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INTERNATIONAL LAWYERS NETWORK



MARTÍNEZ, ALGABA, DE HARO & CURIEL, S.C.
MARTINEZ BERLANGA ABOGADOS, S.C.
BUYING AND SELLING REAL ESTATE IN MEXICO

ILN REAL ESTATE GROUP



ESTABLISHING A BUSINESS ENTITY IN MEXICO

Preface

Martínez, Algaba, De Haro y Curiel, S.C. (“**MAHC**”), and Martínez Berlanga Abogados, S.C. (“**MBA**”) are law firms in Mexico with recognized trajectory, based in Mexico City, committed to provide the highest standard of professional legal counsel and representation.

MAHC was established in 1969, the firm is comprised of a highly experienced and qualified team of professionals in the diverse areas of law practiced by the firm. MAHC is reputed to be one of the few law firms in Mexico that offers first class litigation services, encompassing virtually every aspect of commercial, civil and administrative legal procedures, including domestic and international arbitration, as well as a consulting legal area in matters related to corporate, financial, banking, regulatory, real estate, energy and communications.

MBA, established in 2006, is comprised by professionals with high experience in general corporate, restructurings, corporate finance, mergers and acquisitions, joint-ventures, cross border transactions, real estate, local and cross border trust structures and testamentary successions, as well as regulatory.

These combination of practice areas and fields of expertise allow our firms to render enhanced legal advice, a result of the synergy and collective experience of our trial and consultant lawyers that grants our clients a competitive advantage hard to match by any law firm in Mexico.

I. Real Estate General Overview

The real estate business in Mexico has been increasingly growing during the last decades to

the point that now it is considered as a serious, viable and promising economic activity among both Mexicans and foreigners. This growth has developed in a more dynamic and secure economic sector in our country. However, it is still a relatively new business in Mexico, in which real estate agents are not yet required to be licensed and real estate professional organizations are not that regulated nor common as in other countries.

Investors now can find a variety of specialized agents and corporations that provide tailor-made services, ideal for foreign investors that seek to buy or sell real estate in the country. These services are highly recommended specially for those not familiar with the local real estate regulations and the Spanish language.

II. Property Rights in Mexico and Limitations

In Mexico, all property rights come from the State itself, who owns “*the original property of lands and water... and has had and has the right to transfer ownership of property to private persons, thus, transforming it into private property.*”¹ Accordingly, the Mexican Federal Civil Code (*Código Civil Federal*), as well as those Civil Codes of each Mexican State, provide that it is the people’s right to use, enjoy and dispose of their property, under the limitations and modalities established in Mexican law.

There are also other several limitations to the ownership rights of real estate property imposed in the Mexican Constitution, like, for example, the Nation’s direct domain over natural resources such as oil, minerals and underground water, or the expropriation of the land by the State in case of public interest

¹ Article 27 of the Mexican United States Political Constitution (*Constitución Política de los Estados Unidos Mexicanos*) (the “**Mexican Constitution**”).



situations and pursuant to a prior indemnification.

As a rule, only Mexican citizens, by birth or naturalization, and Mexican corporations have the right to acquire real estate property or to obtain concessions from the Mexican State to exploit national natural resources. However, the Mexican Constitution states that the Nation may grant the same rights to foreigners, provided that they agree with the Mexican Ministry of Foreign Affairs (*Secretaría de Relaciones Exteriores* or “**SRE**”) to consider themselves as nationals in respect of such acquired property and shall agree not to invoke the protection of their government in respect thereof, under the penalty, in case of failure to honor such commitment, to forfeit such real estate property to the benefit of the Mexican Nation. This covenant or statement is known as the “Calvo Clause”.

Another restriction to foreigners imposed in the Mexican Constitution is that they will not be able to acquire real estate within 100 kilometers (approximately 62.13 miles) along the borders and 50 kilometer (approximately 31.06 miles) from the coast, referred to in Mexican law as the “**Restricted Zone**”. However, pursuant to the Mexican Foreign Investment Law (*Ley de Inversión Extranjera* or “**LIE**”) and its regulations, foreigners may acquire property located in the Restricted Zone for non-residential purposes, in which case, they would require to give a notice to the SRE of such acquisition within the next sixty (60) days following the date of the acquisition. In such cases, as we will analyze hereinafter, a foreign-owned Mexican corporation or a Mexican trust must be created to indirectly acquire real estate property.

Non-residential purposes pursuant to the regulations of the LIE are considered as those destined to time sharing, industrial, commercial or tourism related activities and generally those

used by entities pursuant to their corporate purpose, such as sales or transfers, urbanization, construction or development of real estate projects.

