

Foreign Investment in Mexico's Real Estate: An Introduction to Legal Aspects of Real Estate Transactions

MANUEL F. PASERO* AND HÉCTOR TORRES**

I. INTRODUCTION

During the past ten years, and since the deregulation in most sectors of the Mexican economy, real estate investments increased considerably. Possibly, one of the reasons why people's interest has turned to Mexico is the thousands of miles along the border and seashores that still have not been developed. Whatever the interest of a foreign individual or corporation might be, Mexico is now offering a variety of investment opportunities in the real estate field. Touristry, recreational, industrial, commercial, and even residential purposes are attracting foreign investment in the Mexican real estate market, representing a substantial

* Manuel F. Pasero graduated from the Universidad Nacional Autónoma de México (UNAM) and is licensed to practice law in Mexico. Additional articles written by Mr. Pasero include *Legal Framework of the Maquiladora Industry* and *How to do Business in Mexico as a Foreign Investor*, published by World Trade Press in 1994. He also serves as Honorary Chairman of the Tijuana Economic Development Corporation, which is an association devoted to the promotion of foreign investment in the city of Tijuana, Baja California. Mr. Pasero has more than 25 years of experience in his practice, and is currently the Managing Partner of the Tijuana-based law firm of Pasero y Martín-Sánchez. His practice focuses on legal counseling for foreign investors doing business in Mexico.

** Héctor Torres graduated from the Universidad Autónoma de Baja California, Facultad de Derecho Zona Costa, and in 1997, earned a Masters in Laws in Comparative Law (LLMC) from the University of San Diego School of Law. Mr. Torres did postgraduate studies in Real Estate Law at the Instituto de Investigaciones Jurídicas (UNAM).

portion of the foreign capital flow into the country.

Furthermore, with the enactment of NAFTA, the Mexican federal government in conjunction with state and local authorities has been implementing better laws and policies related to human settlements, urban development, zoning and environmental issues in order to address a sustainable economic growth and international integration. The above policy has resulted in a complex body of law that requires continuous attention when dealing with a real estate transaction in Mexico.

Therefore, in an attempt to consider all legal aspects most commonly encountered when foreign investors are involved in a real estate transaction, we have prepared this article with the purpose of providing a panoramic view.

It is possible that some of the information in this article may not be relevant for all readers; and similarly, it is possible that certain topics relevant to readers' needs are not included in this article. Due to the fact that there is a complex body of law dealing with the subject, this article will deal solely with the most commonly encountered subjects and legal considerations.

II. FOREIGN INVESTMENT RULES FOR THE ACQUISITION OF REAL ESTATE

A. *The United Mexican States' Political Constitution*

As a brief historical background, before explaining the constitutional provisions dealing with real estate located within Mexico, it should be noted that from its early days as an independent nation (1821) through the dictatorship of President Porfirio Diaz (1876-1911), Mexico confronted several threats to its sovereignty, wars, and a revolution that ended in the loss of several parts of its territory.¹

During the days of President Porfirio Diaz, foreign investment in the most strategic sectors of the economy flourished, giving Mexico great economic prosperity. However, prosperity did not reach most of the country's population and thus, the Diaz days ended with the Mexican Revolution of 1910.² Resentment of the foreign investment control of

1. During 1845, Southern Texas, which formerly belonged to the Republic of Mexico, was added to the territory of the United States of America. Following the Mexican-American War, with the signing of the Treaty of Guadalupe-Hidalgo in 1848, Mexico ceded California, most of Arizona, and parts of New Mexico, Nevada, Colorado, and Utah to the United States. During the Government of Mexican President Santa Ana, Mexico sold the remaining land on the Arizona border to the United States for ten million dollars in 1853.

2. Because of the Plan de San Luis proposed by Francisco I. Madero, the

the economy, as well as the loss of territories formerly belonging to Mexico, led the legislators to enact the Mexican Political Constitution, which gave the Mexican government the power to impose modalities of ownership of property that conform to the public welfare.³

The new Constitution did not jeopardize foreign ownership of means of production, but rather it adversely affected foreign ownership interests regarding natural resources.⁴ Basically, the Constitution provides that the Mexican Nation has original ownership of all land and water within the national territory, as well as minerals, salts, ore deposits, natural gas and oil. It also states that use and exploitation of said land and natural resources may be assigned or granted in concession to individuals or corporations, in accordance with the rules and conditions set forth in the respective laws.⁵

The Constitutional principles governing land ownership within the Mexican territory are contained within Article 27. Specifically, Section I, paragraph one proclaims that only Mexicans by birth and Mexican companies have the right to acquire ownership of lands, waters and their easements, and concessions for the exploitation of mines or waters. Nonetheless, the same paragraph also states that the Mexican Government may grant the same right to foreign individuals or corporations provided that they agree to the "Calvo Clause."⁶

Under the Calvo Clause, the theory of which is reflected within the language of the first paragraph, Section I of Article 27, foreign individuals and/or corporations must agree before the Ministry of Foreign Affairs to consider themselves as Mexican nationals with regard to their acquisition of land or waters. They must further agree not to invoke the protection of their governments in matters relating thereto.

Mexican Revolution War started on November 20, 1910, ending with the separation and exile of Porfirio Díaz as President of Mexico, and with the establishment of a new democratic government.

3. See CONSTITUCIÓN POLITICA DE LOS ESTADOS UNIDOS MEXICANOS [Mexican Constitution]. The United States Mexican Political Constitution was enacted on February 5, 1917, in the city of Querétaro, Querétaro.

