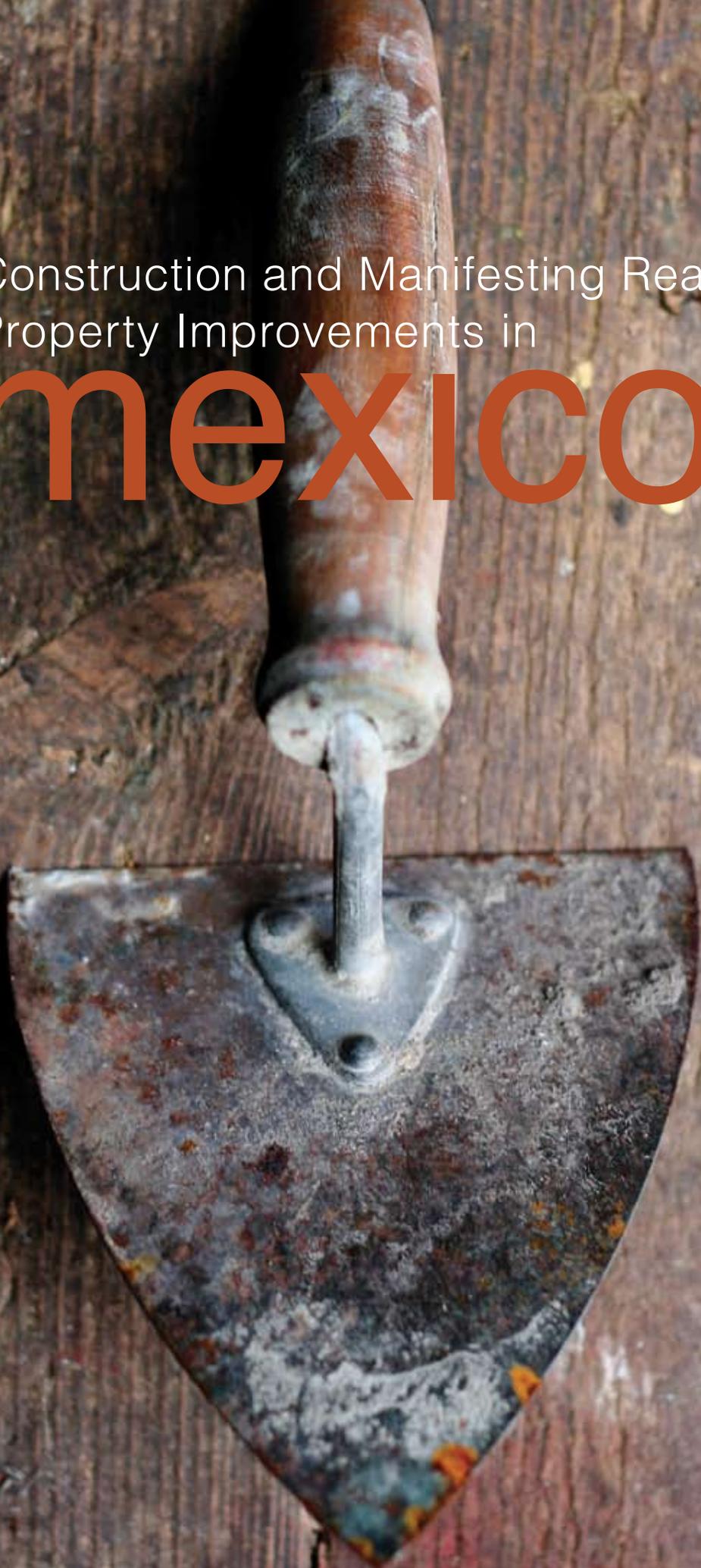




Construction and Manifesting Real
Property Improvements in

mexico



The purpose of this article is to provide the reader with an overview/guideline about the reporting or manifesting of construction of real estate improvements in Mexico. The article has been structured with headings pertaining to the most important issues presented in the process.

reporting or manifesting the construction of property

Whenever a party sells their home, the reported or manifested cost of construction of the residence plus the cost of the property as stated in the recorded transfer deed for the property will be used to determine the cost basis of the property for purposes of the applicable capital gains tax liability.

The reporting or manifesting of construction to the applicable authorities and the issuance of the letter of completion of construction work (*Aviso de Terminación de Obra*) from the Department of Public Works (*Departamento de Obras Publicas*), and the Manifestation Certificate from the Public Registry Office (*Dirección Municipal de Catastro*) are all necessary if the cost of construction of the residence is to be added to the cost basis of the property.



process for construction of property

Much like in the U.S., construction of a residence in Mexico is typically handled through a contractor. The manner in which services by a contractor are arranged is similar to the way they are provided for domestically. Such services are typically performed through what is commonly known as a *Cost Plus Contract* or a *Fixed Price Contract*.

The basic premise of a Cost Plus Contract is that the owner pays for the cost of all materials, services, permits, etc., while the contractor receives as payment for his services a negotiated percentage for the work. In a Cost Plus Contract, the owner of the property is responsible for paying the Social Security tax applicable to every person working on the construction of the home. Social Security, known in Mexico as *Seguro Social*, is of extreme importance as it is the tax that ultimately provides the workers' insurance coverage for most matters during the period of their service at the job site. As the owner is the party ultimately responsible for all filing matters under this type of agreement, it is of primary importance that the contractor provide the owner with an invoice (*Factura*) for each time the contractor is paid. Such an invoice must be in the owner's name and must include the "IVA" or Value Added Tax applicable for such services. Said invoice or *Factura* is necessary in order to deduct such expenditures and add them into the reporting or manifesting of construction.