Finally, foreigners may acquire real estate properties outside of the Restricted Zone provided that they must obtain a permit from the SRE for such purposes.

III. **Ways of Acquiring Real Estate Property in Mexico**

After the prospective buyer has find the desired real estate property and its offer has been accepted by the seller, there are several legal vehicles or capacities classically used to own real property in Mexico.

An individual may hold title over real estate property in Mexico, directly or indirectly, allowing her/him to use, enjoy and dispose such property, through three different means: (i) as the direct owner, holding a property title under her/his name; (ii) through a Mexican corporation, as a stockholder; or (iii) through a bank trust, as a beneficiary. As a foreigner, the latter two would be the most recommended vehicles to hold title.

(a) **Foreign-Owned Mexican Corporation**

A foreign-owned Mexican corporation (a “**Mexican Corporation**”) is a vehicle frequently used by foreign investment to do business in the country, not just to hold title over real estate. As a national, provided that all LIE requirements are met, a Mexican Corporation complies with the Mexican Constitution requisite in order to hold title over private property. However, it is important to point out that holding title of real estate through a Mexican Corporation has to be pursuant to the corporate purpose of the entity.

A Mexican Corporation is typically incorporated before “public faith officer”,



such as *Notarios Públicos* (authorized by local governments) or *Corredores Públicos* (authorized by federal authorities), and requires a minimum of two (2) share or equity holders since, with a sole exception², the concept of single-shareholder corporations is not allowed under Mexican law. It will have to carry out the corporate activities of any company, such as annual stakeholders' meetings, have an active administrative body, file tax statements, etc. We strongly advise to seek local legal counsel in order to properly incorporate and tailor-made the Corporation's purpose to the specific client's necessities.

The main advantages of holding real estate property through a Mexican Corporation could be, for example, that a national corporation, pursuant to applicable immigration requirements, would directly own the real estate, it could allow its stakeholders to live and work in the country and there is no limit as to the number of properties it may own.

While the main disadvantages of a Mexican Corporation could be, for example, the undertaking of the daily corporate activities, including, but not limited, its administration, accounting reports, tax filings, LIE filings regarding its foreign stakeholders, etc.

(b) Mexican Trusts

Mexican trusts are very useful and flexible and therefore widely used as a vehicle by

foreigners not only to acquire real estate, but for general business purposes as well. It provides solution to a wide range of personal and commercial needs. Trusts are mainly regulated by the Mexican General Law for Negotiable Instruments and Credit Transactions (*Ley General de Títulos y Operaciones de Crédito*) ("**LGTOC**").

Pursuant to the LGTOC, a Mexican trust is a commercial contract by which a settlor transfers title and management of certain assets and/or rights to a trustee — *generally a bank or any other financial institution*—, so that the trustee manages them under agreed terms, for the benefit of a person —*could be, among others, a Mexican Corporation, a foreign individual or a foreign entity*— appointed as beneficiary thereto.

The bank, as trustee, will be subject to fiduciary duties while representing the settlor interests in the trust assets. For example, should the trust purchase real estate property, the trustee should only carry out the transaction after verifying that all the title documents, property dimensions and/or any other documentation related to the property, are in order. On the contrary, if the real estate is not in good standing or up to date with the applicable legislation, the bank's fiduciary duties shall prevent the trust to acquire such irregular property.

During the past few decades, it has been very popular among foreign investors to hold property of real estate through a

² Simplified stock corporation (*sociedad por acciones simplificada*), which is a recently created type of entity not useful to acquire real estate. It is allowed to be incorporated by an individual single-shareholder (no entities allowed as shareholders). However, this type of entity is not recommended for foreign investment purposes, since its main purpose is to regulate small and

medium businesses. Its shareholders may not have any equity participation in any other Mexican entity that allows them to control such entity and the corporation's annual total income shall not exceed the equivalent to \$5.6 million Pesos (approximately \$256,135.00 Dollars, as of September 2020).



Mexican trusts, where the individual investor or a corporation transfers financial resources to the trust and then the trust itself acquires the real estate and holds title thereof. Thus, it can be created to indirectly acquire the property, whereby the real estate is settled in trust, since no real estate rights would be owned by the trust beneficiaries, only trust rights.

The maximum duration of such trust is 50 years, subject to renewal; provided further that, in such cases it is required to obtain a permit from the SRE in order for such trust to own the relevant real estate property in the Restricted Zone. As of today, there have been no amendments to the relevant laws in order to delete this foreign investment restriction on real estate.

