Comparative Analysis of U.S. vs. Mexican Commercial Real Estate Transactions (with Tax Considerations Commentary)

Patrick W. Martin
Comparative Analysis of U.S. vs. Mexican Commercial Real Estate Transactions* (With Tax Considerations Commentary)

Patrick W. Martin**

Table of Contents

I. Introduction
   A. General Principals and Restrictions of Real Estate Ownership from the Mexican Constitution
   B. Classification of Types of Mexican Real Estate
      1. Title Evidence: Deeds
      2. Deeds, Title Insurance, Eviction, and Recording
      3. Types of Deeds
      4. Title Insurance and Escrow
   C. The Role of a Notary Public (Notario Público) in Mexican Real Estate Transactions
      1. Principle Differences with the Role of a U.S. Notary Public
      2. Common Functions of the Notaries
   D. Mexican Tax Considerations for Mexican Real Estate Investments
      1. Mexican Income Tax
      2. Asset Tax
      3. Value Added Tax

* Prepared by the International Practice Group of the Tax Team and Real Estate Team of Procopio, Cory, Hargreaves & Savitch LLP, researched and written by Mexican attorney, Lic. Liliana Sandoval, and U.S. partners Patrick W. Martin, Esq. and Todd E. Leigh, Esq. Additionally, Mexican attorney Lic. Carlos Perez-Gautrine provided input regarding the Mexican tax consequences and practices in the International Practice Group of the Tax Team of Procopio, Cory, Hargreaves & Savitch LLP.

** Mr. Patrick W. Martin is a U.S. lawyer licensed in California and Washington, D.C. and specializes in international tax and related international law matters, especially relating to Mexico. Mr. Martin is the partner in charge of the international practice group of the Tax Team with the San Diego based law firm of Procopio, Cory, Hargreaves & Savitch LLP. Mr. Martin received his J.D. from the University of San Diego School of Law, has passed the Certified Public Accountant's exam, previously worked for the Internal Revenue Service, and studied postgraduate law studies in international business transactions at the Escuela Libre de Derecho, in Mexico City.
4. Real Property Transfer Tax (ISAI)
5. Property Tax (Impuesto Predial)
6. Public Recording Fees

E. The Role of Guaranties in Financing Real Estate Transactions in Mexico and the U.S.
1. Traditional Forms of Guarantees in Mexico
   a. Bond Contract or Fianza
   b. Joint Obligor or obligado solidario
2. Issues to Consider in the Guaranty of Payment (Regarding U.S. Law/California)
3. Choice of Substantive Law and Venue

F. Real Estate Property as Collateral in Mexico
1. Mortgage Agreement
2. Rights Acquired by Creditor

1. Non-possession Guaranty
2. Guaranty of Trust

H. Real Estate Property as Collateral in the U.S.
1. Mortgage and Deed of Trust
2. Power of Sale and Foreclosure

II. Conclusion

III. Appendix A. U.S. Tax Implications of Foreign Investment in U.S. Real Estate
A. State and Local Taxation Applicable to Foreign Investors Who Invest in U.S. Real Estate
B. Special Federal Income Tax Rules Applicable to Foreign Investors Who Invest in U.S. Real Estate
   1. Imposition of Taxes Under FIRPTA
   2. Rate of Tax on Disposition of USRPI
   3. Election by Foreign Corporation to be Taxed as Domestic Corporation
   4. Withholding Requirements Under FIRPTA
C. Special Tax Treaty Provisions (e.g., U.S./Mexico Tax Treaty)

IV. Appendix B. California's Standard Form CLTA Policy
V. Appendix C. California's Standard Form CLA Policy Owner's Policy of Title Insurance
VI. Appendix D. Application for Title Insurance on Mexico Land

I. Introduction
The U.S. and Mexico have become increasingly closer, particularly during the last decade of the 20th century. Both countries are connected with a so-called “Free Trade Agreement” and capital investment from the U.S. to Mexico has accelerated at a rapid
pace during this time.¹ The next to the largest importer of goods and products into the U.S. is currently Mexico, and many experts anticipate it will soon become the largest exporter to the U.S. in the very near future.² Many political policies of the two countries seem to be coming closer and more congruent, including the current immigration policy discussions between Presidents Bush and Fox.³

Mexico is now very much a part of the international commercial community. It has a relatively stable political environment, due in part to recent amendments to Mexico's Election Law that have provided a reliable election process, gaining the approval of other countries and international organizations such as the United Nations. Transnational companies have gained from Mexico's labor force and its Government's position in favor of globalization and economic growth.

Since the adoption of the North American Free Trade Agreement (NAFTA), the flow of foreign investment to Mexico has increased dramatically. From 1994 to 1998, direct annual investment in Mexico was almost US $10 billion, compared to about US $4 billion per year before NAFTA.⁴ Of the total foreign investment during that period, US $24.67 billion came from U.S. companies.⁵ By the end of 1998, almost 10,000 foreign firms were operating in Mexico.⁶

As we see these changes, we Americans seem to be more interested in Mexico, and how our neighbor to the South currently is and what it will become. But we still know little about Mexico's legal system and seem to have little to no understanding about Mexico's laws that govern real property and how the commercial real estate industry is, sometimes, wildly different from the system used in the United States. There seems to have been almost no serious articles written about the comparative differences between our two systems and how they apply to commercial real estate transactions. This article sets out to provide, at a minimum, an overview and comparative analysis of U.S. and Mexican real estate law and its applicability to commercial real estate transactions. It is written from a lawyer's perspective and does not discuss or contemplate residential or similar personal-use real property.

Mexico's civil law legal system has its origins in the Napoleonic code, while United States' common law came from elsewhere within England's court rulings, as one of the early genesis of real estate principles. Under Mexico's civil code legal system, the applicable law is codified and united in codes, which are the principal source of law, while jurisprudence is a secondary source of law. In Mexico, leases and purchases and sales of real estate property are civil acts (as opposed to commercial transactions), and

¹ The North American Free Trade Agreement (NAFTA) entered into force in Canada, the United States, and Mexico on January 1, 1994. Designed to foster increased trade and investment among the partners, NAFTA contains a schedule for tariff elimination and reduction of non-tariff barriers, as well as comprehensive provisions on the conduct of business in the "free-trade" area. These include disciplines on the regulation of investment, services, intellectual property, competition and the temporary entry of businesspersons.

