Reporting Of Interests In Mexico Fedeicomisos

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U.S. residents, and other nonresidents of Mexico, are restricted from owning certain real estate in Mexico. The Mexican Constitution prohibits foreigners from purchasing or owning real estate within 60 miles of an international border or within 30 miles of the Mexican Coast.

To facilitate foreign ownership, Mexico law allows for foreign persons to own property through a fideicomiso. A fideicomiso is a Mexico trust arrangement under which a Mexico bank acquires title to the real property, and foreigners own the beneficial interest.

A recently released letter from the Office Chief Counsel warns that such arrangements may constitute foreign trusts for U.S. tax purposes, and thus may trigger Form 3520 and 3520-A filing requirements for U.S. beneficiaries. Interestingly, the letter does not conclude one way or the other whether a fideicomiso will be treated as a trust, only that it *may* be. The taxpayer recipient of the letter was instructed to review Regs. Section 301.7701-4 for the definition of a trust for U.S. tax purposes, and Code Section 7701(a)(31)(B) and the Regulations thereunder for whether a trust is foreign.

There is a reasonable possibility that many fideicomisos will meet the regulatory definition of a trust (at least in the opinion of the IRS), even though common law trusts are not a regular feature of Mexico law. The Regulations define a trust as:

…an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under

the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Further, if a fideicomiso is considered a trust, it should then be considered a foreign trust, at least if a Mexico bank serving as trustee.

However, one may be able to argue that a fideicomiso is more akin to a “business trust” which is subject to taxation as a business entity under Regulations Section 301.7701-4(b).

Some facets of U.S. reporting of interests in foreign trusts only apply if distributions are made to U.S. beneficiaries. However, rent-free use of trust properly can be treated as a distribution to a beneficiary, so this is a reporting trap for many if the fideicomiso is characterized as a foreign trust since most beneficiaries will not be paying rent to use the Mexico property.

The actual income taxation of the U.S. beneficiaries will depend on whether the trust is a grantor trust or a nongrantor trust (or, of course, whether the fideicomiso is taxed as a trust or a business entity). Also, different reporting requirements are triggered based on grantor vs. nongrantor trust status or busines entity status.

Thus, the IRS’ letter is helpful in reminding taxpayers of potential reporting and income tax issues relating to a fideicomiso interests. However, each case will require its own analysis as to whether a foreign trust or other entity exists, if a trust whether it is a

grantor or nongrantor trust, and what particular reporting is required. If worth the cost, a private letter ruling as to "trust" status could also be sought from the IRS.

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