

## **Mexican Trusts**

Most foreigners, including Canadians, first encounter Mexican trusts when they consider the possible purchase of Mexican real estate in what is known as the “Restricted Zone.” The restricted zone is composed of real property located 100 kilometers next to international borders, and 50 kilometers from Mexican coastline. Increasing numbers of Canadians are purchasing real estate in coastal areas of Mexico. It is important to have a basic knowledge of how Mexican trusts work, and more importantly, how they can work for you.

At the beginning of the 20<sup>th</sup> century, no foreigner could directly own real property anywhere in the country. The reason for this restriction lies in history. Today, however, foreigners may freely and directly own real property anywhere in Mexico, except in the mentioned restricted zone.

The most common way to get around the constitutional prohibition on foreign ownership of real property in the restricted zone is to hold the property in a Mexican trust.

### **What is a Mexican Trust?**

Trusts are legal entities created by an agreement to transfer title in property (such as real estate, securities, cash, art collections, etc.) to a second party. This second party, also called a trustee, will then administer the property in favor of designated beneficiaries.

Simply put, a Mexican trust is an agreement entered into pursuant to Mexican legislation.

### **Parties to a Mexican Trust**

There are at least three characters in the creation of any trust: the creator (*fideicomitente*), the trustee (*fiduciario*), and the beneficiary (*fideicomisario*). A fourth party allowed by Mexican law is the technical committee (*comité técnico*).

### **Purpose of Mexican Trusts**

Most trusts in Mexico are created for family and estate planning purposes. Some of the most common uses for trusts are as follows:

- 1) Remove property from the reach of creditors;
- 2) Remove property from the reach of family members, or ex-family members;
- 3) Condition the transfer of property to beneficiaries;
- 4) Secure the privacy of the creator;
- 5) Obtain professional management of trust assets;
- 6) Guarantee a private mortgage;
- 7) Hold property in the restricted zone when the beneficiary is not a Mexican citizen; and
- 8) Manage bequests to charities.

Tax management is usually not an important factor in the creation of Mexican trusts.

The trust agreement will state the purpose of the trust, how and when the property can be distributed, and to whom.

### **Who Can Be Trustee?**

It is important to note that only financial institutions in Mexico can act as trustees. Under no circumstances can the creator of a trust, or any other entity, serve in this capacity. Traditionally, only Mexican banks were authorized to sever as trustees. Recently, however, insurance companies have begun to offer trustee services. For example, the Hartford Insurance Co. has set up offices in Mexico and their goal is to provide the best trust services in the country. If interested, please call Ms. Laura García at (52-5) 481-8210.

Trustees in Mexico are required to provide their services on a fiduciary basis. This means that they are held to a higher standard in handling trust assets than they are in handling their own assets. They must always put the interests of the creator and the beneficiaries first. A trustee should: 1) strictly comply with stipulations in the trust agreement and Mexican legislation; 2) manage the assets, pay debts, collect and distribute income; 3) file tax returns if required; and 4) account for the income and expenses.

It is also well to remember that the assets in the trust do not belong to the trustee (or to the technical committee). Trust assets belong to the trust and are maintained for the beneficiaries.

### **The Technical Committee**

A very interesting possibility allowed by Mexican trust legislation is the formation of what is called a “technical committee”. The technical committee will be organized in accordance with the trust agreement, and its duties and obligations will be spelled out in this document. There are no limits put on the powers of technical committee, beyond what is stipulated in the trust document. Therefore, it is possible to set up a trust which requires that a technical committee be established composed of only one individual, the creator. In this manner, the trust agreement can allow the creator to make all decisions regarding the assets in the trust. Thus, while it is not possible for the creator to act as trustee, the creator can still keep most decision powers to herself.

### **Privacy**

In Mexico trusts are protected by very strict secrecy laws. The creator, the technical committee and the beneficiaries remain entirely private. Courts have unsuccessfully ordered that the identities of the trust characters be revealed. However, the parties to the trust could conceivably sue each other and bring the misunderstanding into court. For example, if the beneficiaries decided to sue the trustee, the identities would be revealed to the courts, but the court proceedings would not be subject to review by the general public.

## **Funded or Un-funded**

Trusts in Mexico can be set up so that the trustee and the technical committee, if there is one, are paid from trust assets. In this case it is necessary for the trust to have enough assets with which to pay the fees. This would be a funded trust.

