

UNIQUE ISSUES OF MEXICAN REAL ESTATE LAW

I. ARTICLE 27 OF THE MEXICAN CONSTITUTION

1. OUTRIGHT PROHIBITION TO ACQUIRE REAL ESTATE PROPERTY DIRECTED TO FOREIGNERS

Article 27, paragraph I: *“Only Mexicans by birth or by naturalization and Mexican commercial societies (companies) have the right to acquire ownership of lands, waters and their accessions, or to obtain concessions for the exploitation of mines and waters. The State may grant that same right to foreigners, provided they agree before the Secretariat of Foreign Affairs (SRE) to consider themselves as Mexican nationals with respect to said properties and not to invoke the protection of their government in matters related thereto; under penalty, in case of violation of the agreement, of forfeiting the benefit of the nation the properties they had acquired by virtue of said agreement. ..Under no circumstances may foreigners acquire ownership of lands and waters within a strip of one hundred kilometers (64 miles) along the international borders and fifty kilometers (32 miles) along the coastline”...*

2. DEFINITION OF THE PROHIBITED AND RESTRICTED ZONE

The expression “Prohibited Zone” or “Forbidden Zone”, which both the 1971 *Acuerdo* (presidential decree) and the 1973 Foreign Investment Legislation (Act) utilized to refer to the strip of 100 kilometers along the international borders and 50 kilometers along the coastline, as described by Paragraph One of Article 27 of the Mexican Constitution. This denomination was not well received by foreign investors and consequently, this name was substituted by the current expression “Restricted Zone” (*Zona Restringida*), which was created by the 1989 Regulations to the Foreign Investment Act of 1973, and used again in the language of the current 1993 Foreign Investment Act.

3. DEFINITION OF THE CALVO CLAUSE

Under Mexican Law, no foreigners are legally allowed to have direct ownership of real estate property anywhere in that country unless they execute before the Secretariat of Foreign Affairs (SRE) an agreement (*Convenio*) known as “Calvo Clause”, expressly mandated by Article 27 (i) of the Constitution. This is a must condition imposed by the Constitution and implemented and supervised by the SRE.

The individual or corporate foreign investor must expressly agree before the SRE:

- a) To consider themselves as Mexican nationals with respect to the properties;
- b) To not invoke the protection of their governments in any matters pertaining to the properties;
- c) Under penalty, in case of violation of this agreement, of forfeiting to the benefit to the Mexican nation the properties acquired by virtue of the agreement.

The following acts cannot take place unless they receive the corresponding permit from the SRE:

- a) To incorporate a Mexican corporation ;
- b) To incorporate a Mexican corporation which bylaws do not include an "Exclusion of Foreigners Clause";
- c) To establish a bank trust (*fideicomiso*) affecting immovable assets located within the Restricted Zone;
- d) For a foreign individual to establish a *fideicomiso* affecting immovable assets located outside the Restricted Zone;
- e) For a foreign individual to acquire real estate property or obtain concessions for the exploitation of mines and waters outside the Restricted Zone;
- f) For credit institutions (banks) to serve as fiduciary in a *fideicomiso* affecting real estate property in the Restricted Zone;
- g) Once incorporated, for a Mexican corporation to change its legal denomination;
- h) To grant authorization to foreign legal entities to conduct business in Mexico...

4. ACQUISITION OF PROPERTY BY FOREIGNERS OUTSIDE OF RESTRICTED ZONE

Mexico may be legally divided in two large zones:

1. The Restricted Zone, just described and
2. The real estate located "Outside the Restricted Zone" which may be referred as "Permitted Zone".

Foreign individuals interested in a) acquiring real estate property located outside the Restricted Zone, or in b) obtaining concessions for the exploitation of mines and waters in Mexico's national territory, 1) must enter into the "Convenio" mandated by article 27 (i) of the Federal Constitution, and 2) obtain the corresponding permit from the SRE. (Art. 10-A, Foreign Investment Act (FIA)).

5. HISTORICAL EXPLANATION OF THE RATIONALE OF SUCH RESTRICTION

Almost since its political emergence as an independent nation in 1821, Mexico was the victim of a number of foreign military interventions led at different times by Spain, France, The United Kingdom, and the United States. Mexico lost more than half of its territory to the United States during the tragic war of 1846-48, as a consequence of these invasions. This Mexican national sentiment had to find a number of avenues to be expressed especially through a series of legislative enactments and especially in the constitutional assembly of 1917.