² According to statistics published by the Mexican Secretary of Economy from January to December of 2000, Mexico exported $151 billion dollars to the United States.


⁴ According to statistics published by the American Chamber of Commerce of Mexico.

⁵ Id.

⁶ According to figures of the Mexican Secretary of Commerce.
are regulated by the local civil code of each of the Mexican States. However, each State has enacted a civil code similar to the Federal Civil Code, or Código Civil Federal. A more detailed discussion of the civil law legal system and the common law legal system is beyond the scope of this article.

The two legal systems, and their applicability to real estate transactions, are strikingly different in many respects. There are, however, many fundamental concepts, which are largely the same at their core. This article sets out to describe some of the differences and commonalities of both. It also provides a basic overview of how both Mexico and the United States (and the States therein) impose taxation upon the use and sale of real property within each country.

A. General Principals and Restrictions of Real Estate Ownership from the Mexican Constitution

The Mexican Constitution establishes that the ownership of land originally belonged to the nation or state, which transferred it to the private individuals. This is something quite different from the U.S. system that does not grant the U.S. government any particular rights in real property. In Mexico, the state is responsible for the natural resources of the subsoil and waters, such as minerals, oil, gas, lakes, and rivers, which cannot be owned by individuals. The Mexican Constitution currently prohibits private ownership of such natural resources. However, these resources may be exploited under concessions granted by the state.

Even though concessions (the right to acquire domain over land, waters, and subsoil) are granted to Mexicans and foreigners, there are many restrictions imposed. For instance, the foreign investor must agree before the Secretaría de Relaciones Exteriores or SRE (Secretary of Foreign Relations) to be considered as Mexican in connection with those assets. This means, among other things, the foreign investor may not invoke the protection of their own governments in connection with these assets, under the penalty of forfeiting the assets they have acquired in favor of the Mexican state. This agreement is known as the “Calvo Clause” (Cláusula Calvo) or Barren Clause, named after Argentinean jurist Carlos Calvo.

Furthermore, due to constitutional restrictions, non-Mexican citizens and most foreign companies, cannot acquire direct ownership of real estate in fee simple, within an area of 100 kilometers along the Mexican international borders or 50 kilometers along the coast. This area is known as the “restricted zone” (zona prohibida). However, Mexico’s law of foreign investment provides that foreigners may acquire rights over real estate located in this “restricted zone” through a civil law trust (fideicomiso), with a Mexican

8. Id. at §27.
11. According to the doctrine developed by Carlos Calvo, a foreigner must waive diplomatic protection of his or her native country and any rights acquired under International Law and appear only before the local courts of the State he or she resides in. Foreigners may receive an equal treatment but do not have the right to receive a more favorable treatment.
banking institution required as trustee (along with their fees) and a foreign individual or corporation as beneficiary. The parties must obtain authorization from the Secretary of Foreign relations, and the term of these trusts is currently limited to fifty years, which may be extended by request of one of the parties.

This provision of the Mexican federal statute makes it possible for transactions and foreign investments in Mexican real estate developments or resorts to take place within the restricted zone. The regulations of the law of foreign investment provide that foreign investors, whether individuals or corporations, may acquire beneficiary rights in a Mexican trust. Additionally, the foreign investor can acquire stock of Mexican corporations that own real estate located in the "restricted zone," provided that these corporations make an investment in industrial or tourist activities and satisfy other criteria.

Under Mexican law, ownership of real estate property may be structured as follows:
(a) Mexican citizens owning real estate property throughout the Mexican territory.
(b) Mexican entities that have included in their bylaws an "exclusion of foreign investment clause," providing that the entity shall not have, directly or indirectly, as partners or shareholders, foreign individuals and/or entities, nor Mexican entities with a "foreign investment clause." These entities may own real estate property throughout the Mexican territory.
(c) Mexican entities with a "foreign investment clause" in their bylaws: providing the possibility of accepting foreign partners or shareholders. These entities may acquire real estate property outside the "restricted zone." These entities must settle a civil law trust with a Mexican bank to acquire real estate property for residential purposes within the "restricted zone" and obtain authorization from the Secretary of Foreign Relations. For non-residential purposes, only a notice to the Secretary of Foreign Relations must be delivered.
(d) Foreign entities and foreign individuals may settle a civil law trust with a Mexican bank to acquire real estate property for any purpose within the "restricted zone," provided they obtain authorization from the Secretary of Foreign Relations. Outside of the "restricted zone," they must obtain authorization from the Secretary of Foreign Relations and agree not invoke the protection of their own governments in connection with these assets (i.e., the Calvo Clause).

The authors consider Mexico's law of foreign investment largely as a method of circumventing the prohibitions of the Mexican Constitution, without requiring the government to take the politically unpalatable step of repealing the restrictions on foreign ownership of Mexican real estate that has its genesis in the Mexican revolution.

13. Authorization must be granted by the Secretary of Foreign Relations, Law of Foreign Investment Law, supra note 11, §11.
14. Id. §§11, 12.
15. Id. §12.
16. Id. §§2, 10.
17. Id. §10.
18. Id. §10.
19. Id. §§11.
20. Id. §§10, 11.
B. Classification of Types of Mexican Real Estate

In Mexico, there is a type of real property known as "agrarian property," which is rural property classified in several categories, including parcels of communal property. This property is granted to common land holders or communities known as *ejidos*. The concepts of *ejidos* have their origins in the Mexican revolution that produced various tangible legal concepts that were incorporated into Mexico's constitution. Ejidos have their own series of rules and restrictions imposed upon them by Mexican federal law. These common land holdings are somewhat like a type of partnership, but made up exclusively of indigenous Mexicans. The U.S. does not have a similar concept set forth in the U.S. Constitution.

These ejidos consist of land, woods and waters delivered by the state at no cost, under an ownership scheme that cannot generally be transferred or seized. The purpose of this type of property is to allow the exploitation and operation of natural resources through the work of its members. This property cannot be negotiated or owned directly by individuals and, hence, instead is owned communally.