4. See Luis Miguel Díaz González Rubio, *Globalización de las Inversiones Extranjeras*, Nuevos Aspectos Jurídicos 39 (1989).

5. See MEX. CONST. art. 27, para. 6.

6. See *id.*, art. 27, § 1. para. 1. Its name honors its author, professor Carlos Calvo from Argentina, whose thesis maintained that intervention of diplomatic representatives or armed forces of a country to support claims of their nationals against another Country is a flagrant violation of the principles of International Law. See LEONEL PEREZNIETO CASTRO, *DERECHO INTERNACIONAL PRIVADO* 461 (1989).

The penalty for failure to comply with this clause is forfeiture of their property interests to the benefit of the Mexican Nation.

Thus it can be concluded that under the Mexican Constitution, acquisition of land and waters by foreigners is permitted, but conditioned by the covenant set forth in the Calvo Clause, as well as the specific rules applicable to foreign investments.

B. *The "Restricted Zone"*

As explained above, during the course of its history, Mexico had to deal with problems regarding its territorial rights. This course of history led the legislators to add a paragraph to Article 27, wherein it is stated that foreigners are prohibited from acquiring direct ownership of land and waters located within the "restricted zone."

The restricted zone encompasses all land located within 100 kilometers (about 62 miles) along the Mexican border, and 50 kilometers (about 31 miles) along the seashores.⁸ The mechanism that the Mexican legislation has developed to allow the use and enjoyment of land within the restricted zone to foreign individuals is the Mexican real estate trust, which will be explained further in this work.

C. *The New Foreign Investment Law and its Latest Developments*

The new Foreign Investment Law permits foreign investment participation in most of the Mexican economic sectors, including real estate.⁹ The new law was restated on March 24, 1996, in order to clarify the rules for foreign ownership of real estate. In agreement with Article 27 of the Mexican Constitution, the new law provides that foreigners may acquire direct title to land and waters within the Mexican territory, provided that a petition is filed before the Ministry of Foreign Affairs

7. The "Restricted Zone" adheres to the criteria being developed through all of Mexico's Constitutional history. Some of the historical background dealing with restrictions on foreigners began even before Mexico's independence days, while it was a Spanish colony. For instance, a decree dated August 18, 1824 established concessions to foreign individuals to acquire land within the national territory. However, for the first time it prohibited foreign individuals from acquiring direct ownership of land within a distance of 20 leagues in border areas and 10 leagues on the coasts. See Luis Miguel Diaz, *supra* note 4, at 76.

8. In the opinion of Luis Miguel Diaz, the constitutional provision of the "restricted zone" had a logical explanation during a period of conflict, when countries wished to protect their territories from a potential invasion. See *id.* at 78. Cornelius Van Bynkershoek (1673-1743) authored the classic statement, "*Potestas terrea finitur, ubi finitur armorum vis,*" that determines that the territorial waters must be measured by the range of the cannonball reaching limits, which in 1800 equaled more or less 3 maritime miles. *Id.*

9. "Ley de Inversion Extranjera", D.O., 27 de diciembre de 1993.

whereby the foreigners bind themselves to the Calvo Clause¹⁰ and obtain the approval from said Ministry.¹¹ The exception to this provision rests within the restricted zone. In accordance with the law's provisions, the following rules will apply when the real estate is located within the restricted zone:

- Mexican corporations with foreign ownership may acquire direct ownership of real estate within the restricted zone provided that such real estate will not be used for residential purposes.¹²
- In the case of foreign-owned Mexican corporations or foreign individuals or corporations wishing to acquire real estate within the restricted zone for residential purposes, a real estate trust must be executed prior to obtaining the approval of the Ministry of Foreign Affairs.¹³

Thus, the new rules provide that foreigners are permitted to acquire real estate property within Mexican territory, provided that they are considered as Mexican nationals and thus waive the protection of their government regarding their acquisitions. Foreign individuals or corporations are required to execute a real estate trust only for residential purposes within the restricted zone.¹⁴

As explained previously, outside the restricted zone, a petition must be filed and approval needs to be obtained from the Ministry of Foreign Affairs before foreign individuals or corporations can acquire title to real

10. See MEX. CONST., art. 27.

11. "Ley de Inversion Extranjera", art. 10-A.

12. *Id.* art. 10, § I.

13. *Id.* art. 11, §§ I-II. Prior to the enactment of the Foreign Investment Law, the Law to Promote Mexican Investment and Regulate Foreign Investment prohibited direct acquisition of land and waters within the restricted zone for foreign owned Mexican corporations in all cases. See "Ley para promover la inversion Mexicana y regular la inversion extranjera", art. 7, D.O., 9 de marzo de 1973.

With the 1996 Restated Foreign Investment Law, foreign owned Mexican corporations are now allowed to acquire direct title without the necessity of executing a real estate trust. This does not apply for residential cases.