II. HOW TO ALLOW FOREIGN INVESTMENT TO FLOW TO THE BORDER AND COASTLINE AREAS?

1. INTRODUCTION OF THE NOTION OF FIDEICOMISO

Mexico determined in 1971, to utilize the legal institution of the U.S. trust contract. *Fideicomiso* provides foreign investors with a legal and practical avenue that allows them to acquire not the direct ownership but, instead, only the beneficiary use of real estate located within the Restricted Zone.

President Luis Echeverria signed on April 29, 1971 a decree allowing Mexican banks and credit institutions to acquire the ownership of real estate property located along the borders and coastlines as fiduciaries, when these real estate properties were to be used by foreigners in industrial and tourist activities.

2. BRIEF HISTORY OF MEXICAN TRUST AND OTHER CONSIDERATIONS

In particular, *fideicomisos* in Mexico, unlike the U.S., may only be executed by banking institutions that have been expressly authorized for this purpose.

Historically, the *fideicomiso* was introduced in Mexico in its Credit Institutions Act of 1924. However, it was not until the current statute (General Act of Credit Instruments and Credit Operations, enacted in 1932) that it was recognized as a valid, autonomous legal transaction.

Foreign investors before the enactment of the 1971 decree had been utilizing to acquire real estate properties in border and coastal areas different risky strategies like the use of name Mexican citizens and lenders as straw man, corporations with unregistered shares, double tired corporations and successive leases, etc.

Under a *fideicomiso* scenario, it should be underlined that the fiduciary is considered to be the holder of the property rights, but not the direct owner. The power of the fiduciary over the real estate property is determined by the specific language of the Mexican trust contract or, in its absence, by the nature of the final objective the assets are destined to accomplish. He assets placed in a given *fideicomiso* become an autonomous patrimony, directly dependent upon the *fideicomiso*'s goals. Under Mexican law, these assets are left outside the personal property of the trustor. Accordingly, the trustor's creditors cannot legally affect the *fideicomiso*'s assets, unless the *fideicomiso* was established in a fraudulent manner.

Nowadays trusts in México are statutorily mandated by the new General Law of Title Instruments Title and Credit Operations (*Ley General de Títulos y Operaciones de Crédito*), the Federal law of Foreign Investment and the Federal Commercial Code. These contracts are not generated by the sole will of the parties as a result of a mere contractual relationship. Notwithstanding its strict regulatory federal frame, *Fideicomisos* now have been applied in Mexico to a large number of commercial transactions: as a mortgage substitute (*Fideicomiso de Garantía/Warranty Trust*); to avoid problems associated with successions (*Fideicomisos hereditarios/using as a will instrument*); in housing development projects (*Master Trust*); to administer and manage real estate, etc.

III. EVOLUTION OF FOREIGN INVESTMENT LEGISLATION IN MEXICO

1. THE 1973 ACT (PROHIBITION OF FOREIGN OWNERSHIP OVER LAND AND WATER)

The 1973 Act represents Mexico's first attempt to systematize and codify, in a single statute, the various legal provisions on foreign investment. Enacted during the administration of President Echeverria the Act included:

- a) The so-called "forty-nine to fifty-one percent" principle, which stipulated that foreigners may not invest more than 49% in any venture in Mexico;

- b) The ample discretion granted to Mexican authorities in authorizing foreign investment projects (The creation of the so-called National Commission of Foreign Investment);
- c) **THE OUTRIGHT PROHIBITION OF FOREIGNERS TO ACQUIRE “DIRECT OWNERSHIP OVER LAND AND WATER IN THE PROHIBITED ZONE, INCLUDING FOREIGN CORPORATIONS, AND MEXICAN CORPORATIONS WITHOUT THE EXCLUSION OF FOREIGNER’S CLAUSE”;**
- d) The requirement that foreigners who acquire properties of any kind in México abide by the “*Calvo Clause*”.

Article 20 of this Act established: *“The duration of trusts, to which this chapter refers, shall in no case exceed 30 years. The trust institution shall always retain legal ownership of the real estate being held in trust; it shall have the right to lease it for periods of not over 10 years and, upon expiration of the trusts, it may transfer ownership rights to persons legally qualified to acquire them” ...*

The vagueness of this provision created a growing concern among foreigners with beneficiary rights in the PZ, as they did not know what was going to happen to their rights at the expiration of the 30 years trust.

2. THE 1989 REGULATIONS

President Salinas relied on the strong regulatory powers expressly conferred by the Constitution upon the Executive by enacting the 1989 Regulations by presidential decree. The 1989 Regulations permit the establishment of trusts through which foreign investors can acquire voting and pecuniary right, even when the forty-nine percent limit is exceeded or the investment is in areas or activities previously restricted.