The closest counter part of an ejido in the U.S. is probably Native American reservation land that may be communally owned. However, unlike the legal framework of ejidos in Mexico, the regulation of reservation land does not derive from the U.S. Constitution, but from federal statutes instead. Native Americans have their own sovereignty, which has been recognized by the U.S. Government's recognition of the Native Americans' government. Another characteristic of U.S. reservation land is that it is made up of allotted areas and communal property as well. Additionally, the Bureau of Indian Affairs (BIA) must approve every agreement to alienate or sell reservation land; thus, the BIA is a Federal Agency acting as trustee.

1. Title Evidence: Deeds

The basic concept of real estate ownership in the U.S. and Mexico is largely the same.

Under U.S. law, the basic concept of ownership of a thing is the right of one or more persons to possess and use it to the exclusion of others, and the thing that may be owned is called property. The term "ownership" and "owner" are also applied to interests that do not amount to complete legal title, such as persons in legal possession.
of property who have one or more interests. For instance, a real property tenant does not generally have legal title but has incidence of ownership with their rights to use and exclude others therefrom.

Likewise, in Mexico the term "owner" applies to the person who is able to use and dispose of a thing. In the event that the owner of a Mexican thing allows someone else to have its temporary possession, the two of them will be considered in possession of the thing, the owner having the "original possession" (posesión originaria) and the trustee, lessee, or depositary having the "derived possession" (posesión derivada). For instance, a Mexican landlord has posesión originaria, whereas the tenant of that Mexican real estate has posesión derivada.

In United States real estate transactions, the parties generally seek evidence that the title they will acquire is marketable, that the property involved in the operation is free of liens and encumbrances, and that the other party (i.e., seller or landlord) is the legitimate owner of the property. These protections are as equally important to the property owner in Mexico as they are to the U.S. property owner, since possession and the right to use and enjoy the property is the basis of ownership.

2. Deeds, Title Insurance, Eviction, and Recording

The main evidence of title in both countries is the Deed, which is a written instrument that transfers or conveys title to real property. To be effective in the United States, the Deed must be written, must name a grantor and grantee, must be subscribed by the grantor and must be delivered to and accepted by the grantee. These are the minimum requirements for a valid Deed, and if they are all present, the Deed is effective to transfer title to the grantee, but if any one of the essential elements is missing, the Deed is ineffective to transfer title. It is not essential that the Deed be under seal.

The grantor's signature need not be witnessed or acknowledged to make the transfer of title effective. However, acknowledgment is required for the document to be recorded. While it is not necessary that a Deed be recorded to transfer title (since title is transferred by duly executed and delivered unrecorded Deed), the document should be recorded to give constructive notice to subsequent parties who deal with the property. Additionally, recordation of the Deed in the public records is prima facie evidence of the existence and content of the original recorded document, and of its execution and delivery by each person who executed it.

30. See id.
31. Id.
32. Código Civil para el Distrito Federal (C.C.D.F.) art. 830.
33. C.C.D.F. art. 791.
34. The lessor must deliver lessee possession of the leased property. Id. §2412.
35. CAL. CIV. CODE §1039.
38. CAL. CIV. CODE, §1629.
3. Types of Deeds

In California, the Civil Code sets forth a simple form of Deed that can be used to transfer title to real property. This statutory form of Deed is known as a “Grant Deed” because of the specific reference to the word “Grant” in its operative words of conveyance. A Grant Deed is the most commonly used document to transfer title to real property in California. Through a Grant Deed a person grants an interest in real property to another individual. A Grant Deed is presumed to convey the grantor’s entire interest in the property, unless otherwise derived from the deed itself.

A less frequently used form of conveyance in the United States is a Quitclaim Deed, which transfers whatever interest the grantor may have in the property. Unlike the Grant Deed, a Quitclaim Deed does not contain any implied covenant of freedom from encumbrances regarding the grantor’s right of possession.

Warranty Deeds are used infrequently in the United States because of the common use of title insurance. A Warranty Deed expressly warrants title and the quiet possession of the property to the grantee. The grantor agrees to defend the premises against any unlawful claim to the title or possession of the property.

4. Title Insurance and Escrow

Due to the great complexity of modern real estate titles in the United States, the use of title insurance to guaranty title is an accepted fact. It is always customary that the title of the seller be insured as a necessary condition to the conveyance. The practice of obtaining title insurance has grown to the point that a buyer will rarely accept title to U.S. property without appropriate insurance coverage regardless of the condition of legal title.

Title company practice, therefore, has become very important in the conveyance of U.S. real estate. For this reason, title companies have been called the “supreme court on titles in real property.”

A title insurance policy is defined in California by its Insurance Code as a contract insuring, guaranteeing, or indemnifying owners of real or personal property or the holders of liens or encumbrances thereon, or others interested therein, against loss or damage suffered by reason of: (a) liens or encumbrances on, or defects in, the title to said property; (b) invalidity or unenforceability of any liens or encumbrances thereon; (c) incorrectness of searches relating to the title to real or personal property. The policy of title insurance is a contract of indemnity and not of guaranty in which the insurer promises to indemnify the insured against losses resulting from defects in the title or...
from liens or encumbrances affecting the title as described in the policy at the time that the policy was issued.\textsuperscript{47}

The standard type of title insurance used in the U.S. is the CLTA form of Owner's Standard Coverage Policy. CLTA Insurance is used for all types of property and basically provides protection against matters of record. In most large commercial transactions, the preferred policy is the ALTA Owner's policy, which provides protection for off-record matters that could be discovered by a physical inspection of the property. The premium for ALTA coverage is generally thirty percent more than the premium for CLTA coverage. Many endorsements are offered by the title insurance industry to cover specific concerns and can be attached to either the CLTA or ALTA form of policy.