14. Under the new law, there are no provisions that further explain the extent of the meaning for "residential purposes." As a key term for determining whether a trust will be required or not, it is of utmost importance to limit the interpretation of the term. For instance, would a trust be required for a developer wishing to build condominiums and sell them? Or should only the final buyers (if they are foreign individuals) be required to set up a real estate trust? An article appearing in *El Financiero Daily Newspaper* stated that the new regulations to the Foreign Investment Law would define the scope of residential purposes. To date, however, the regulations have not been officially enacted. Rosario Avilés, *Esperan empresarios mayor fluidez en el nuevo reglamento de inversiones*, *EL FINANCIERO*, May 29, 1997.

estate properties or concessions for mines or water exploitations in Mexico. However, the law goes further, stating that the Ministry of Foreign Affairs may enact rules for specific cases that will not require such approval.¹⁵ To the present date, the Ministry of Foreign Affairs has enacted two Official Statements that enable foreign individuals to file only a writ before the mentioned authority, agreeing to submit to the Calvo Clause, without requiring that they obtain approval for acquisition of real estate, mines and water concession outside the restricted zone.¹⁶ These provisions are applicable only to individuals from countries that maintain diplomatic relations with Mexico.

III. REAL ESTATE CONDITIONS

As the real estate business becomes more complex because of the applicable statutes and laws, it is also very important that in addition to the foreign investment rules, other rules restraining or limiting property rights be reviewed.

It was Mexico's population growth, as well as its integration into the international trade arena, that turned the eyes of foreign investors on a number of economic sectors, and obliged the Mexican government to enact rules regulating human settlements, urban development and environmental protection. During the seventies, the Mexican government amended the Constitutional act to address the responsibilities of authorities in dictating measures concerning the uses, infrastructure, urban development and rules for the human settlements within the Mexican territory.¹⁷

It would be very difficult to enter into an analysis of all the statutes and regulations that deal with the subject because in addition to the federal rules now being enforced, state and local laws and regulations are also being enforced. Therefore, if a person is interested in acquiring a piece of land within Mexican territory, depending on the use of the land, it is highly recommended that there be verification of the real estate conditions from several perspectives. Due to the extent of the subject, we will analyze only some of the most important and common considerations to be taken into account when dealing with a real estate transaction in Mexico.

In the first place, one should ensure review of the title documents of the property in order to assess legitimate ownership. Careful review of

15. See "Ley de Inversion Extranjera", Law, last paragraph.

16. Calvo Clause, D.O., 2 de marzo de 1998, *as amended by* D.O., 11 de mayo de 1998.

17. MEX. CONST., amend. Feb. 6, 1976. The articles amended were 27, 732 section XXIX C, and 115 sections IV and V.

the chain of conveyance, recordation data, description of the property and verification of measures and boundaries are some of the basic considerations of which one should consider carefully.

Secondly, as explained above, the governmental authorities at all levels—local, state and federal, are now truly aware of the need to regulate human settlements and urban development. For that reason, it is imperative to verify the zoning regulations affecting a property in order to define limitations on the use of the property.¹⁸

Whether a property will be used for an industrial, commercial or residential activity, it is of utmost importance to verify its zoning status. There have been cases in which foreign investors encountered severe problems with the development of a project because they did not address the issue at the time the property was bought.

Thirdly, environmental restraints imposed on real estate must be carefully considered, although not all cases will involve these environmental aspects issues, such as when buying a home. If real estate is acquired to develop a tourist or industrial activity, an environmental impact authorization from the environmental authorities will be required. In 1988, Mexico enacted a federal environmental law that specifically provides for this obligation.¹⁹ Recently most states within the Mexican Republic have enacted their own state laws, in order to address environmental issues affecting them.

Finally, since there are many areas in Mexico where there are few or no utilities such as water, sewer, drainage, gas, electricity and telephone lines, it is highly advisable to practice due diligence to discover the status of the property.

IV. MOST COMMONLY USED REAL ESTATE CONTRACTS IN MEXICO

Typically, most real estate transactions begin with interested parties agreeing on an offer and acceptance to purchase a piece of property.²⁰

18. For instance, the northern state of Baja California recently enacted modern Urban Development Laws, Construction Laws and a State Urban Development Program to address the zoning irregularities that are present within cities located at the U.S.-Mexico border. The geographical location of Baja California has played a key role in attracting the development of a flourishing industry, commercial and tourist activities that demanded good zoning planning.

19. See "Ley General del Equilibrio Ecológico y la Protección al Ambiente", D.O., 28 de enero de 1988 as amended by D.O., 13 de diciembre de 1996.

20. For purposes of this analysis it is important to define what is considered "real" estate under Mexican law and theory. The Mexican legal theorists agree that real estate

The first step to take is writing a letter of intent that contains the basic information regarding the real estate description and location, the price consideration and terms for payment. The seller signs the proposal and the buyer accepts it by signing in conformity. Under Mexican law, a letter of intent will suffice to be considered as a valid contract or agreement.²¹

After the letter of intent is signed, the parties convene on the best manner in which the real estate is to be transferred, and the kind of agreement that the parties will execute to finally formalize the transaction. One should be aware that, under Mexican law, real estate transactions must follow certain formalities, or else be nullified.

Other than the real estate trust that is required for foreigners when acquiring properties within Mexican territory, the most commonly used agreements for a real estate transaction in Mexico are a general purchase sale agreement, a reserve title and an installment sales agreement. There are other kinds of agreements that are used as an accessory or compliment to the above agreements, but these are essentially the most important.²² Since our analysis focuses primarily on the acquisition of real estate, we will analyze only these most common agreements.

shall be defined in accordance with two main characteristics: 1) those goods that can not be moved from one place to the another; fixed to the ground; and 2) final use and destiny of the goods. See RAFAEL ROJINA VILLEGAS, *DERECHO CIVIL MEXICANO T. III*, 273 (1976).

