

International Tax Planning White Paper

Tax Issues: How to integrate your Mexican property purchase with your tax situation at home

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Frequently Asked Questions

Q: A person selling a Mexico property (not a primary residence) for a gain, is he liable for both U.S. & Mexico capital gain taxes?

A: Generally, a person will get tax credits on his U.S. tax return, for Mexico taxes paid (no double taxation).

Q: Can a Mexico property be bought as a second home? What is deductible for tax purposes?

A: Yes, Mexico property can be considered a second home, thus interest & property taxes are deductible on U.S. returns.

Q: Are there wage & housing exclusions for U.S. citizens working in Mexico?

A: Yes, wage exclusion (up to \$80K) & housing exclusion (for expenses over \$32/day) apply for employees working abroad.

Q: Can one invest Mexico real estate in a retirement plan?

A: Yes, with restrictions (annual appraisal / audit, bond coverage).

Capital Gains Pointers

Capital gains tax law in Mexico states that tax is owed on the profit you receive when you sell your home or property (not a primary residence).

By law there are two options for you.

- Option 1 : 30% of the net profit. (variety of deductions included in this option)
- Option 2 : 25% of the gross sales amount with no deductions.

Rule Number 1: Always record the full value of your purchase.

You purchase a lot for \$1 million, but record a value of \$500,000. In the eyes of the Mexican tax law, your cost basis is now \$500,000. If you sell the lot for \$1.2 million you see a profit of \$200,000. However, according to your recorded cost basis, Mexico sees a profit of \$700,000 and your capital gains tax for Mexico will be 30% of \$700,000 (\$210,000.) You just lost \$10,000 instead of making a profit.

- Recording the real value benefits you and establishes your cost basis in Mexico.
- The Amount you pay for a property has no impact on your yearly property taxes.
- Capital gains taxes you pay in Mexico can be applied to your U.S. taxes
- When you sign your new trust, ask the Notary to jot down the exchange rate on the document itself. This will come in handy years later."

As soon as you pay your 2% acquisition tax to receive your trust, you are eligible to receive an inflationary credit from the Mexican Government for every year you own the property.

- This credit is added to your cost basis when you decide to sell your property.
- The credit is based on consumer index adjustments (inflation) and can be quite significant. We have seen credits in excess of 15 percent per year applied to a cost basis. On a million-dollar property, this can be as much as \$200,000 USD per year added to your cost basis, significantly reducing your capital gains tax should you decide to sell in the coming years;
- You are not eligible to receive the inflationary credit unless you have paid your 2% acquisition tax; and
- You can receive the inflationary credit based on the date of your buy/sell agreement, provided you paid the 2% acquisition tax for the property.

The tax incentive in Mexico states that if you sell your "primary residence" after two years, you pay no capital gains.

This law is in place for "residents" (Mexicans nationals or foreigners) of Mexico only, and there are several items required to establish residency status. In order to claim your home as your primary residence in Mexico, you must be able to prove that it really is your primary residence.

At the closing, you will be required to provide the Notary with a residence visa (FM2), as well as a bank account, water, phone, and electric bills, paid tax receipts and your trust, all in your name, all with the address of the home and all in place for more than two years.

- The capital gains tax exclusion is intended for residents of Mexico, not for persons owning second homes or vacation home;
 - Resident individuals are subject to Mexican income tax on their worldwide income, regardless of their nationality;
 - Foreign individual will be considered a resident of Mexico for tax purposes when he has established his home in Mexico;
 - Foreigners working in Mexico under a visitor's permit should probably not be considered as residents until they have established some type of physical home in Mexico and have remained in the country for at least 183 days in a calendar year; and
 - Maximum federal income tax rate of 35%.
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- Other federal taxes include: value added (15% of goods/services), social security (5.15%, max \$1,650), tax on assets held (1.8%);
 - Gains on the disposition of real property or shares of capital stock receive favorable income tax treatment in that historical costs may be increased by factors (based on the number of years the asset had been held) to adjust them for inflation;
 - Gains on sales of securities through the Mexican stock exchange, when the securities are classified as available to the general public, are exempt from tax; and
 - Gains from the sale of the taxpayer's principal residence are exempt, provided the taxpayer occupied it as such during the two years before the sale.
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Taxes in Canada