In contrast, in Mexico any person who sells or transfers the use and possession of real estate is required by law to warranty the title of the property and the right of possession (somewhat like a U.S. Warranty Deed).\textsuperscript{48} This means that if for any reason the purchaser or user of the property loses its ownership or possession, the seller or lessor must indemnify the purchaser or lessee. The practical problems associated with enforcing a right of indemnification are largely the same in Mexico as they are in the U.S. For instance, if the transferor of defective title is gone (or has no assets), it may be difficult, if not impossible, for the transferee to have an adequate remedy against the transferor of the real estate.

Until recently, U.S.-type title insurance or a similar type of indemnification agreement; did not exist in Mexico. However, in 1996, Chicago Title Insurance Co. entered into a re-insurance treaty with Grupo Nacional Provincial (G&P) one of Mexico's largest insurance companies offering title insurance through G&P's agent, Title Insurance de Mexico. The policies offered are similar in coverage to the ALTA policy offered in the United States. These policies cover commercial property throughout Mexico including beachfront and border properties. The policies can be issued in either U.S. Dollars or Mexican Pesos and can be written to insure the fee estate, leasehold, trust or beneficial ownership. The policies may be obtained by Mexican corporate entities (domestic or foreign owned) or Mexican nationals as well as U.S. and foreign citizens.

A U.S. buyer of real estate in Mexico may obtain a Direct Access Endorsement to the Mexican Title Insurance Policy. This endorsement permits presentation and settlement of claims with Chicago Title in the United States without having to go through the Mexican court system. The authors are not aware of any claims (to date) that have been brought in the U.S. under one of these Mexican title insurance policies. By obtaining the endorsement, the insured can deal directly with Chicago Title on all matters concerning the policy. The premium cost for a title policy equivalent to that in the United States is approximately five times greater than the premium cost in the United States.\textsuperscript{49}

\textsuperscript{47} King v. Stanley, 197 P. 2d 321, 325 (Cal. 1948).
\textsuperscript{48} C.C.D.F., art. 2412(iv).
\textsuperscript{49} According to information published by TIM at http://titlemex.com/coverage.htm, basic policy coverage provides a purchaser/lessee of real property, or a lender secured by real property, protection against loss in the event that title to the property is encumbered or defeated by the interests of third parties, not otherwise disclosed in the policy. Among the risks against which the insured is protected are the following:

1. Agrarian matters.
2. Mortgages.
Copies of the American CLTA and ALTA policy used in the United States and Policy Insurance Procedures and Application for Title Insurance used in Mexico are attached in the Appendix.

Even though this type of "new" title insurance is available in Mexico, the most important source of information will continue to be the Public Registry records, so the parties should always consult them. Also, this insurance should not be confused with the certificado de libertad de gravátmen, or lien-free certificate, which is a document issued by the Public Register where the real property is located, stating that there are no liens on the property at the time it is issued.

Escrows are used extensively in the United States. An escrow involves the deposit of documents and/or money with a third party (often the Title Company) to be delivered on the occurrence of some condition. Since the buyer does not want to part with the purchase price until he or she is certain of receiving title that is marketable at the time the deed is recorded. Likewise, the Seller does not want to risk transfer of title until he or she has received the purchase money. Hence, the use of an escrow to receive the documents and money and deliver them in accordance with the instructions of the parties.

In Mexico, the parties do not use third party escrow holders. Rather, the Notary Public serves as the intermediary. The purchase price is paid in his presence, and the Deed is signed before the Notary Public at the same time that the purchase price is paid.

Traditionally, the system for conferring title of ownership or possession in Mexico has been done through a Public Notary and then recorded before the Public Registry, because the title of ownership analyzed and recorded by the Public Notary is a valid public document. All titles of ownership, as well as mortgages and other liens or encumbrances on real estate, must be recorded in the public registers, and therefore they should always be consulted before entering into a real estate transaction.

In the event any document or transaction that, according to Mexican law must be recorded in the Public Register, is not recorded; it shall not have any negative legal effects against third parties. Third parties may seek the annulment of the document or transaction before court, or the recordation of the document or transaction to comply with legal requirements.

C. THE ROLE OF A NOTARY PUBLIC (Notario Público) IN MEXICAN REAL ESTATE TRANSACTIONS

In Mexico, the role of a Notary Public (Notario Público) is very different from its counterpart in the U.S. A Mexican Notary is an attorney who, after passing several

3. Tax liens.
4. Easements.
5. Contractual obligations restricting the use of the property.
6. Adverse possession by a third party.

51. Regulation of the Public Register of Property of the Federal District, §1.
52. C.C.D.F. art. 3007.
53. Id. art. 2232.
examinations that focus on different fields of Mexican law, obtains an authorization (called a patent) granted by the Government of each State of Mexico. Thus, the Mexican Notary performs a quasi-public function delegated by the State government, holding office for life unless he or she is removed for cause. The Notary Public is invested with the authority to attest documents, and is empowered to draft documents, verify the acts therein, and record documents before the Public Registry. Other acts that are necessarily performed before a Notary include the drafting of wills, the incorporation of companies and any amendments to their bylaws, the granting of powers of attorney, and certifying real estate transactions such as sales, purchases and certain leases. This means that in order for certain transactions to be valid under Mexican law, they necessarily must be formalized before a Notary Public through a public deed.

Notaries are also legal advisors to the parties in operations authorized under their signature, and also often draft the corresponding documents. In some cases, the parties negotiate the terms and conditions of the transaction and draft the agreement (with the assistance of Mexican counsel who is not a Notary Public), and then appear before the Public Notary to formalize the agreement as required by law. In other cases, the parties negotiate the terms and conditions of the real estate transaction and ask the Public Notary to draft the agreement and to formalize it. In each of these scenarios the documents issued by a Public Notary are valid public documents and their validity cannot generally be objected to. Accordingly, documents issued by a Public Notary are considered to be true and legal in any legal controversy brought before a Mexican court. Certain documents must be recorded in Public Registers, such as that of Property (real estate) or Commerce (corporations) as officially certified documents. Every Notary is