The Mexican Federal Civil Code, within several of its provisions, states that real estate may be classified in two major categories: *Fincas Rústicas* (rural property) and *Fincas Urbanas* (urban property). See *CODIGO CIVIL PARA EL DISTRITO FEDERAL* [Federal Civil Code] [C.C.D.F.] arts. 2248 & 2249. The first one refers to real estate lacking all utilities infrastructure, such as public lighting, drainage and sewer systems, potable water, or those properties devoted to agricultural and cattle activities. The second one refers to real estate that has all of the above and is located within the urban area. See H. LEFERVE, *GLOSARIO DE TERMINOS DE SOBRE ASENTAMIENTOS HUMANOS* 148 (1978). Moreover, in a specific manner, article 750 details the classification of goods considered real estate. For the purposes of our study, we will only mention the most relevant: the land and constructions thereon (section I); all that is attached in a fixed manner to a real estate and removal of which can cause serious damages to the real estate (section III); machines, instruments and other tools destined by the owner for the exploitation of the real estate (section VI); and rights over property known as *derechos reales* (section XII). See C.C.D.F. art. 750.

21. See C.C.D.F. arts 2248, 2249. The articles provide that there is a valid agreement when the seller and buyer express their mutual consent to transfer and buy a specific property (object matter of the contract). The general rule specifies that a purchase sale agreement is binding when the price and object are agreed upon notwithstanding that the price has not been fulfilled.

22. In the Mexican Civil Codes, the following agreements are considered forms of transferring property of goods, including real estates: purchase sales, swap agreements, and donation and loan agreements. In addition to the above, there are other accessory agreements that purport to secure a guaranty, such as mortgages, industrial mortgages, or guarantee trusts. See, e.g., *id.*, art. 2243 et seq.

A. *The Promissory Agreement*

In most real estate transactions, it is highly advisable to execute a promissory agreement. The main convenience of executing one is the ability of a potential buyer to verify the conditions of the property through due diligence, thus assuring that he is aware of the exact circumstances that affect the real estate. Also, a promissory agreement may involve only advancing a deposit to prevent the property from being acquired or transferred to a third party, but at the same time leaving the opportunity to decide whether or not a buyer may proceed to formalize the transfer of title.

As opposed to a mere letter of intent, a promissory agreement serves as a preliminary agreement by which parties clearly fix the basic terms and conditions of the sale and the scope of the mutual obligations of each of the parties. An additional benefit of executing a promissory agreement would be the amount of time to obtain all the necessary documentation and preparation of paperwork required in formalizing the transaction in the manner provided by the Mexican laws.

A promissory agreement must meet the following requirements to be valid:

- It must be in writing;
- Parties to the agreement must have legal capacity to enter into the agreement;
- The agreement must include the basic characteristics of the final and formal agreement, and;
- The agreement must provide that the final agreement must be executed within a certain period of time.²³

B. *General Purchase Sale Agreement*

The general purchase sale agreement is the most common and simple way to acquire title to real estate in Mexico. Although foreigners are impeded from using this form of acquisition when buying property within the restricted zone, most of the real estate acquisition choices have some elements in common.

In a broad sense, under Mexican law, a purchase sale agreement occurs when one of the contracting parties obligates itself to transfer, and the other party obligates itself to accept title of property by

23. See C.C.D.F. arts. 2243-2246.

exchanging certain consideration for the property rights.²⁴ The contract is binding between parties when the property and the price are agreed upon, even if the property has not yet been materially delivered and the price not paid.²⁵ Under Mexican contract law, all contracts such as these must meet specific requirements for their existence and validity.²⁶

The essential existence elements of any contract are:

- *Consent*, which is granted by the seller at the moment he agrees to transfer title of the property, and by the buyer at the moment he agrees to pay a certain price in consideration of the property rights, and;
- *Object*, which is the purpose of the title transfer of the real estate, as well as the payment of consideration for this property transfer.²⁷

Validity elements in contracts are:

- *Legal capacity*, referring to the entitlement of the parties to enter into the contract;
- *Absence of error or willingness* to enter into the contract;
- *Legal object or purpose*, referring to the requirement that the subject matter of the contract be legally permitted;
- *Formality*, in that the laws governing the contract specifically require that some rules for perfecting the agreement need to be followed.²⁸

For instance, real estate transactions must be formalized by a Mexican Notary Public and recorded before the Public Registry of Property and Commerce of the domicile where the real estate is located, unless an exception is provided in the laws.

As can be inferred from the same nature of the contract, the primary obligations of the seller in a purchase sale agreement are:

- To materially deliver the property that is transferred;
- To guarantee the quality and conditions of the property, and;
- To guarantee effective title (cure in the case of eviction).²⁹

On the other hand, the buyer has to comply with all he had agreed upon in the contract, and in particular, pay the price at the time, place and manner previously convened.

24. *See id.* art. 2248.

25. *See id.* art. 2249.

26. Most, if not all, of the Mexican legal theorists classify the contract elements in two categories: essentials for existence and validity. *See* MIGUEL ANGEL ZAMORA Y VALENCIA, *CONTRATOS CIVILES* 25 (1989).

27. *See* C.C.D.F. art. 1794.

28. *See id.* art. 1795.

29. *See id.* art. 2283.