There are great benefits and advantages of holding real estate property through a Mexican trust, for example, the trustee shall be responsible for the administrative work and for the conservation and protection of the trust assets —*subject to an annual fee to the bank*—, the investor's heirs can inherit the rights to the trust and some tax advantages, among others.

(c) Real Estate Investment Trusts

In recent years, Real Estate Investment Trusts (*Fideicomiso de Inversión en Bienes Raíces*) ("**FIBRAs**") have also become important investment vehicles for foreigners who seek to invest their capital in Mexico. They are a specific type of trust designed for the real estate business and are regulated by, among others: (i) the LGTOC; (ii) the Mexican Securities Law (*Ley del Mercado de Valores*) ("**LMV**"); and (iii) the Mexican Income Tax Law (*Ley del Impuesto sobre la Renta*) ("**LISR**").

The Mexican Congress, in order to make more attractive the investment of capital

in the real estate market in Mexico, included in the LISR special tax benefits for FIBRAs.

According to the Mexican Brokers-Dealers Association (*Asociación Mexicana de Intermediarios Bursátiles*), FIBRAs that have placed public offerings in the Mexican Stock Exchange have captured resources equivalent to thirty-seven point three percent (37.3%) of the total foreign investment in Mexico.

According to the LISR, in order for a trust to be considered a FIBRA and to have the tax benefits provided by the LISR, it needs to comply, among others, with the following requirements:

- (i) to be executed pursuant to Mexican laws and with a Mexican trustee.
- (ii) to have as its main purpose the acquisition or construction of real estates in Mexico that may be destined for lease, or the right to obtain income from the real estate.
- (iii) that the real estate contracted or acquired by the FIBRA be destined to lease (or equivalent) and not be sold within a period of 4 years following the date the construction of the real estate was completed or as of the date of the acquisition of the real estate, as applicable.
- (iv) that the trustee of the FIBRA issues trust certificates to represent the assets allocated in the FIBRA so that such certificates may be placed through a public offering in the Mexican Stock Exchange and registered before the National Securities and Intermediaries Registry (*Registro Nacional de Valores*); and



- (v) that the trustee of the FIBRA distributes to the holders of the relevant trust certificates issued through the public offer, at least once a year and no later than March 15th of each year, at least ninety-five percent (95%) of the total taxable income accrued during the immediately preceding fiscal year.

IV. **Promissory and Purchase Agreements**

Once the buyer has decided in what capacity she/he will acquire title over the real estate, whether directly or through a Mexican Corporation, a regular Mexican trust or a FIBRA, transfer of ownership will take place through the execution of an agreement.

Note that it is strongly recommended, at all times but specifically before closing of the contract takes place, to undertake a thorough due diligence and seek proper legal advice before engaging in any transaction.

The following are the agreements typically used to formalize the real estate property acquisition in Mexico:

(a) Promissory Agreement (*contrato de promesa*)

A promissory purchase agreement is a very common way to agree with a seller the acquisition of a real estate property, without executing at that point the final purchase agreement itself. Through a promissory purchase agreement both parties reciprocally agree or promise, one to sell and the other to purchase real property at a stated price, as well as to enter into a final purchase agreement within a certain period of time, having agreed upon the essential terms thereof.

This type of agreement is different from a “letter of intent” since, under Mexican law, a promissory agreement is binding on the

parties and may be judicially enforced, in order to oblige the promisor to execute the final agreement. Meanwhile, a letter of intent is largely used merely to express a non-binding intention of one party, lacking the essential terms of the final agreement.

The promissory purchase agreement, as well as the private purchase agreement — *as analyzed herein after*—, is commonly used as a preparatory agreement providing the parties with an agreed timeframe generally used to finalize the due diligence and formulate the final and definitive agreement to be executed at a later date. For instance, before executing the final agreement, the public notary needs to draft the correspondent public deed comprising the definitive agreement, collect data and personal information of the parties, file a preemptive notice and a lien certificate before the Public Property Registry for priority or preference purposes, calculate taxes, etc.

It is not uncommon to agree therein to a down payment from the promisor buyer, usually held in deposit by the promisor seller. After the agreed period of time, should the promisor buyer fail to buy, at no fault of the promisor seller, then the promisor buyer will forfeit the down payment. On the contrary, failure from the promisor seller to sell would generally trigger an agreed penalty, usually consisting on an amount equal to the down payment, plus returning the deposit to the promisor buyer. In the case that the promisor seller does not return the down payment and/or pays the agreed penalty, then the promisor buyer will have a strong claim against the promisor seller, in order to judicially demand either the deposit and penalty due or the execution of the final purchase agreement, as some courts may



consider some promissory purchase agreements —*pursuant to the provisions therein*— as a definitive private purchase agreement.

