

RESIDENCY REQUIREMENTS IN MEXICO FOR TAX EXEMPTION PURPOSES*

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In the United States, American citizens may exclude the capital gain they realize when they sell their principal residence after occupying it for a period of not less than two years during the five years preceding the sale and meeting other specific IRS requirements. That is to say, there is no federal income tax liability on up to US\$250,000 gain (US\$500,000 gain for joint filers) on the sale of their primary residence. Mexico has a similar provision in its tax code. Pursuant to the Mexico Tax Revenue Code (*Código Fiscal de La Federación*), Mexican nationals and foreign owners of a residence in Mexico may be entitled to certain tax exemptions on the capital gain realized if the “home” is a “primary” residence.

The issue of capital gains tax has long been a troubling problem for many foreign purchasers of residential property in Mexico. Many sellers, whether Mexican or foreign, have tried to reduce their tax liability on the sale of a residence by using a lower “declared value” in the transaction rather than using the actual sales price. As a result, an unknowing buyer can inherit additional tax consequences when they ultimately sell the home in question because their “basis” in the property is less than what they actually paid. For several years now, some real estate agents in Mexico have advised their non-Mexican clients not to worry about capital gains taxes because they would qualify for an exemption. They often advised the prospective buyer that he or she would be able to demonstrate to the local public notary (*notario publico*), who is responsible for the collection and payment of the capital gains tax, that the residence was their primary residence and therefore qualify for the exemption. At the very least, this was misleading and poor advice to receive from a seller or real estate agent. At its worst, it could be considered tax fraud.

Pursuant to recent amendments of the Mexico Tax Revenue Code, a foreign national who is a “homeowner” may qualify as a “Resident” of Mexico for Mexican tax purposes and may qualify for a capital gains tax exemption on the sale of residential property in Mexico. The following are some points you may consider to determine whether you qualify as a Mexican “Resident”:

- Is your primary residence in Mexico?
- Is more than 50 percent of your total income generated or earned in Mexico?
- Is your main business operation or your “main professional center” for business income purposes located in Mexican Territory?

If you have answered “yes” to these questions, you may be considered a Mexican Resident and may be entitled to some residency benefits such as the capital gains tax exemption. You should always contact a local *notario publico* to discuss the specific requirements and benefits of Mexican Residency. You should also consult with other Mexican legal counsel and tax advisors to explore these and other possible benefits.

American and other foreign buyers of Mexican residential property must be aware of Mexico’s capital gains tax liability when they sell. If the original Seller did not declare the total purchase price when selling the property, the Buyer could face increased capital gains tax liability when the Buyer sells the property due to the artificially reduced basis. It is not uncommon for this consequence to be a “deal killer” when the buyer

seeks to sell the property and discovers that he or she must write a check just to cover the income tax due at the pending sale. This is a clear case of *caveat emptor* – let the buyer beware! One simple solution to this problem is to declare the **actual** purchase price in the sale of all real estate.

***This article is only intended to provide general information. It is not intended to be relied upon as legal, accounting, tax or other professional advice or services. Please consult with legal counsel and a tax advisor to address your concerns.**

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