C. Reserve Title and Installment Sales Agreement

The reserve title and installment sales agreement is a variant of the purchase sales agreement, with which the seller reserves title to the property until full payment of the price, but the buyer may use and enjoy the real estate in the meantime.³⁰ By using this agreement the parties agree that default in any of the installments may grant the seller the right to rescind the agreement and have the property revert back to him.³¹

Some of the advantages to executing this kind of agreement include:

- First, the agreement can be recorded at the Public Registry of Property and Commerce, thus binding third parties.
- Second, if the buyer complies with the sale terms, meaning that he is current in payment of the corresponding installments, the seller will not be allowed to sell, encumber or in any manner transfer the property.³²

In a reserve title and installment sales agreement the obligations of the parties are subject to what has been called in Mexican law "Condición Suspensiva" (condition precedent), in which case full transfer of title is reserved and conditional upon full payment of the price agreed.³³

V. REAL ESTATE TRUSTS

It has been said that the Mexican government incorporated the real estate trust as a legal way of avoiding the constitutional prohibition of allowing foreign investors to acquire rights over real estate located within the restricted zone for industrial or touristy purposes. As mentioned before, supporting some commentators on the subject, we believe the constitutional prohibition had a legitimate justification in those days. However, in these days of globalization, it seems to be more of an obstacle to foreign investment than a protective provision.³⁴ In an attempt to encourage foreign investment along the border and seashores, the Mexican government took advantage of the trust to allow foreign investment participation in tourist and industrial projects.³⁵

30. See *id.* art. 2312.

31. See *id.* art. 2310, § I.

32. See *id.* art. 2313.

33. *Id.* art. 1939.

34. See MIGUEL ACOSTA ROMERO & PABLO ROBERTO ALMAZAN ALANIZ, *TRATADO TEORICO PRACTICO DEL FIDEICOMISO* 432 (1997).

35. See *id.*

As we mentioned in the second chapter of this article, which dealt with the foreign investment rules for Mexican real estate, the new law permits foreign-owned corporations to acquire direct title to land located within the restricted zone for purposes of developing non-residential activities.³⁶ Based on the previous statements, we can conclude that in accordance with the new Foreign Investment Law, a real estate trust will only be required in case of:

- Foreign individuals or corporations wishing to acquire real estate for residential purposes, and/or
- Foreign owned Mexican corporations wishing to acquire land for residential purposes.³⁷

A. *Defining the Real Estate Trust*

It has been said that the trust was poorly regulated by Mexican laws. It was incorporated in the General Law for Credit Notes and Negotiable Instruments.³⁸ Article 346 of the aforementioned law provides that by means of a trust, the "trustor" destines certain goods for a defined purpose to the trustee.

For purposes of this article, a real estate trust can be defined as an agreement created for the benefit of a foreign buyer, which is executed by a Mexican bank, the original owner, and the original seller of the real estate. The bank, acting as "trustee," buys the property on behalf of a "beneficiary" (usually the foreign buyer), and has a fiduciary obligation to follow the instructions given by the beneficiary.

Since there is a constitutional impediment to foreign acquisition of real estate within the restricted zone, the bank acts on the foreign beneficiary's behalf.³⁹ The beneficiary retains and enjoys all the rights of ownership, while the bank holds title to the property. In addition, the beneficiary is entitled to use, enjoy and, in the event that the property is transferred, benefit from the proceeds. The beneficiary may instruct the trustee bank to transfer the property to whomever the beneficiary desires at the market value or agreed upon price.⁴⁰

The foreign investment provisions further state that a permit from the Ministry of Foreign Affairs is required to set up a real estate trust.⁴¹ The

36. This means, for instance, that a foreign-owned Mexican corporation developing industrial activities, such as a Maquiladora, can acquire land in the restricted zone by fee simple, without the need for execution of a trust.

37. "Ley de Inversion Extranjera", art. 11, § I-II, D.O., 27 de diciembre de 1993.

38. "Ley General de Títulos y Operaciones de Crédito", D.O., 27 de agosto de 1932.

39. See "Ley de Inversion Extranjera", art. 11.

40. See *id.* art. 12.

41. See *id.* art. 11.

criteria that the Ministry will take into consideration for granting the permit includes the social and economic benefits that these kinds of transactions represent to the Mexican nation.⁴² Upon submitting the application, the Ministry will decide whether to grant the permit within a 30 day period.⁴³ The new foreign investment provisions extend the duration of the real estate trust to a period of 50 years, which can be renewed upon expiration.⁴⁴

When considering setting up a trust, a foreign buyer should also verify the status of the Federal Maritime Zone that limits the use of beachfront. Land located within the zone is considered to be national public property, and thus only the Mexican government can grant a concession for its use, enjoyment or exploitation.⁴⁵ During 1993, the Ministry of Foreign Affairs detected some cases in which the zone was invaded by trust beneficiaries. They were required to obtain proper concessions from the government and to pay concession fees.⁴⁶ Since then, every time a permit is requested for real estate bordering on the maritime zone, the authority is required to notify the beneficiaries, through the trustee bank, of the ability to obtain a concession for use and enjoyment of the maritime zone that complies with certain requirements.⁴⁷

Finally, it is important to add that executing a real estate trust involves the same formalities as any other real estate transaction, plus some additional requirements that basically can be summarized as follows:

- Obtaining approval from the Ministry of Foreign Affairs, and paying the corresponding fees.