54. Ley del Notariado para el Distrito Federal (Notary Law for the Federal District), §1.
55. Notary Law for the Federal District, §133.
56. The ownership of real estate is recorded in Public Registers, depending on the type of property. All Registers are public and therefore third parties are able to research its files and know all the operations that have been made in connection with a specific property.
57. C.C.D.F. arts. 1511, 2551, 3005; General Commercial Corporations' Law §5.
58. C.F.P.C. arts. §129, 130.
60. According to Federal Civil Code, articles 2316, 2320, if the value of appraisal of the real estate is greater than 365 times the minimum wage salary, the purchase and sale agreement must be in writing, executed before a Public Notary and recorded in the Public Register of Property. The current minimum wage salary equals N$ 37.90, and therefore 37.90 pesos times 365, equals N$ 13,833 (or approximately US $1,400). If the real property value exceeds this amount, the transaction requires the participation of a Notary Public. Likewise, Section 2406 of the Federal Civil Code, provides that real estate lease agreements must be in writing. Similarly, in certain Mexican States such as Jalisco, lease agreements with a lease term longer than six years must be recorded in the Public Register of Property (Civil Code for the State of Jalisco, §2045).
62. Id. arts. 129, 130.
63. The main Registers in Mexico are twofold. First, the Public Register of Property, which records property that belongs to private individuals, and contains information such as surface area, location and boundaries, name of the owner and operation by which it was acquired, and any liens or encumbrances that exist on the property. Second, the Public Register of Commerce
also responsible, and in charge of, calculating taxes and requesting their clients to pay these amounts, and they, in turn, pay them to the tax authorities.

1. Principle Differences with the Role of a U.S. Notary Public

The Mexican Notary Public is an official who possesses much greater rank and responsibility than the Notary Public in the United States, who is not required to be, and rarely is, a licensed attorney. A U.S. Notary is only authorized to (i) certify or witness the signing of documents, (ii) administer oaths, and (iii) act as an impartial witness regarding the signing of documents. U.S. Notaries are forbidden to give legal advice, draft or prepare legal documents for others or act as a legal advisor, unless he or she is also an attorney. Unlike Mexican Notaries, they are also not responsible for the accuracy or legality of documents they notarize, since they only certify the identity of signers. The parties themselves (e.g., a signatory) and their legal advisors, are responsible for the content of the documents.

U.S. notaries, of course, have no role or obligations regarding the collection and payment of U.S. taxes of any kind (see Mexican tax discussion below).

2. Common Functions of the Notaries

The only common functions of the U.S. Notary Public and the Mexican Notary Public, are they both can (i) certify the signing of and authenticate signatures of documents (including public documents such as Deeds), (ii) administer oaths, and (iii) act as an impartial witness (e.g., before the signing of a Will).

D. Mexican Tax Considerations for Mexican Real Estate Investments

There are several federal and municipal taxes applicable to the transfer of real estate in Mexico.

1. Mexican Income Tax

Commonly, the main cost for the seller is the Impuesto Sobre la Renta (ISR) or Income Tax. A Mexican resident corporation is liable for corporate income tax on its worldwide income. The corporate income tax rate in Mexico is 35 percent. Mexican corporations selling real estate are taxed on the capital gain realized from the transaction. The capital gains are normally included in gross receipts and subject to the yearly income tax. The income must be reflected in the advance income tax payments (pagos provisionales) corresponding to the period in which the transaction is to be recognized. In order to compute the capital gain on the sale of land, the taxpayer must subtract from

records corporations and partnerships, and related entity information such as names, address, main business activities and representatives of recorded.

65. Id. §§1185, 1196.; Notary Law for the Federal District §§80, 81.
66. A resident company is one that has established the principal administration of its business in Mexico.
the sale price the cost of acquisition (tax basis), adjusted by the Mexican inflationary rate (\textit{Indice Nacional de Precios al Consumidor}).

A nonresident corporation with a permanent establishment in Mexico is also liable for Mexican corporate income tax, at the general 35 percent rate, on any income effectively connected to the permanent establishment. Accordingly, capital gains realized by a nonresident corporation with a permanent establishment in Mexico are imposed in the same terms as indicated above. As a rule of thumb, a permanent establishment is deemed to exist in Mexico if the nonresident corporation maintains a place in which business activities are conducted, or if the nonresident conducts its activities in Mexico through a "dependant" agent. However, several other events may also create a permanent establishment in accordance with Mexican income tax law and the tax treaties.

On the other hand, income obtained by nonresidents without a permanent establishment is subject to income tax withholding in Mexico if such income is effectively connected to a "Mexican source of wealth." As a general rule, the transfer of real estate located in Mexico is from a "Mexican source of wealth" and therefore subject to Mexican withholding tax at a 20 percent rate on the gross proceeds. Nevertheless, the nonresident, under certain circumstances, may opt out of this withholding tax regime and instead be subject to tax at a rate of 40 percent on net gain.

2. \textit{Asset Tax}

The Asset Tax (\textit{Impuesto al Activo}, or the "IMPAC") levies the assets, including real estate, owned by resident and nonresidents with permanent establishment, if such assets are used in business activities carried out in Mexico. The IMPAC is currently assessed at a rate of 1.8 percent on the value of the assets. The IMPAC has an effect similar to the "Alternative Minimum Tax" implemented in the United States, the purpose of which is to enforce the payment of income tax. Thus, under the IMPAC system, the income tax may be credited against the yearly amount of IMPAC. Hence if the income tax due is higher than the IMPAC, no IMPAC amount is to be owed by the taxpayer.

Importantly, the IMPAC is not a tax that can be credited in the U.S. (for the U.S. owner) for purposes of calculating the U.S. foreign tax credit.\textsuperscript{67}

3. \textit{Value Added Tax}

Additionally, the buyer may pay a 15 percent value added tax, commonly referred to as the IVA, or \textit{Impuesto al Valor Agregado}, to the Federal Government.\textsuperscript{68} The IVA rate is generally only 10 percent in the international border region; however, this 10 percent rate does not apply to real estate. This IVA tax is only applicable when there are nonresidential improvements added to the land, and is calculated by paying 15 percent of the value of the nonresidential improvements added to the land during the time the seller owned the property.\textsuperscript{69} As a general rule, the value of the land and improvements is agreed upon by the parties for purposes of paying the IVA. The value of the improvements may be calculated by using the so-called "80-20 rule," which assumes that 80 percent of the sales

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{67} I.R.C. §901(b) (2001).
\item \textsuperscript{68} Ley del Impuesto al Valor Agregado (Value Added Tax Law), §1.
\item \textsuperscript{69} Id. §9, II.
\end{itemize}
\end{footnotesize}
price represents the construction and building value and 20 percent represents the land value. There are many other methods of calculating the value of the improvements for purposes of determining the Impuesto al Valor Agregado. In the case of a raw land sale, no IVA is paid. The seller must pay the IVA to the Notary, who in turn has 15 working days from the time of the Deed signatures are witnessed to remit the payment to the Secretaría de Hacienda y Crédito Público (the Mexican equivalent of the U.S. Internal Revenue Service).