An un-funded trust, on the other hand, requires that someone pay for the trustee fees, at least annually, from sources other than trust assets. This would be the case of most trusts that hold real estate owned by non-Mexican citizens.

## **Revocable vs. Irrevocable**

Here again we find an interesting characteristic of Mexican trusts. It is possible to set up an irrevocable trust. However, if the creator the beneficiaries, and if applicable, the technical committee, are all in agreement, the irrevocable trust can be transformed into a revocable trust, or dissolved altogether.

## **Taxes**

If a trust is created for business purposes, it will be considered a taxable entity. In this case, the trustee (or the beneficiaries) is required to obtain a tax-identification number for the trust. Tax returns will need to be filed. What remains in the trust after income taxes have been paid can be disbursed to the beneficiaries according to the trust agreement, or accumulated within the trust.

In Mexico, trust income which has already been subject to taxation, will not be taxed twice. Thus, if income taxes have already been paid by the trust, the beneficiaries need not pay Mexican income tax on this particular income.

A common example of a trust with a business purpose is property purchased in the restricted zone which is then rented out, either on a full or part time basis. Mexico considers this Mexican source income and will tax it accordingly.

On the other side of the equation we have trusts that do not have a business purpose. In this case, income, if any, will pass through to the beneficiaries and will be subject to regular income taxes. Most property held in trust in the restricted zone is not held for business purposes and does not generate any income.

## **Trust Expenses**

There are no standard trustee fees and thus these are open to negotiation. Fees for real estate trusts for non-Mexican citizens, range from \$250 a year to 1% of the value of the property, for example. Obviously, the more complex the trust, the more expensive it is to administer.

## Keep in Mind

There are some issues that you should be aware of when establishing a Mexican trust. Because you are the creator of the trust, you have the right to choose the trustee. You do not need to use the financial institution first suggested to you. Shop around. Ask who has better service and more reasonable fees?

Historically, banks provided you with a standard trust agreement, and you had no choice in the design of the agreement. While you cannot get away from transferring title to a trust, as the creator you have the right to design the trust agreement in such a way as best benefits your interests.

Also keep in mind that if you are the creator of a real estate trust in the restricted zone, you are also the initial beneficiary. As beneficial owner, you have certain rights. In fact, as beneficiary you can usually do with the property anything any other owner of real property could do. For example, you can modify the property, sell it, rent it, keep it unoccupied, gift it, divide the ownership rights among your children, provide for a life estate for the surviving spouse, etc. For all intents and purposes it is your property to do as you please.

Finally, as beneficiary of a Mexican real estate trust, you usually have the right to change the trustee. It is better to make sure that this right is spelled out in the trust document in the first instance, but it need not be the case. If you do not feel that you are receiving the services you deserve, or if you believe that the fees are unjustified, switch trustees. There are costs involved in effecting the transfer, so make sure that you know what they are before you switch.

## Trusts and Wills

Mexican trusts can work as Will substitutes. For example, if you live in Puerto Vallarta and your condo is in a trust, and further assuming that you do not own any other property in Mexico, a Mexican Will might not be necessary. The trust agreement will state who will receive the property at your death. Usually this is a spouse, followed by other family members.

However, if you own other property in Mexico, for example, other real estate outside of the restricted zone, cars, a brokerage account, an art collection, etc. you might want to consider drafting a Mexican Will. Mexican Wills are relatively inexpensive to draft. Probate in Mexico is comparatively inexpensive, quick and private.

Finally, it is possible to order the executor of your Mexican Will to set up a trust pursuant to your wishes.

## Conclusion

We have seen that it is a necessity for foreigners to own real property located in the restricted zone in a trust. I have attempted to give you a basic understanding of why this is a requirement and how these instruments work. Mexican trusts have often been seen as working against the interests of foreigners, principally because the trustee fees were expensive and because the banks that provided the trustee services were not known for the quality of their service. As the banking system has opened up to more foreign ownership and as new players enter the field of trustee services, fees have come down and service has improved. Now Mexican trusts, when properly structured, can actually work to your advantage. I hope I have given you some ideas in this regard.



Raoul Rodríguez-Walters is an international financial planner, and can be reached at [raoul.rodriguez@mexadv.com](mailto:raoul.rodriguez@mexadv.com)