42. *See id.* art. 14. The broad meaning of the "social and economic benefits" provides the discretionary ability of the Ministry of Foreign Affairs to grant the permits to set up real estate trusts. Since the past government administration, the Ministry has developed an operational code for granting real estate trust permits. For instance, in the case of a beneficiary's assignment of rights to a third party, the Ministry requires that the trustee bank obtain an approval from the referred authority on behalf of the beneficiary prior to the execution of the instrument. With respect to the Baja California region, the authority requests a "commitment letter" from the beneficiaries, whereby they must state the investment to be made as well as the timeframe within which to do so. *See* Oficio ASJ 8447 Dirección General de Asuntos Jurídicos, Artículo 27 Constitucional.

43. *See* "Ley de Inversion Extranjera", art. 14.

44. *See id.* art. 13.

45. *See* "Ley General de Bienes Nacionales", arts. 2, 16, 19, D.O. 8 de enero de 1982 *as amended* by 29 de julio de 1994.

46. *See* ROMERO & ALANIZ, *supra* note 34, at 438.

47. For further information and the requirements to be fulfilled, see "Reglamento para el Uso y Aprovechamiento del Mar Territorial, Vías Navegables, Playas, Zona Federal Marítimo Terrestre y Terrenos Ganados al Mar", D.O., 21 de agosto de 1991.

- An authorized bank institution must act as trustee in these transactions, which means that fees for its performance need to be considered.
- The real estate trust must be recorded at the National Registry of Foreign Investment, as provided by the Foreign Investment Law.⁴⁸

VI. REQUIREMENTS FOR CLOSING AND FORMALLY EXECUTING A STANDARD REAL ESTATE TRANSACTION

Formal execution of a real estate transaction in Mexico requires several forms of documentation that a Mexican Notary Public must review and state in the final title deed. Formalization is a very important requirement with which every real estate transaction must comply in order to avoid defects in title or nullity.⁴⁹

Federal and local laws demand that real estate transactions be formalized and authenticated by a Notary Public to give them legal effect, with a few minor exceptions.⁵⁰

The title deed, with which real estate is transferred, must observe among others the following formalities:

- Date;
- Place of execution;
- Notary's data;
- Detailed description of the real estate, with all measures, boundaries and limits to fully identify it;
- Recordation data from the seller and title of the property from the Public Registry of Property and Commerce;
- Clear and concise clauses enumerating the obligations of both the seller and the other parties;
- Complete names, marital status, and other identification data of the individuals attending for the purpose of signing the deed;
- If applicable, a description of the faculties or powers of the persons appearing on behalf of any interested party;
- The Notary's explanation of the full value and consequences

48. See "Ley de Inversion Extranjera", art. 32, § III.

49. As provided in the Mexican Federal Civil Code, lack of formality can cause a contract invalidation, (see C.C.D.F. art. 1795), and even relative nullity (see *id.* art. 2227.).

50. Most of the States' legislation follows the criteria set forth by the Federal Civil Code regarding the formalization of real estate transactions. Also, article 78 of the Notary Law for the Federal District (which in most of its parts, conforms with the other states' legislation on the subject) states that all transfers of real estates must be formalized by means of a public instrument, with the exceptions set forth in the Civil Code and others that may be referred to in specific provisions. See "Ley del Notariado para el Distrito Federal", D.O., 8 de enero de 1980 as amended by D.O., 6 de enero de 1994.

derived from the execution of the instrument.⁵¹

Also, laws regarding real estate transactions require that the Notary state in the title deed that the following requirements were satisfied and documents were properly obtained.

The following is an outline of the basic documents that a Notary requires in order to formalize a real estate transaction. Due to the existing legislation in each of the Mexican Republic States, the names of the documents may vary, as may the authorities from which the documents are obtained. Nonetheless the essence of the documents remains the same.

A. *Certificate of No Encumbrances*

The Notary requires that a certificate of no encumbrances be obtained from the Offices of the Public Registry of Property and Commerce. The certificate will guaranty the buyer that the real estate is free from any mortgage, lien or encumbrance, or any *litis* or pending claim over it, and that it therefore can be transferred with clean title. Basically it must contain at least the following information:

- The number of years back the search on the property was done;
- The surface area of the property in accordance with the records;
- The metes and bounds of the property;
- The name of the owner;
- Classification of the property (urban or rural) and a legal description of the property (such as if it is owned in a trust, or if there are several owners);
- The name and signature of the registrar as well as the official seal of the Public Registry of Property.⁵²

It is also important to assess whether local urban development laws, or human settlements laws within the jurisdiction where the real estate is located, impose limitations on the Notary Public's performance. This can be done by reviewing the Public Registry's records or consulting the archives of Urban Development departments.

51. See BERNARDO PEREZ FERNANDEZ DEL CASTILLO, *DERECHO NOTARIAL* 62 (1986).

52. See *id.* at 235.

B. *Certificate of No Property Tax Liability*

The certificate of no property tax liability will enable the Notary Public to determine that the property tax has been paid prior to the transfer of the property. Property tax is a local tax that is predominantly contained in the Municipal Treasury Laws governing the states of the country. In some municipalities of the Mexican Republic, the certificate also must state that there are no pending debts related to services and utilities, such as water or other urban development limitations. Its purpose is basically to evidence that the prior owner of the real estate (the seller) does not have pending debts before the municipal authorities regarding the property. In other places, such as Baja California, it is requested that such certificate also state that there are no pending debts with other authorities, such as the State Water Services Commission and the Urban Municipal Council. The certificate should at least include the following information:

- Real estate tax property number (“clave catastral”);
- The tax appraisal value;
- The name of the owner;
- Signature of the department head, and seal of the Municipal Treasury Office.⁵³

C. *Property Appraisal and Topographical Survey*

In most jurisdictions and Mexican states, the local laws provide that a Notary Public cannot authorize a title deed for purposes of transferring real estate if a topographical survey has not been properly elaborated, and in some cases authorized by an official appraisal.⁵⁴ The appraisal estimates the commercial value of the property, considering its surroundings, a market survey and zoning regulations, and must include a detailed description of the metes and bounds, commercial value, subdivisions, kind of lot, industrial or commercial constructions on the real estate, uses and any other relevant information about the property. The appraisal must be prepared and certified by a Mexican banking institution or by a Public Broker (“Corredor Público”).⁵⁵

53. *See id.* at 232-34.