4. Real Property Transfer Tax (ISAI)

Next, the buyer also pays a real estate transfer tax or ISAI (Impuesto Sobre Adquisición de Inmuebles) to the local Municipality (Tesorería). The buyer pays the ISAI to the Notary, who in turn pays it to the Tesorería. The total transfer tax is usually 2 to 4 percent of the greater of either (1) the real estate tax valuation or (2) the total sales price (which is almost always the greater amount). The ISAI must generally be paid within 30 days after the deed signatures are witnessed by the Notary Public.

5. Property Tax (Impuesto Predial)

The Property Tax (Impuesto Predial) is a Municipal tax levied on owners and possessors of real estate. The tax base is the official value of the property recorded by the local tax authorities (valor catastral); however, sometimes the basis is determined by the appraisal value of the property. The applicable tax rate may vary from place to place.

6. Public Recording Fees

Next, the Notary must obtain the registration of the sale from the Public Registry. To obtain this registration of sale, the Notary must have (1) the lien-free certificate (certificado de libertad de gravamen), (2) the real estate tax valuation (avalúo), (3) the signed deed (escritura pública), (4) the proof of payment of the capital gains like tax (impuesto sobre la renta), (5) the proof of payment of real estate transfer tax (impuesto sobre adquisición de inmuebles), and (6) proof of payment of the value added tax (IVA or impuesto al valor agregado).

Please see the appendices attachment, U.S. Tax Implications of Foreign Investment in U.S. Real Estate, for a comparative discussion about how the U.S. imposes income taxation on foreign investors of U.S. real estate.

E. The Role of Guaranties in Financing Real Estate Transactions in Mexico and the U.S.

In recent years cross-border operations between the U.S. and Mexico have greatly increased, especially in the manufacturing and assembling sector. Most of the U.S. corporations (parent corporations) typically establish a subsidiary in Mexico to conduct the

70. Id. §9, 1.
71. Id. §33.
72. Notary Law for the Federal District §79.
Mexican commercial business operations. This subsidiary enters into the Lease Agreement with a Mexican lessor. The Mexican subsidiary will normally not have significant assets. Accordingly, the guarantee of performance of the U.S. subsidiary may be just as important as the Lease Agreement itself, since the lessor generally wants assurance that a third party will guarantee the obligations that the newly formed corporation will acquire under the Lease Agreement.

The parent corporation then typically enters into a Lease Guaranty with the Mexican Lessor, under the form of a Guaranty of Payment. This type of guaranty is generally a direct obligation, depending upon its terms. A direct obligation is preferred by the Mexican Lessor, as the beneficiary of the guaranty, so it may sue either the person primarily liable (Mexican Lessee), or sue the guarantor, without having to previously exhaust any efforts to collect from the primary obligor.

In the scenario of a cross-border Lease Agreement, the Guaranty of Payment usually has the following key elements:

(a) The Guarantor has the same obligations of the Guaranty as the subsidiary corporation has on the Lease Agreement.

(b) The Guarantor will be a guarantor of the Lessee's obligations to the Lessor if, pursuant to the Lease Guaranty Agreement, the Lessor has the right to demand payment or compliance against the Guarantor for the Lessor's obligations to the Lessee.
(c) The Guarantor becomes a guarantor "pursuant to contract," that is the Lease Guaranty. The parties can establish anything they mutually agree on permitted by law, so the terms of the Guarantor's responsibility will depend on the commercial and business relationship between the parties and on the terms and conditions agreed to by them.

However, a guaranty is generally more than a contract because it involves three separate relationships. First, the Lessee has an underlying obligation to the Lessor to perform the obligations acquired in the Lease Agreement. Second, the Guarantor has a secondary obligation, established in the Guaranty, to pay the Lessor in the event of non-performance by the Lessee. Third, the Lessee will typically have a reimbursement and other obligations to the Guarantor in the event that the Guarantor is required to pay or incur economic costs in favor of the Lessor under the Guaranty.

In each of these relationships there are reciprocal obligations between the parties, and a party may have defenses based on the performance or non-performance of the other two parties involved. For instance, the Guarantor could be partially or totally discharged from its obligations under the Guaranty in the event that the Lessor releases the Lessee from the Lease Agreement.

1. Traditional Forms of Guaranties in Mexico
   a. Bond Contract or Fianza

   In Mexico, traditionally the performance of the Lessee under Lease Agreements is guaranteed by a bond contract (fianza), or by establishing a third party as a joint obligor (obligado solidario) by inserting a clause in the Lease Agreement.

   The bond contract is an agreement in which a person agrees to pay a creditor in the event of failure of payment of the debtor. In the case of commercial transactions such as Lease Agreements, the Lessee must enter into a bond contract with a financial institution specialized in providing commercial bonds (Institución Afianzadora). The disadvantage of this type of guaranty is that the bond contract does not create a direct obligation, and, in consequence, the Lessor will have to demand payment first from the Lessee. In the event that he is unable to perform, the Lessor will be empowered to demand payment from the financial institution.

   b. Joint Obligor or obligado solidario

   The joint obligor (obligado solidario) is a third party who agrees to pay the Lessor in the event of the Lessee's non-performance. Under Mexican Law, the parties must expressly agree to a joint obligor by inserting a Clause in the Lease Agreement stating the obligor's name, and the terms and conditions of payment to the Lessor, in the event of non-performance by the Lessee. The Lessor must carefully negotiate the terms of this Clause in order to establish a direct obligation in his favor, so that he will be empowered to demand performance directly to the joint obligor, without having to first demand payment from the Lessee. In order for this Clause to establish a direct obligation of the

73. C.C.D.F. art. 2794.
74. Id. art. 1987.
75. Id. art. 1988.
Lessor, the joint obligor must expressly waive the benefits of the so-called “order and exclusion” (beneficio de orden y exclusión).

