing so simply establishes a lower cost basis for the property which increases the capital gains tax liability. The capital gains tax liability is the responsibility of the seller.

The recording and ownership process in Mexico, although different from that of the U.S., properly provides the investor with the legal means to safeguard his/her investment. Recording the real purchase price and properly documenting such purchase is the only real way to maximize profits. A purchaser should never allow there to be the recording of a lower value than what has actually been paid for the property—otherwise, he/she will assume the seller's capital gains tax liability.

confirming the actual purchase price is recorded correctly

The process of confirming that the actual purchase price is recorded correctly is rather straightforward. The first page of the transfer deed or Trust document will typically provide same in the text. If the purchaser can't find it, his/her attorney or the Notary Public handling the closing of the transaction will be able to point it out easily. The purchaser should note that the purchase price will typically be noted in Mexican Pesos. Figuring out the amount in dollars is easy: simply divide the current exchange rate into the Mexican Peso amount provided.

Due to the applicable tax laws, and in order to have certainty, it will be helpful to the purchaser that he/she have the Notary Public handling the closing of the transaction provide in the transfer deed the applicable exchange rate at the time the execution of documents for the transfer takes place. This will benefit and assist the purchaser in the future when he/she sells the property.

Any purchaser should consider that if the accurate value of the purchase is not properly recorded, he/she will be taking on someone else's capital gains tax liability. Furthermore, any purchaser should note that the amount paid for a property has no impact whatsoever upon the property taxes applicable to such property. Such tax is arrived at by the taxing authorities and may change from year to year, depending on the authorities' appraised value—which is typically much lower than the market value.

inflationary credit

As soon as the property is purchased and the acquisition tax is paid (about 2% of the purchase price), applicable Mexican tax law provides that the owner is eligible to receive an inflationary credit for every year he/she has owned the property. This credit is added to the cost basis when the property is sold.

The credit is based on the inflation index (i.e., the Consumer Index Adjustment) provided by the Mexican government. The figure, over the years, can be quite significant and may have an impact in the reduction of the capital gains tax upon the sale of the property in later years.

capital gains tax exclusion

Much like the U.S., Mexico provides its residents with a capital gains incentive applicable to ownership of their primary home. The basic premise of this incentive is that if a party sells their primary residence after at least two years of owning same, there are no capital gains due on such sale. The key to this law is that it applies only for residents of Mexico—whether Mexican nationals or foreigners—who comply with the requirements to establish residency status in the country.

In order to claim such property as the primary residence in Mexico, the seller must be able to prove that this is the case. At closing the seller will be required to provide to the Notary Public handling the closing of the transaction: confirmation of citizenship, or alternatively his/her residence visa or working permit (FM3 or FM2) as well as bank account, water, phone and electric bills and paid tax receipts. All must be in the seller's name and all with the address of the home being sold and all in place for the last 2 years.

It should be noted that this exclusion applies to improved properties, not raw land.



use of independent counsel

As with any other major transaction, the use by the purchaser of a reputable and knowledgeable attorney is very important and is highly recommended. Any potential purchaser/owner should seek the advice and assistance of counsel in order to make the purchase/ownership/sale experience manageable and more secure.

As noted above, this article is only intended to be an overview/guideline pertaining to the applicable laws/rules for capital gains tax liability at the time of sale of real estate in Mexico. Any purchaser/owner/seller should contact a specialist in the area (attorney, accountant or consultant) who will be in a better position to answer all issues in greater detail and specificity.



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