

## U.S. LLC's as BENEFICIARY's of FIDEICOMISO's "CAVEAT EMPTOR BUYERS"

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For years, Americans have been creating U.S. LLC's to be the beneficiary's of Mexican bank trust, known as *fideicomiso's*, for the ownership of residential real estate that is located in Mexico's restricted zone. It has been a practice utilized for more than 20 years when foreigners acquire houses on Mexican beaches intended for their third party residential use. The intent, as was originally contemplated, considered that the sale of the U.S. LLC, having established trust rights as "fideicomisaro" (beneficiary) of the Mexican realty, would not trigger a taxable event under Mexico's tax law. It was thought to be a sale of the entity in the U.S. and therefore didn't create a "capital gains" or income tax liability for the seller. It further contemplated that the buyer would also not have a tax liability in any subsequent sale as long as they sold the U.S. entity and a new trust was not created. The fallacy in the contemplation is that Mexico has long considered sales of residential realty owned by non-Mexicans to be a taxable event, unless one can qualify for a tax exemption under Mexican residency requirements, regardless of whether the beneficiary's are individuals or a foreign LLC. The realty of this situation has now come to light in a United States District court in Harris County, Texas.

The case before the District court was simply this: was the sale of a U.S. entity with 50% or more of its value derived in a fideicomiso a taxable event under Mexican law at the time of the transaction between the parties? The court found in the affirmative for the plaintiffs. The District judge, in his Memorandum Opinion and Order dated May 9, 2007, stated "the court determines as a matter of law that the transaction did give rise to a tax liability under Mexican law." It has long been the suggestion AND recommendation of some attorneys and real estate agents in Mexico that creating an LLC as the beneficiary of the trust was the best way to go from a tax liability standpoint. They have been persuasive in convincing U.S. buyers that as long as it's the sale of the entity, i.e., the assets or stock of the U.S. LLC transacted on this side of the border, there is no taxable event triggered in Mexico. Nor would the Mexican IRS, known as "*Hacienda*", even know about. After all, it occurred in the U.S. and not before a Mexican notario publico. The truth is that that's completely false and could be very costly. At its very least, it is **tax avoidance** and the last buyer of the LLC is the one "holding the tax liability bag" if there has not been prior contractual considerations and/or adjustments for the ultimate tax due. Many of us have long said there will be a day of reckoning concerning this matter. The government of Mexico is not blind and has been aware of the tax avoidance issue for some time now. It is unfortunate that we've had a case in a U.S. court where Americans sue one another over Mexican income tax liability, or capital gain tax, as it's often referred to. The sad reality is that it was just a matter of time before it would happen and not whether it actually would. The caveat is this buying public: it's ok to buy the LLC that is the beneficiary of the trust for the residential property. *However*, one needs to be aware of the potential tax implications that are inherent in the acquisition of the LLC and make appropriate financial adjustments in the purchase concerning the tax liability. Why should you get stuck paying someone else's capital gains tax in Mexico when they're the ones that made the windfall profit on the sale of the residential property? It really is an easy answer, isn't it!