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TAX OBLIGATIONS FOR FOREIGNERS IN MEXICO

DEATH and TAXES.....both are inevitable!

By Linda Jones Neil

Whether a property owner or just the occasional visitor on a beautiful beach in Mexico, everyone pays taxes, natives and foreigners. Some of the taxes are hidden and others are not. The purpose of this article is to touch on some of the important taxes levied and paid in Mexico.

WHO COLLECTS TAXES: The SAT (*Servicio de Administracion Tributaria*), also known as Hacienda, is the federal tax collector. It collects all federal taxes such as the ISR (Income or Capital Gains) tax, the IVA (Added Value) tax, the IDE (Tax on Cash Deposits) and the IEPS (Special Tax on Production and Services). Each state government has its own taxes such as the 2 to 3 percent tax on lodgings and tourism. The municipal governments assess and levy taxes on real and personal properties.

IVA TAX: This is the **Value Added Tax** which is charged on goods and services. The only exemptions are medicines and food. Often this tax is INCLUDED in the price of food served in a restaurant, legal services, and the items purchased in a department or clothing store. The business owner and tax resident is obligated to file a monthly declaration with Hacienda and pay the tax on earnings. Credited against this tax are IVA taxes paid on goods and services acquired.

There is no IVA tax on the sale of vacant land or on the sale of residential dwellings. The tax is levied on all commercial construction when it is sold or transferred, at the rate of 16% of the value of construction.

IVA tax is charged on lodgings, hotel rooms and furnished homes which are rented.

The IVA tax is 16% throughout the entire country of Mexico.

IEPS TAX: This is the Special Tax on Products and Services which was a new tax in 2010. It will cover certain internet and cable TV services, alcohol, cigarettes, and gaming.

PROPERTY TAX; This is a municipal tax with assessments on properties generally being made annually. The tax can be paid in six installments (every two months) but probably should be paid in full within the first two months of the calendar year to obtain a discount. Rates vary from area to area but are often far lower than U.S. or Canadian property taxes.

ISR TAX; Literally the Tax on Rents has been described as both an income tax and a capital gains tax. It is complex and a subject of confusion.

ON INCOME. Any income generated from sources within Mexico, is taxable. From business or salary, the rates are variable depending upon the amount of income received.

ON THE SALE OF A PRIMARY RESIDENCE No primary residence is exempt from tax UNLESS the taxpayer has resided in the home for the previous five years. Proof of residency is in the form of taxpayer identification number (RFC), voter's registration with the property address, bank statements and utility bills. Foreigners must establish permanent residency in order to obtain their RFC documents..

For those who have sold or transferred a primary residence within the past five years and have not declared an exemption previously, an exemption of up to 700 UDIs or approximately 3,500,000. Mexican pesos, is available.

This applies to nationals and to those foreigners who have established a tax residency in Mexico (obtained their tax identification numbers) and make declarations on world wide income. They must also provide documents that the property being transferred is a primary residence.

ON THE SALE OF A VACATION OR SECOND HOME OR A RENTAL PROPERTY

No exemptions are permitted.

The tax on non-exempted transactions is 35% of the difference between the value declared in the deed and the value of the new sale, less allowable deductions or 25% of the entire amount of the transaction, whichever is less. It is very important when acquiring property to insist upon having the full amount of the sale declared in the deed, in order to avoid overpaying taxes upon sale.

Enforcement on the ISR tax on transfers is the obligation of the Notary Public formalizing the transfer. He has the obligation to enter the seller's name and data on the internet and to check status of prior transfers.

ON RENTAL INCOME: There are several ways to calculate tax on rental income:

1. The blind deduction of 35% of total income, without deductions with tax of 35% paid on the remaining amount;
2. A 30% tax on income, less allowable deductions which include property tax, maintenance, interest on loans for construction expenses, insurance, salaries of employees and commissions paid to rental agents and property managers..
3. A 25% tax on the gross income, no deductions.

Hacienda is paying more attention to internet advertising and is beginning to inquire into the income of those who are renting their homes. It makes sense to become legal since penalties for non-compliance can be considerable. Methods one and two above require the RFC (taxpayer identification number) which can be challenging for a foreigner to obtain. Method three outlined above does not require residency or official status.

IDE TAX This is a Tax on Cash deposited into banks. In the year 2009, it was applicable on any combination of deposits made in a month totaling 25,000.00 pesos, or more. Tax was 2% of the excess. This tax has now been eliminated but banks receiving cash deposits of over \$15,000. pesos in any one month or certain credit card payments are required to report this to SAT. This requirement is thought to discourage the informal economy (the street vendors).

STATE HOSPITALITY TAX. This is charged by hotels and on furnished short-term rentals. Money generated from this tax is used for promotion of tourism in the state and varies

from state to state but is generally two to three percent of the per night cost of lodging.

It is important to understand the difference between Tax Resident and Non-resident for tax purposes.

The Tax Resident is the person, citizen or non-citizen, who has acquired his Federal Taxpayer Identification Number and who files and declares taxes in Mexico on his world-wide income. Any party receiving income from Mexican sources, such as from rental or from the sale of real properties, or from business activities, is required to file. No distinction is made between citizens of Mexico and non-citizens as to tax rates.

Tax authorities in the U.S., Canada and Mexico are working together and share information. Everyday there is more cooperation between the countries due to tax treaties. It is no longer possible to own a property in one country, enjoy income from that property, and not report it in BOTH the country where the property is located, and the country where the owner lives. Failure to comply means the owner is subject to double taxation and heavy penalties when the omission to file and declare is discovered.

Now REALITY!! DIGITAL FISCAL INVOICES. Taxpayers must use invoices produced by Hacienda (SAT) on internet. Hopefully this will simplify the “factura” situation which at present is challenging for the tax payer attempting to obtain receipts for deductible items. .

This is an overview of the tax situation in Mexico and may vary in individual cases. For additional information and consultations, please contact the author.

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about the author:

LINDA NEIL is the founder of *The Settlement Company*, which specializes in real estate transfers, escrows, and consultations. Just added as a new service, Settlement will now prepare monthly tax declarations on rental properties, file them and perform additional essential landlord accounting services.

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