The basic premise of a Fixed Price Contract is that the contractor provides a flat fee for the construction of the home. This will include all materials, services, permits, labor, Social Security, etc. It is in essence a turnkey contract. In this type of agreement it is the contractor who has the responsibility for handling all record keeping matters. While the invoice or *Factura* is still required, the IVA or Value Added Tax should not be due for such services.

building permit

A building permit is required to both start and also to finish construction. Typically, the contractor is the party responsible for acquiring such a permit. Two of the key components that this permit should provide are that it is pulled in the name of the owner of the property or beneficiary of the trust holding title to the property, and that it accurately reflects the amount of construction proposed or agreed to be performed by the contractor. The owner should always make sure that the construction costs are recorded accurately, and that the fee for the building permit is based on the estimated value of construction. This will assist in ascertaining the cost basis of the property—hence, the capital gains tax liability at the time of sale.

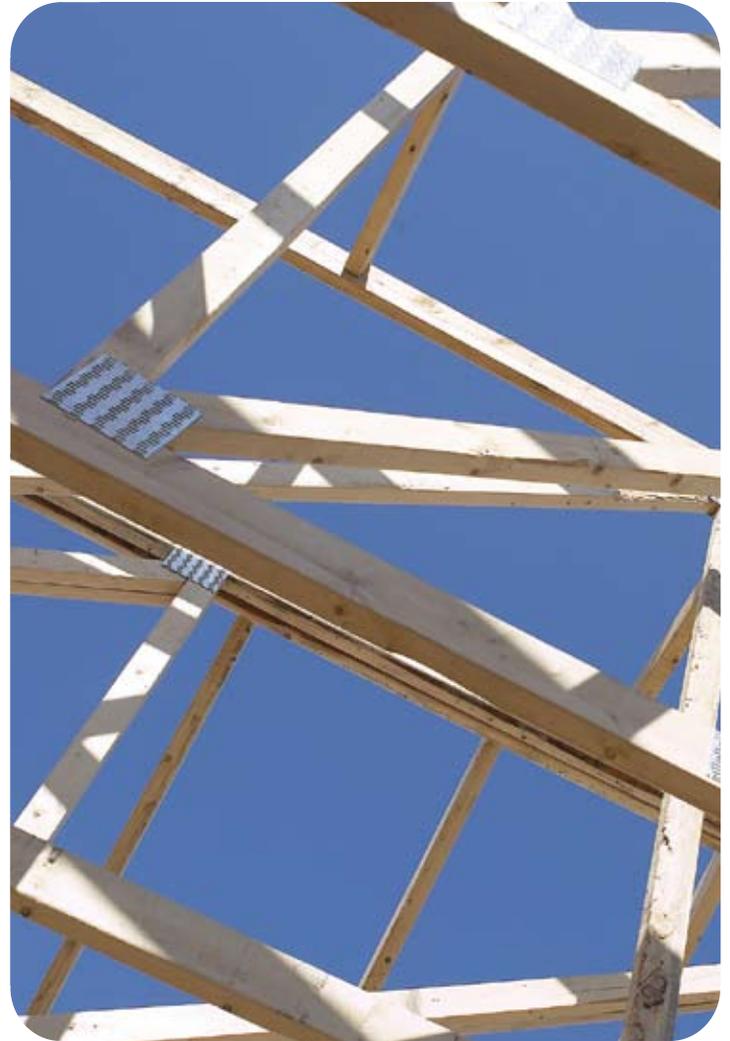
process for the reporting or manifesting of construction

Upon completion of construction, the process for reporting or manifesting construction of the property is ready to take place. This is a three-step process:

First, the building permit will need to be delivered to the *Departamento de Obras Publicas* (Department of Public Works) office with a detailed letter providing the amount of money spent on the construction and verifying termination of construction. This letter will request official confirmation of completion from the department. Said confirmation, to be issued by the *Departamento de Obras Publicas*, is known as the *Aviso de Terminación de Obra* (letter of completion of construction work) and will provide verification of the amount of money spent on the construction of the property. This letter will be in effect the document that establishes the construction cost basis with the *Dirección Municipal de Catastro* (Public Registry Office).

Second, the *Departamento de Obras Publicas* will send a copy of the *Aviso de Terminación de Obra* to the *Seguro Social* (Social Security) office. *Seguro Social* will compare the amount provided as the amount of money spent on the construction of the property with the figure that was actually paid to the *Seguro Social* during construction. If the amount of *Seguro Social* taxes paid corresponds to the amount of money spent on the construction of the property, *Seguro Social* will issue a letter called *Carta de Razonabilidad de Pago* (Letter of Confirmation of Payment).

Third, once the *Aviso de Terminación de Obra* and *Carta de Razonabilidad de Pago* are in hand, these are to be taken to the *Dirección Municipal de Catastro* (Public Registry Office) where the values provided in such letters will be recorded and added to the cost basis reflected in the transfer deed. Upon completion of these steps, the reporting or manifesting of the construction has been successfully effectuated.



use of independent counsel

As with any other major transaction, the use by the purchaser of a reputable and knowledgeable attorney or accountant is very important and is highly recommended. Any potential purchaser/owner should seek the advice and assistance of counsel in order to make the purchase/ownership/sale experience manageable and more secure.

As noted above, this article is only intended to be an overview/guideline pertaining to the reporting or manifesting of construction of real estate improvements in Mexico. Any purchaser/owner/seller should contact a specialist in the area (attorney, accountant or consultant) who will be in a better position to answer all issues in greater detail and specificity.



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