A guarantor has two rights or benefits under Mexican law, known as the beneficio de orden y exclusión. The concept means that a guarantor cannot be forced to pay a creditor if the creditor has not previously brought a legal proceeding against the debtor, and his assets have been exhausted.\(^7\) “Excusión” is a legal action against the assets of the principal debtor before proceeding against those of the guarantor, by applying the value of the debtor’s assets to the payment of the obligation, which shall then reduce the obligation under the guaranty.\(^7\)

Mexican Federal Circuit Courts have ruled that a plaintiff, before suing the guarantor or filing a claim against him, must first previously sue and conclude a civil trial against the principal debtor. Only after doing so, assuming a debt is still owed, may the creditor then sue the guarantor.\(^7\)

Excusión shall not take place in the event a guarantor has expressly waived this right or benefit.\(^7\) The Supreme Court of Mexico has ruled that if a guarantor expressly waives the benefits of orden y excusión, then a creditor may demand payment either against the principal debtor or the guarantor, without having to first demand payment again the principal debtor.\(^8\)

The Mexican Supreme Court has also ruled that in the case of a lease agreement, if the guarantor waived the benefits granted by Sections 2814, 2845, 2848, and 2849 of the Federal Civil Code, he or she may not invoke the benefits provided by such Sections.\(^8\)

Additionally, regarding the issue of jurisdiction and choice of venue, in the event the obligations of a guarantor are regulated in a specific Clause of a lease agreement, then the obligations of the guarantor derive from the lease agreement. The provisions of the lease agreement, then, shall determine Mexican law provides the corresponding jurisdiction and venue. The court, which has jurisdiction over the lease agreement, shall have jurisdiction over matters pertaining to the guaranty (as an “accessory” agreement) of the lease (as the “principal” agreement). The Federal Circuits Courts in a case in Mexico City held this opinion.\(^8\)

Also, in a case in the State of Nuevo León, Mexico, the Federal Court hearing a guaranty case ruled that even though a guarantor is not physically located within the


\(^8\) See ruling Arrendamiento Inmobiliario, Competencia de los Jueces del, Cuando se Demanda al Fiador, Octava epoca, Cuarto Tribunal Colegiado en Materia Civil del Primer Circuito, Semanario Judicial de la Federación, Parte IX-Abril, Página 428.
jurisdiction of the court, he or she is subject to the jurisdiction of the place where the obligation must be performed.\textsuperscript{83}

2. Issues to Consider in the Guaranty of Payment (Regarding U.S. Law/California)

(a) The Guaranty of Payment is a secondary and not a primary obligation, and can only exist where there is a principal liability on the part of the third person, either express or implied\textsuperscript{84}

(b) Three parties are involved in the Guaranty of Payment: the person obligated by the underlying agreement, the person before whom the obligation is acquired, and the person guaranteeing performance of the obligation of the underlying agreement.

(c) The Guaranty of Payment must refer to the Lease Agreement entered into by the Lessor and Lessee.

(d) The Guarantor is liable only to the extent specified by the terms of the Guaranty of Payment, and its obligation may not be larger in amount nor more burdensome than that of the principal. In the event that the terms of the Guaranty exceed the obligation of the Lessee, the obligation is reduced in proportion to the Lessee's obligation.\textsuperscript{85}

(e) The Guarantor is liable to the Lessor immediately on default of the Lessee, without the need of demand or notice,\textsuperscript{86} and the Guarantor's obligation is deemed unconditional unless the terms of the obligation establish a condition to the liability of the Guarantor.\textsuperscript{87}

(f) In some occasions the Guaranty will have a time and a monetary limit. These limits will depend on the business objective and transactions of the parties involved.

3. Choice of Substantive Law and Venue

In lease transactions involving the celebration of a Lease Agreement and a Guaranty of Payment, between a U.S. Parent Corporation, its Mexican Subsidiary and a Mexican Corporation, it is very likely that the choice of venue and jurisdiction will be different for each contract. Under Mexican law, the creation, regulation and extinction of rights over real estate, including lease agreements and the temporary use of this type of property, is typically governed by the law of the State where it is located, even though their holders may be foreign.\textsuperscript{88} However, the parties may agree to designate a different applicable law.\textsuperscript{89}

---

\textsuperscript{83} See ruling Fiador, Sustitucion del Cambio de Jurisdiccion no Constituye Base Legal Para la Legislacion del Estado de Nuevo Leon, Octava Epoca, Tercer Tribunal Colegiado del Cuarto Circuito, Semanario Judicial de la Federacion, Parte XIII-Enero, Página 241.


\textsuperscript{86} Cal. Civ. Code \$2807.

\textsuperscript{87} Id. \$2806.

\textsuperscript{88} Id. art. 13, III.

\textsuperscript{89} Id. art. 13, V.
It is very unlikely that the parties will select a foreign venue and jurisdiction regarding the Lease Agreement, because Lessor and Lessee are Mexican entities, since the Agreement is entered into under the laws of a Mexican State where the real property is located. Therefore, the parties are more likely to agree that any disputes arising from the Agreement shall be decided in a Mexican Court. How can a U.S. judge and court effectively apply Mexican law regarding a Mexican real estate transaction?

The Guaranty of Payment presents a different scenario from the one described above, because the Guarantor is typically a foreign corporation. It may be advisable that the Guaranty be governed by the laws of the Country and State of origin of the Guarantor, and that the applicable venue and jurisdiction be in the Country and State of origin of the Guarantor. This is particularly true, given the nature of the obligations acquired by the Guarantor, and the consequences in the event of non-performance by the Lessee.