Upon the agreed period, the parties shall execute the final purchase agreement before a public notary —*as analyzed herein after*—, pursuant to the essential terms agreed upon on the promissory agreement.

(b) Purchase Agreement (*contrato de compraventa*)

Contrary to the promissory agreement³, the purchase agreement itself is final. However, it may be executed either privately, as a preparatory agreement —*needing to later comply with the legal formal requirements*—, or directly through a public deed granted before a notary public. As a rule, the sale is perfect and obligatory for the parties when they have agreed on the thing —*the real estate*— and its price, even if the first has not been delivered nor the second satisfied.⁴

The private purchase agreement, similar to the promissory agreement, is commonly used as a preparatory agreement providing the parties and the notary public with an agreed timeframe to prepare the definitive agreement. As mentioned above, before executing the final agreement, preparations need to be made, such as drafting of the correspondent public deed, filing a preemptive notice and

a lien certificate before the Public Property Registry for priority or preference purposes, etc.

Pursuant to the legal formal requirements stated on the applicable Civil Codes, a real estate purchase agreement shall be generally executed through a public deed and recorded before the local Public Property Registry, in order to be effective against third parties.⁵

The public notaries will be responsible to ensure the validity and enforcement of the transaction. Prior to closing, they will check for the existence of any debts or liens against the property; that the correspondent taxes and other government fees are paid in full, that the real estate description is correct and that the seller has the capacity to execute the transaction. In addition, they will take care of the tax matters of the transaction, for instance, that the property taxes, transfer fees/taxes and any capital gains taxes are paid at or prior to closing. They are also responsible to properly record the transaction before the local Public Property Registry.

After closing, the notary public will be responsible to provide each party with a certified copy of the property title, duly registered before the relevant authorities.

V. Closing and Ongoing Costs

(a) Closing costs

is being entered into.” Judicial precedent entitled “PURCHASE UNDER APPEARANCE OF PROMISSORY PURCHASE” (“*COMPRAVENTA BAJO ASPECTO DE PROMESA DE VENTA.*”), with registry number 241344.

⁴ Article 2249 of the Mexican Federal Civil Code (*Código Civil Federal*).

⁵ Articles 2316 to 2322 of the Mexican Federal Civil Code (*Código Civil Federal*).

³ However, pursuant to the terms and conditions set forth therein, courts may consider some promissory purchase agreements as final agreements. “*When a promissory purchase agreement contains elements that belong to definitive transactions, such as the way in which the price will be paid, or it is stipulated that the purchased thing is delivered, the promissory purchase agreement is disrupted, because then the consent therein no longer refers to granting a future contract, but actually the final contract*



For guidance purposes only, these are typically the expenses that a buyer needs to take into consideration when acquiring real estate in Mexico, subject to different local requirements that each City or State may have in the correspondent local regulation:

- (i) In case of a Mexican Corporation, incorporation costs such as notary public fees and registration fees — *regulated locally in each State*—;
- (ii) In case of a regular Mexican trust or FIBRA, if needed, notary public fees and registration fees —*regulated locally in each State*—;
- (iii) Real estate appraisal;
- (iv) Notice to SRE, if applicable;
- (v) Tax or services certificates, evidencing that no government fees or taxes are outstanding;
- (vi) Taxes, whether local or federal, if applicable, such as income tax —*for the seller*—, acquisition of real estate tax, value added tax, etc.; and
- (vii) Notary fees and filing fees, such as, preemptive notices, certificate of encumbrances, registration of the change of title thereof, expedition of public deeds, etc.

(b) Ongoing costs

For guidance purposes only, these are typically the ongoing expenses that a real estate owner, direct or indirect, needs to take into consideration in Mexico, subject to different local requirements that each City or State may have in the correspondent local regulation:

- (i) In case of a Mexican Corporation, issuance of annual financial statements and filing fees before the Public Commercial Registry in case of Stakeholders Meetings minutes required to be recorded therein, for example, amendments to by-laws, transformation, mergers, spin-offs, dissolution, liquidation and, optionally, the powers of attorney granted by the corporation⁶;
- (ii) In case of a regular Mexican trust or a FIBRA, formalization and trustee’s annual fees;
- (iii) Annual property taxes, like real estate tax (*impuesto predial*); and
- (iv) Payment of services, such as water, electricity, and gas supply, among others.

Disclaimer

This note is for general guidance only. Specific legal advice should be obtained in all cases.

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We remain at your disposal in relation to questions regarding this note and in relation to your business and look forward to assisting you.

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⁶ Articles 19 and 21 of the Mexican Commercial Code (*Código de Comercio*).