



**Confused - and Concerned - About Tax Obligations
Related to the Sale of Your Mexican Real Estate?
Here's How to Build Your Case for a Mexican
Homestead Tax Exemption!**

By Raoul Rodríguez-Walters, CFP ®

"How can I obtain a capital gains, or homestead, tax exemption on the sale of my Mexican real estate?" is one of the most frequently asked questions by expatriate residents in Mexico when they contemplate selling their homes.

Residents may not be aware that the requirement that you live in your Mexican home for two years before it can be sold as a qualifying property under the homestead exemption was eliminated by tax reform in 2002. And, different interpretations by *Notarios* (the attorneys responsible for preparing and recording deeds of title and for calculating taxes on real estate transactions) may have sparked the current concern in the expatriate community about the so-called "capital gains" tax. A new awareness and sensitivity to how it's applied, especially to foreign sellers, seems to have created the confusion.

Answers differ depending on where in Mexico you are selling property. For instance, in Los Cabos, foreigners are almost never granted the homestead tax exemption by *Notarios*. In Mexico City, homestead exemptions are almost always granted to foreigners. And, in San Miguel, the homestead exemptions are granted on a case-by-case basis to the extent that the sellers comply with certain legal requirements.

What it boils down to is the tax status of the seller, not his or her residency status.

What Notarios Decide is Critical

Under Mexican Income Tax Law, *Notarios* are jointly liable with the seller for all taxes due on the sale of real property in Mexico. If Hacienda (the equivalent to the Treasury Department in the US) decides the *Notario* did not calculate these taxes correctly, the *Notario* may be required by the tax authorities to make up the difference. Obviously, when they are doing dozens of transactions each year, very possibly involving millions of U.S. dollars, *Notarios* have to be very careful and will generally take a conservative approach.

The homestead tax exemption is still available to resident taxpayers in Mexico, and it is the *Notario* who decides who meets the requirements of tax residence. To make this determination, *Notarios* base their decision on two different sets of laws: Mexican tax laws and Mexican immigration laws.

Who is a "Tax Resident"?

How foreign nationals who reside in Mexico are taxed in this country depends, first of all, on the tax treaties Mexico has signed with other countries. Often, tax treaties override any national legislation. In the case of U.S. citizens, therefore, one must review the Mexico-U.S. Tax Treaty, as amended in November 2002.

Article 4 of this treaty states that a "tax resident means any person who, under the laws of that state, is liable for tax therein by reason of his domicile, place of incorporation, or any other

criterion of similar nature." This article goes on to state that if the taxpayer is a resident of both states he or she will be considered a resident of the country where he or she has a permanent home.

A tax resident in Mexico is distinctly different from someone who is a legal resident, although often a legal resident generally is also a tax resident. Article 9 of the Fiscal Code of Mexico, amended for 2004, establishes that tax residents are those "who have established an abode in Mexico". If they have two homes available to them, one in Mexico and another one abroad, they will be considered a tax resident of the country where the taxpayer has his or her center of vital interests. Mexico will consider that the center of vital interests is Mexico if over 50% of the taxpayer's income is derived from sources inside of Mexico.

Expatriate tax residents have all the obligations and benefits of all other tax residents in the country, including the homestead exemption contained in Article 109 of Mexican Income Tax Law, which identifies that the transfer of certain properties are exempt from taxes, including: "Those resulting from the transfer of...the taxpayer's home..."

Where the current confusion arises is that some *Notarios* are of the opinion that the homestead exclusion is available only to legal permanent residents, and they make their tax liability determination on the basis of immigration law, not tax law.

What Constitutes "Legal Residency" in Mexico?

Legal permanent residence is granted pursuant to Article 48 of the General Population Law and is

evidenced by possession of an FM-2 visa. Temporary visitors on an FM-3 visa pursuant to Article 42, or on a tourist visa, are not considered *permanent* legal residents. In fact, the FM-3 document specifically states that the holder does not automatically acquire residency by merely holding the visa.

Building a Case for the Exemption

Your *Notario* will carefully examine a "fact pattern" before deciding if you qualify for a homestead tax exemption when you sell your Mexican residence. By complying with as many of the points below, you can greatly increase your chance of obtaining a homestead exemption on your Mexican property:

1. Obtain an FM-2 visa to establish legal and permanent residence. There are some *Notarios* in Mexico who will indeed grant holders of an FM-3 visa a homestead exemption to the extent that the seller qualifies under the tax laws. However, you will gain more credibility as a legal resident with the FM-2. Most *Notarios* will allow the tax exemption if you hold an FM-2.
2. Obtain a Mexican tax identification number, known as "RFC", to show that you take your tax responsibilities seriously. Remember: the homestead exemption is available to "taxpayers" per Article 109 of the Mexican Income Tax Law. What better way to prove that you are a taxpayer than by showing that you have a Mexican tax ID?
3. Open a Mexican bank account that pays interest. The bank will withhold income taxes on your behalf, making you a taxpayer.

4. Live in your home for at least six months. While there is now no time requirement to establish tax residence, often Notarios will want to see at least six months of continued residence at the house.

5. Make sure that your utility bills are in the name of the person who holds title to the property. If the property is owned jointly, try to obtain at least one utility bill in the names of both persons. Gather at least six months of these utility bills as documentation for your Notario.

5. Make sure that the address of the property is exactly the same as the address listed on your FM-3 or FM-2.

If you meet most of the requirements above, and you have been told that you do not qualify for a homestead exemption, you owe it to yourself to get a second opinion and possibly save yourself tens of thousands of dollars in taxes.

Raoul Rodríguez-Walters, CFP® is the founding partner of Mexico Advisor, the only company in Mexico offering financial management, legal, tax and title services under one roof, to English-speaking foreigners wanting to live, retire or set up a small business in Mexico. Read more about the comprehensive, integrated services provided by Mexico Advisor at: <http://www.mexadv.com>. Or, contact Raoul at his San Miguel de Allende office: Correo #24, CP 37700 tel.: 415-152-0586; e-mail: raoul.rodriguez@mexadv.com.