



HOMES WITH MILLION DOLLAR VIEWS SELLING FOR \$300,000 IN MEXICO

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Real estate investors, developers or just plain folks hoping for a sweet deal on a vacation home in Mexico can find their ventures heading seriously south if they don't do their homework.

"Don't leave your brains at the border when you go over there," said Russ Schreier, founder and chief executive officer of the Del Mar-based Finance North America, which specializes in providing mortgage financing on real estate deals in Mexico.

There is much to know. For instance, U.S. citizens can't acquire direct title to Mexican real estate along the coastal beach communities unless they form a fideicomiso, a Mexican residential trust that lets you buy, improve or sell property.

The problem is that few U.S. tax practitioners or taxpayers are aware of the U.S. tax reporting requirements that exist under current law, according to Enrique Hernandez-Pulido, an international tax attorney with Procopio, Cory, Hargreaves & Savitch LLP in San Diego, and the current chairman of the State Bar of California's Taxation Section, International Committee.

In May, he joined the bar's other committee chairs and headed to Washington, D.C., for an annual confab with the feds. Each had prepared papers on their areas of concern, as well as legislative proposals. In Hernandez-Pulido's case, that involved Mexican residential trusts, or MRTs, and the Internal Revenue Service's reporting requirements.

He met with members of the U.S. Senate and House committees, the U.S. Treasury Department and the IRS, sharing his concerns about what he considers to be "highly discriminatory and inequitable treatment" of U.S. taxpayers who buy land through MRTs. The IRS requires them to report the sale within 90 days, or risk penalties that could amount to more than 35 percent of their Mexican property investment, he said.

"You don't have to pay taxes on it until you sell it or get rental income on it, but you have to report it," he said.

Hernandez-Pulido wants the IRS to suspend, or at least modify and simplify, the current reporting requirements involving Mexican trusts.

"I think the timing is right," he said. "If you can plan before going in, you have more options available," he said. "Most of the time, it's less costly when you look for exit alternatives before you sell. You end up with more money in your pocket."

Herd Mentality

Patrick W. Martin, who heads Procopio's international tax team in San Diego, also cautioned that buyers need to make sure that they aren't being taxed twice on the same income.

"Many investors have no understanding of that," he said. "In Mexico, the tax treatment of companies is basically the same. But in the U.S., we have different tax regimes for different types of companies. In Mexico, one size fits all, and it doesn't change the tax consequence. But it can for a U.S. investor."

But a lot of people on glorious Mexican vacations tend to get caught up in the heady "herd mentality," said Schreier. They impulsively leap into a real estate deal, and common sense falls by the wayside.

"You shouldn't do anything in Mexico that you wouldn't do in the United States," said Schreier. "You wouldn't sign a contract you can't read. You would make sure you have clear title."

David Wiesley, the president of San Diego-based FirstMexico Group, a title insurance broker, was instrumental in introducing title insurance to Mexico, his native country, more than a decade ago. He understands how this so-called herd mentality works.

"A friend is being told by another friend, 'I have a condo here. You should come down and buy. The developer treated me great,'" said Wiesley. "But it's a time bomb sitting there, and it goes off in two or three years."

A high-profile case several years ago had a chilling effect among U.S. citizens considering a purchase south of the border. Residents of a development in Punta Banda in Ensenada were caught up in a lengthy legal dispute about who owned property rights to a parcel in a large agricultural land grant, ultimately resulting in evictions. But many eager buyers too often jump into too-good-to-be-true real estate opportunities, said Schreier.

"It happens all the time," he said. "People putting all their money in and not getting free and clear title. You want to do your due diligence."

Penny-Wise

Mexican law requires the involvement of a so-called notario publico, a certified attorney who is authorized by the government to draft documents, and make sure that all the legalities are met. While they are highly trained and indispensable in any real estate transaction in Mexico, said Schreier, buyers also should purchase title insurance.

"Less than half of those who do loans will take title insurance," he said of his own experience with clients. "They trust the notario system. But

it seems silly to save a couple thousand dollars on a large investment." It's especially important when clueless buyers don't follow the rules.

"You'd be surprised how many transactions are done with just a contract and no notario involved," said Schreier. "They had never taken legal title."

Wiesley agreed.

"Notarios normally are only obligated to go back to the last deed," he said. "They do their due diligence based on certificates and documents issued by the Public Registry of Property, one being a certificate of freedom from liens and encumbrances."

But even though the well-meaning notario proclaims that everything is in order, lapses can happen, said Wiesley.

"We have found problems in the public registry, with certificates that might have inadvertently omitted a lien or encumbrance." When that happens, there is little recourse for the buyer who doesn't have title insurance, he said.

With the protection, the title insurance company will hire an attorney at its own expense, and cover the loss once all legal options fail.

Wiesley said that he's continuously mystified by the attitudes of buyers when it comes to Mexico, some making deals with a "handshake, on a napkin in a bar."

"Many people don't want to pay \$1,000, \$2,000 or \$3,000 for the title insurance," he said. "They would get it in La Jolla, but not in Ensenada. They are penny-wise and pound-foolish."

John B. McNeece, a partner at the San Diego law office of Luce Forward's business practice group and a specialist on international transactions, agreed that title insurance is a good investment.

"There is a strong environmental movement in Mexico now," he said. "Making sure that property has covered all its environmental bases is important."

Exit Strategy

But Hernandez-Pulido said he thinks there is relatively little risk these days, if buyers do their homework and get proper legal advice.

The problems crop up when the buyers want to sell their property, and need an exit strategy, said Hernandez-Pulido. In that case, the sooner an attorney gets involved, the better, he said, to help buyers understand the consequences of U.S. tax requirements.