54. For instance, in Baja California, the local law provides that it is mandatory to appraise the property in order to update its commercial value and determine the amount to be paid as Property Tax.

55. Public Brokers can act as appraisers for purposes of real estate transactions. *See* “Ley de Correduria Publica”, art. 6, § II, 1993. Their intervention in these kinds of operations is not very common, however. With the enactment of the new Public Brokerage Law, public brokers have been more active in the field of real estate operations.

VII. THE NOTARY PUBLIC AND THE RECORDATION SYSTEM FOR REAL ESTATE TRANSACTIONS

As stated during the course of this article, real estate transactions in Mexico require both the participation of a Mexican Notary Public and the recordation of title deeds at the Public Registry of Property in order to be valid.

The nature of the Notary Public in Mexico requires him to act as an artificial extension of a judge or the government, in that his duty is to ensure that a real estate transaction is formally executed and complies with all legal requirements.⁵⁶ Public Notaries in Mexico are empowered to authenticate and certify the acts formalized before them. In accordance with Mexican law, Notaries are licensed attorneys who have passed a specific exam. They are entrusted to verify that all the acts formalized before them fully comply with the law and are in accordance with the documents exhibited. Today the function of the Latin Notary Public consists of listening, interpreting, preparing, certifying, authorizing and issuing the notarial instrument, which will eventually be recorded with the Public Registry of Property and Commerce.⁵⁷

The Latin Notary Public's performance secures the legal interest of the people requiring his services in a way opposite to the public notary function in common law systems such as the United States of America. In such systems, the capacity of the notary public to act is limited to appearing as a certified third party witness to the execution of a determined act, without assuring the legal validity or providing legal security to the interested parties.⁵⁸

The Public Registry of Property and Commerce is an institution of extreme importance within Mexican law. This is primarily because of the legal security that it provides to all the transactions that are recorded therein, which represent a significant amount of investment.⁵⁹ The Public Registry of Property and Commerce is a branch office of the Mexican government. Its main function is to provide public access to its records and security to all the legal instruments formalized by a notary

56. See "Ley del Notariado para el Distrito Federal", art. 10, D.O., 8 de enero de 1980 as amended by 6 de enero de 1994.

57. See FERNANDEZ DEL CASTILLO, *supra* note 51, at 201.

58. See *id.* at 202.

59. The origins of the institution in Mexico come from the old Spanish law of the Colonial days. See GUILLERMO COLIN SANCHEZ, PROCEDIMIENTO REGISTRAL DE LA PROPIEDAD 21 (1985).

public and regulated by the civil law.⁶⁰

The Registry facilitates the flow of legal transactions related to real estate in a secure manner. Publicity and security can be obtained by recording all legal acts and instruments therein. With this recordation, any interested party is allowed to verify the title status for any real estate, including the chain of conveyance, easements, use of the property, metes and bounds, which prevents, to the extent possible, fraud or induced errors in real estate transactions.⁶¹

A legal instrument effectively binds the parties that took part in executing it. However, upon the execution of a real estate transaction, the deed of title must be recorded at the Public Registry of Property and Commerce of the domicile where the real estate which is the subject matter of the transaction is located. By recording the deed of title at said Registry, not only are the parties to the transfer bound to the transaction, but third parties are also bound by it.⁶²

VII. TAXES

Real estate transactions entail diverse local and federal taxes. These taxes are contained in the Municipal Treasury Laws ("Leyes de Hacienda Municipal"), the Income Tax Code ("Ley del Impuesto Sobre la Renta") and the Value Added Tax Law ("Ley del Impuesto al Valor Agregado").⁶³

Transfer of Property Tax. Municipal Treasury Laws of the several states of the Mexican Republic establish this tax.⁶⁴ It is important to note that each local law requires payment of said tax by persons acquiring real estate. For instance, the local laws in the state of Baja California provide a transfer tax which is calculated by subtracting the authorized deductions from the transaction value or the appraisal value, whichever

60. See *id.* at 17.

61. See *id.* Since part of the Government's duty is to protect the legitimate interests of private parties regarding real estate transactions, it has a branch institution entrusted to fulfill said duty: the Public Registry of Property.

62. See *id.* at 100.

63. See *id.* at 307.

64. In the early decade of 1980, the Mexican Government enacted a Federal Statute called *Ley del Impuesto sobre Adquisición de Inmuebles*. See "Ley del Impuesto sobre Adquisición de Inmuebles", D.O., 31 de diciembre de 1970. This Statute imposed a tax credit for persons acquiring real estate property. See *id.* art. 1. However, since the States' laws also provided a tax credit for persons acquiring real estate, article 9 of the federal statute provided that if the Federal Government enters into a coordination agreement with the particular state, the Federal Government would suspend the collection of the tax. See *id.* art. 9. In such a manner, the Federal Government would leave the tax collection to the Municipal authorities in each State, and would avoid the problem of double taxation for the same act. To date, the tax is collected by each state through its local Treasury Laws.

result is higher, and then taking 2% of the resulting balance, which is the applicable tax.⁶⁵ There are some exemptions to the transfer of property tax. However, such exemptions need to be analyzed on a case-by-case basis.