The Regulations allow for real estate investment trusts in the Restricted Zone, granting beneficiary rights to foreign investors for thirty years for industrial, tourism or residential purposes, thereby providing a mechanism for extending the original term by means of consecutive trusts. Renewal of the 30 year period is automatic and is obtainable within 45 working days of application for an additional 30 years. This change allows foreign investors to avoid transfer costs and income tax liabilities. The Regulations did not establish a limitation on the number of trusts that may be authorized in favor of the same beneficiary. Prior to the new Regulations, there was no explicit provision in Mexico's domestic legislation designed to dispel the mounting concern shared by most foreign

investors regarding the final disposition of their *fideicomisos* at the expiration of the original term.

3. THE 1993 ACT AND 1996 AMENDMENTS INCLUDING THE 1998 NEW REGULATIONS TO THE 1993 ACT

The most distinctive feature of the 1993 Act is its clear policy to promote, not regulate, foreign investment in Mexico. The most marked departure from the 1973 act is the abandonment of its traditional “forty-nine to fifty-one percent” rule.

Four areas of the new Act appear to be inspired by the 1989 regulations:

- a) A simplified version of the *Fideicomiso*;
- b) Neutral investments;
- c) Implicit approval of foreign investment projects and;
- d) More efficient National Registry of Foreign Investment.

The first of these changes is the extension of the duration of the *Fideicomisos* from 30 to 50 years. This duration may be renewed at the request of the interested party. Future renewals of the original 50 year term are likely to become automatic if certain conditions are met. The beneficiary, terms, and conditions of the trust remain the same. Additionally, the application for renewal must be made prior to the expiration of the original trust.

Another change was pursuant to Article 10 of the 1993 Act. Under the Provision, Mexican corporations with an Exclusion of Foreigners Clause, or those corporations that have entered in to the “*Calvo Clause*” agreement, may acquire direct ownership over immovable assets in the restricted Zone when those assets are used for non residential activities such as industrial, commercial, and tourist purposes. These new method of acquisition through a Mexican corporation clearly simplifies transactions by eliminating the cumbersome trust mechanism. The Act however maintains the use of the *Fideicomiso* when foreign individuals or foreign legal entities acquire beneficiary rights over real estate property located in the restricted Zone for residential use.

The second improvement in this Act was the introduction of the notion of “neutral investment” into the Mexican legal system. Article 18 of the Act defines neutral investment as “that invested in Mexican corporations or in authorized trust that is not taken into account in calculating the percentage of foreign

investment in the capital stock of Mexican corporations. Neutral investment was created to liberalize foreign access to the Mexican stock market.

The third change corresponds to the introduction of the implicit approval of foreign investment projects. Article 8 lists eleven economic activities that require authorization from the Commission for investments exceeding 49% in those activities or in Mexican corporations. Among those included are port services, shipping corporations, administration of air traffic terminals, private education, legal services, cellular phones, and construction/drilling of oil and gas pipelines and wells. Consistent with the 1989 regulations, this new Act requires the Commission to decide on these projects within 45 working days from the date of the application. If the Commission fails to decide within this time the application is considered approved under the terms submitted.

ARTICLE 14 OF THE 1996 REVISIONS OF THE ACT PROVIDE THAT THE SRE SHOULD RESOLVE WITHIN 5 WORKING DAYS AN APPLICATION SEEKING AUTHORIZATION FOR ANY KIND OF FIDEICOMISO WHEN THE APPLICATION IS PRESENTED TO THE SRE OFFICES IN MEXICO CITY. THIS PERIOD IS EXTENDED 30 WORKING DAYS WHEN THE APPLICATION IS SUBMITTED TO ANY OFFICE THE SRE HAS IN MAJOR CITIES THROUGHOUT MEXICO'S 31 STATES. IF THERE IS NO OFFICIAL ANSWER BY THE SRE, THE APPLICATION IS UNDERSTOOD TO BE APPROVED; A NEW ADMINISTRATIVE MEASURE KNOWN AS "APROBACION FICTA" (**APPROVAL BY DEFAULT**).

LIKEWISE ARTICLE 27 OF THE 1998 REGULATIONS ESTABLISHES THAT ALL MATTERS SUBMITTED BEFORE THE COMMISSION (*COMISION NACIONAL DE INVERSION EXTRANJERA*), WILL BE RESOLVED WITHIN 5 WORKING DAYS AND IF THERE IS NO OFFICIAL ANSWER IT WOULD BE UNDERSTOOD THAT APPLICATIONS ARE APPROVED.