- Resident individuals are subject to Canada income tax on their worldwide income, regardless of their nationality;
- Non-resident individuals are taxed on Canadian income only. Non-residency is established by severing social & economic ties (like not having a Canadian driver's license, no Canadian health plan, etc.);
- Maximum federal income tax rate of 29%;
- Other federal taxes include: GST (7% good/service tax), Canadian pension plan, which is similar to social security in the U.S. (4.95%, \$38,000 income limit);
- 50% of capital gains are tax exempt, the other 50% is taxed at ordinary tax rate;
- Gains from the sale of the taxpayer's principal residence are exempt; and
- Non-residents can leave/maintain Canadian retirement plans (but subject to 25% withholding tax).

Taxes in United States

Real Estate as a Plan Investment

"Investing in real estate within a qualified retirement plan is a nontraditional investment that requires careful consideration."

- Real estate includes but is not limited to Limited Partnerships, land, buildings, etc;
- Some issues do not take into account issues such as changes in law or government policy, or unforeseen events;
- Plan Document Language — Does the Trust Document allow investment of Plan assets in real estate?;
- Valuation — At least annually, all plan assets must be valued at their fair market value. Valuation requires an independent, third-party appraisal;
- Prudence and Diversification — Do Real estate investments impact prudence and diversification requirements?
- If the investment constitutes 20% or more of the total plan assets and to disclose the amount of the investment;
- Liquidity — Are plan assets tied up in real estate?
- Fiduciary Bond Coverage — Does the Fiduciary Bond cover real estate investments?
- Benefits, Rights & Features — Do all Participants have the right to invest in real estate?

- In-Kind Distributions — Does the plan document allow in-kind distributions? If not, the plan can be amended.
- Debt Financed Income — Income earned by a trust as a result of debt-financing, for example gains on property purchased via a mortgage, could be taxable to the Trust at trust rates.
- Unrelated Business Taxable Income — Does the investment of real estate result in unrelated business income tax? If the trust has so many real estate investments that it is deemed to be operating as a business rather than investing assets for retirement, the earnings become subject to unrelated business taxable income.
- Mortgage — Can the trust obtain one if needed?
- Prohibited Transactions — Does the real estate investment benefit a "party-in-interest" (as defined by the Internal Revenue Code)? The fiduciaries are obligated to maintain the plan and trust solely for the exclusive benefit of participants and their beneficiaries.

Non-Resident Canadian Taxes

- Canadian citizens can elect to become non-residents;
- Bid Canada Customs and Revenue Agency farewell;
- Wish to shelter future wealth accruing from capital gains taxes (75%) by taking residence in just about any country other than the US and interest generated outside of Canada ceases to attract any tax whatsoever;
- Interest accrued on bank deposits;
- Other countries have varying tax schedules of interest accrued in the country of residency;
- These taxes are well below the prohibitive and confiscatory rates levied in Canada;
- Allows Canadians to live in a climate of their own choosing and experience a better quality of life for comparatively the same amount of Canadian living expenses;
- A Canadian living in Vancouver spending \$2000.00 CDN per month in after-tax-dollars can easily find superb living conditions in a high cost city like Guadalajara, Mexico, for \$600 per month;
- The non-resident Canadian in Guadalajara will —
 - pay \$350 per month for a live in maid;
 - can obtain first class medical insurance for \$150 per month;
 - have a low utilities bill of \$60 per month which will include telephone service; and
 - And spend no more than \$400 per month for food.
- Rental or commercial real estate can be held provided that they are leased to parties who are at arm's length;
- Taxes on Canadian based rental income will have to be paid on a quarterly basis;
- Canadian stocks can be also held, but will attract no capital gains taxes upon sale;

- Dividends, however, will continue to attract a withholding tax at varying percentages depending on the country of residency;