Income Tax. Another tax credit that arises from a real estate transaction is the Income Tax. According to the Mexican Income Tax Code (hereinafter referred to as ITC), foreign nationals obtaining revenues from a source of wealth located in national territory are obligated to pay Income Tax.⁶⁶ The ITC also states that the source of wealth shall be deemed to be located in national territory if the property is located within the national territory.⁶⁷

The applicable tax will be withheld from foreigners involved in a real estate transaction for property located in Mexico. There are two options to pay said tax, as explained below:

- i. The tax is based on 20% of the total value of the transaction, without any deductions being applicable.⁶⁸ Typically the notary public withholds such amount and files the tax return before the authority, in order to be able to produce the final deed of title for its recordation at the Public Registry of Property.

It is interesting to point out that when a buyer acquires property below its commercial value, there might be a risk that the tax authorities will appraise the real estate and determine that the buyer is obliged to pay additional tax. If the tax authorities appraise the real estate and the amount thereof exceeds more than 10% of the price covenanted by the parties, the balance shall be deemed to be revenue or profit to the buyer. In such a case, he will be obligated to pay a tax of 20%, applicable to said balance.⁶⁹

- ii. An alternative tax on a real estate transaction is based on the profit margin obtained from the transfer of the property, in which case the applicable rate would be 35% of the profit determined in accordance with the provisions of the ITC for such purposes.⁷⁰

Under said provisions, the seller is allowed to make all possible deductions with regard to such real estate, except those referring to

65. See "Ley de Hacienda Municipal del Estado de Baja California", art. 75-bis B, §§ I-IV.

66. See L.I.S.R. art. 144.

67. See *id.*

68. See *id.* art. 150, para. 2.

69. See *id.* para. 5.

70. See *id.* para. 3.

losses.⁷¹ The tax is then based on the difference between the acquisition price of the seller and the price agreed upon in the new transfer. As in the other case, the Notary Public shall withhold the tax on behalf of the seller and pay it by filing a tax return within 15 days of formally executing the title deed.⁷²

In any event, one may decide to pay the taxes at a rate of 20% on the total transaction value or 35% on the profit. Again, there are some exemptions to these taxes, but they also have to be analyzed on a case-by-case basis.

Value Added Tax. The general rule stated by the Value Added Tax Law provides that all persons transferring real estate property must pay taxes in the manner and at the rate indicated by law.⁷³ Although the obligation to pay the tax is ultimately on the seller, the law states that the tax payment first will be transferred to the buyer, who in turn must pay the tax to the seller.⁷⁴

The law states that the tax rate will be 15% of the transaction price in cases of real estate transactions.⁷⁵ However, the law specifically exempts payment of said tax in the following cases:

- Transfer of real estate consisting only of a piece of land without constructions,⁷⁶ or
- Transfer of real estate with constructions used for residential purposes.⁷⁷

In the second case, it should be noted that careful analysis must be made to determine whether a construction fits the concept "residential purposes." Otherwise, the tax may be applied to the transaction.⁷⁸

VIII. CONCLUSIONS

As we reviewed above, the real estate sector is a very important source of investment flow for the Mexican economy. Thus, it is clear to us that the trend of the Mexican government is to eliminate barriers and restrictions to foreign investment in the real estate market.

The last amendments to the Foreign Investment Law can be interpreted as a clear signal by the government of its intention to

71. *See id.* art. 97.

72. *See* L.I.S.R. art. 150, para. 2.

73. *See* "Ley del Impuesto al Valor Agregado", art. 1, D.O. 29 de diciembre de 1997.

74. *See id.* para. 3.

75. *See id.* art. 2.

76. *See id.* art. 9, § I.

77. *See id.* § II.

78. Article 21 of the Regulations to the Value Added Tax Law defines the concept "residential" for tax purposes. *See id.* art. 27.

continue encouraging investment in projects involving real estate transactions. The only restriction that still applies is the acquisition of real estate for residential purposes within the restricted zone, meaning along the border and the seashores. It is our belief that the new regulations to the Foreign Investment Law, yet to be enacted, will stress the importance of opening the gates to foreign investment, and will also clarify the few misconceptions concerning the "rules of the game" for real estate projects.

We stress the importance of careful planning for long term real estate projects and acquisitions, since, as we have seen, Mexico now has a complex body of laws dealing with real estate. Specifically, the federal and state governments are now aware of the need to strictly enforce the environmental and zoning laws and regulations, in order to ensure a sustainable growth of human settlement and economic activity.

Real estate transactions in Mexico require careful preparation and review of all legal considerations. A transaction of this nature can be as simple as the transfer of property by a fee, or as complex as a transfer which requires careful review and analysis of the urban development and infrastructure, or obtaining approval from governmental agencies, depending on the specific case.

Finally, in preparing this article, our primary goal was to briefly introduce the reader to the basic legal aspects involved in real estate transactions in Mexico. Further study is necessary in order to obtain a deeper understanding of the foreign investment laws governing Mexican real estate.