Another change in this act is a more efficient National Registry of Foreign Investment. The registry includes the following entities:

1. Mexican corporations with foreign investment participation;
2. Foreign natural persona or foreign legal entities that routinely conduct acts of commerce in Mexico, and subsidiaries of foreign investors established in Mexico; and,

3. Trusts of capital corporate stock or shares over immovable assets and neutral investment by virtue of which rights are created in favor of foreign investment.

Compared to the 1989 Regulations, the 1993 Act simplifies and expedites the Registry procedures.

4. AUTHORIZATION OF MEXICAN COMPANIES WITH FOREIGN INVESTMENT TO ACQUIRE REAL ESTATE WITHIN THE RESTRICTED ZONE

Mexican companies with an “Exclusion of Foreigners Clause” or which have entered into the “*Convenio*” mandated by article 27 (i) of the Constitution, may acquire the direct ownership of real estate property within the Restricted Zone, without having to obtain any permit from the SRE, when the assets in question are destined to a non-residential activity (*a commercial, industrial or tourist projects (Arts. 10 and 36, FIA and Art. 36, Regs.)*). **HOWEVER, THESE COMPANIES MUST REPORT TO THE SRE THE TRANSACTION (ACQUISITION OF THE REAL ESTATE PROPERTY) IN QUESTION WITHIN THE FOLLOWING 60 DAYS (Art. 10 (i) FIA).**

5. DEFINITION OF RESIDENTIAL AND BUSINESS ACTIVITIES

The new Foreign Investment Act introduced the current terminology of “Residential Activities” and “Non-Residential Activities” to indicate the use given to a real estate property located in the Restricted Zone. Article 5 of the 1998 Regulations clarifies the meaning of these activities:

“For purposes of what is provided in Title II of the Act, an immovable asset for residential purposes is the one destined exclusively for housing to be used by the owner or by third parties. In an indicative but not limited manner, the following immovable assets will be considered to be destined to Non-residential activities:

- I. Those destined to a timeshare project;
- II. Those destined to an industrial, commercial or tourist activity **and those that are simultaneously used for residential purposes;**
- III. *Those acquire by credit institutions, financial intermediaries and credit ancillary organizations, to recover debts owed to them derived from their own activities;*
- IV. *Those used by entities to comply with its corporate objectives consisting in the sale, urbanization, development and other activities included in the development of immovable projects up to the time of their marketing or sale to third parties; and*

- V. *In general, immovable assets destined to commercial, industrial, agricultural, livestock, fishing, forestry and the rendering of service activities.*

In the case of doubt as whether an immovable asset is considered to be destined to residential activities, the SRE will resolve the corresponding inquiry in a period of time not exceeding 10 working days. Once such term elapses without a resolution having been issued, it will be deemed that Non-residential activities are carried out in the immovable asset in question”.

6. SANCTIONS

The 1993 Act devotes its final section articles 37, 38 and 39 to establish a punitive mechanism, when foreign investors violate provisions of the Foreign Investment Act and its Regulations.

The sanctions may range from cancellation of the granted authorization to monetary sanctions. The specific penalties applied depend upon the kind of activities or omissions SRE construes as violating the federal act. In general, most of the sanctions consist of fines, ranging from the minimum salary in Mexico City to the maximum fine of five thousand times the minimum salary.

For the determination and imposition of the corresponding sanctions, the interested party shall be heard previously and, in the case of monetary sanctions, the SRE shall take into consideration the nature and seriousness of the violation, the economic means of the violator, the time elapsed between the date in which the obligation should have been complied with and its actual compliance and regularization, and the total monetary amount of the transaction.

IV. OWNERSHIP STRUCTURES. HOW TO ACQUIRE PROPERTY IN MEXICO?

The determination as to how the foreign investor is going to acquire property in Mexico is going to depend on the purpose of the investment

- a) Through a Mexican Corporation;
- b) Using a Mexican Bank Trust;
- c) Having as beneficiary of the trust foreign entities, etc.

1. BANK POLICIES REGARDING TRUST ISSUES LIKE AREA AND INVESTMENT

Most banks have restrictions when acting as fiduciary when the area of the real estate exceeds certain parameters.

- a) Area restrictions;
- b) Investment commitments

2. PROS AND CONS OF OWNERSHIP STRUCTURES

- a) Formalities to form a Mexican entity;
- b) Tax filing and immigration requirements;
- c) Taxation requirements (stock transfers, renting, sale of residence, withholdings).
- d) Inheritance.

Document prepared by law Firm Tapia Bours and Borquez, Attorneys: Miguel Tapia, Ricardo Bours and Ricardo Borquez.

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