As you can see, the cross-border nature of international guaranties presents a number of interesting, and sometimes complicated, questions. Some of the questions presented are never resolved satisfactorily, due to the conflicts of laws questions of U.S. law, Mexican law, and State laws within both of the states.

F. Real Estate Property as Collateral in Mexico

1. Mortgage Agreement

In Mexico, creditors secure real estate property as collateral by entering into a mortgage agreement with debtors, or hipoteca. By entering into this agreement, the creditor acquires the right to obtain the sales price of the real estate property in the event of default of the debtor. Although Mexican law does not establish a limitation regarding the type of property that may be secured through a mortgage (e.g. it may be used for real property as well as movable property), in practice mortgages are seldom used to secure movable property, because the guaranty agreement, known as prenda, is specifically designed for movable property. Under Mexican law and doctrine, the terms hipoteca and prenda are used to refer to the agreement or contract as well as the power or right over real property.

A mortgage agreement is considered under Mexican Law as an “accessory” contract. The underlying obligation is generally a payment obligation, and the principal contract is generally a commercial loan. The Mexican Supreme Court has ruled that even though the hipoteca is not regulated by commercial law (civil law provisions regulate issues concerning its creation, contents, or extinction), a mortgage agreement may be used as a guaranty in commercial agreements and loans.

---

90. *Id.* art. 2893.
91. *Id.* art. 2856.
92. The Federal Civil Code defines the mortgage and prenda as rights over property, and subsequent provisions refer to them as contracts.
93. Federal Civil Code, art. 2927 provides that an hipoteca shall exist (generally) as long as the debtor's obligation has not been extinguished.
94. See resolution Via Ejecutiva Mercantil en Caso de Obligaciones Típicamente Mercantiles Garantizadas con Hipoteca, Tercera Sala, Semanario Judicial de la Federación; Página: 20, Quinta Época.
The parties entering into a mortgage agreement must record this document before the Public Register since the transaction involves real estate.95

2. Rights Acquired by Creditor

Even though a mortgage agreement grants a creditor a right over the secured real property, the creditor does not have an immediate right of possession over the property upon a default of the underlying loan obligation. In other words, the creditor only has the right to demand the sale of the property before a court.96 Only after default of the debtor may the creditor sue before a Civil Court,97 the person in possession of the property.98 Only after the court summons the debtor to trial99 may the creditor have "legal possession" (posesi6n juridica) of the property.100 Consequently, the debtor, in that case, is only a depositary of the real property and its products (which may be any labor product, agricultural products, manufactured goods, or periodic income or rent).101

Although Mexican law provides a summary procedure, generally this procedure does not conclude quickly, since the debtor has many motions he may file against the creditor, thereby prolonging the trial.

Under Mexican Law, a creditor also has a preference right in payment, upon the judicial sale of the property.102 If there are several creditors regarding the same debtor and property, the creditor holding the oldest hipoteca shall be the first creditor to receive payment.103 The ordering rules are not the same as in the U.S.

However, the court is first required to make several third-party payments before paying the mortgage creditor, such as paying for trial expenses, and management and maintenance of the secured property.104


1. Non-possession Guaranty

As of May 24, 2000, Mexico's Law of Negotiable Instruments and Credit Transactions (LNICT), the Commerce Code (CC) and the Law of Credit Institutions (LCI) were amended to modernize Mexico's secured transactions. Our law firm consulted with a Mexican Congressman who was instrumental in bringing about these changes. As a

95. Federal Civil Code, art. 3042 (1).
97. In Mexico, mortgage agreements are regulated under Civil Law (as opposed to Commercial Law), and therefore the competent court shall be a local State Court having jurisdiction over Civil Law matters.
98. C.P.C.D.F. art. 12.
99. Under Mexican law, there is a special trial for mortgage matters. Discovery and procedure rules are established in the Code of Civil Procedure for the Federal District, as well as the Codes of Civil Procedure of each State.
100. The term "legal possession" is used to distinguish between the physical possession of property and the right of possession appointed by law or a Court resolution.
101. C.P.C.D.F. arts. 481, 482.
102. C.C.D.F. art. 2981.
103. Id. art. 2982.
104. Id. arts. 2985 (1), (II); 2986.
result, it is now possible for a debtor to remain in possession of secured movable personal property, which does not have to be deposited with the creditor or a third depositary (Non-possession Guaranty). The purpose of these provisions is to help guarantee compliance of the debtor's obligation, while allowing the debtor to have possession of the secured property, to use it in his operations or business.  

Mexico had no effective secured financing laws (comparable to the Uniform Commercial Code) prior to these amendments.

A Non-possession Guaranty may only be used regarding movable property. These recent amendments provide that any obligation, regardless of the activity or business performed by the debtor, may be secured through a Non-possession Guaranty. Before these amendments came into power, the LNICT established two types of credit known as the *avio* and *refaccionario* loans. These loans are specially designed to finance production or agricultural activities. Traditionally, *refaccionario* loans are used to prepare a new enterprise for production, while the *avio* loans are generally used for the process of production. Although the May 24, 2000 amendments do not repeal the *avio* and *refaccionario* loans provisions, it is possible the Non-possession Guaranty will replace the *avio* and *refaccionari* loans system.

2. Guaranty of Trust

These amendments also include new provisions regarding a Guarantee Trust, or *Fideicomiso en Garantía*. Under Mexican law, the Trustee must be a Mexican financial institution, because only banks and institutional stockbrokers (as opposed to individual stockbrokers) may act as Trustees. The only limit to the purpose or objective of a Mexican trust is that it shall be a "legally determined purpose." Under such a broad purpose, a trust may be used to secure any type of transaction.

Under the Guaranty of Trust provisions, the settlor (debtor) transfers to the trustee (a bank, an insurance institution, a bond institution, or a grantor public warehouse) his title over certain personal property, to guarantee the performance of an obligation and a right of preference of payment in favor of the beneficiary (lender or creditor). Any type of rights, as well as movable and real property may be subject to a Guaranty of Trust. Similar to the Non-Possession Guaranty, unless otherwise is agreed to between the parties, the debtor shall continue in possession of the movable property, and may use and even sell this property.

---

105. This type of pledge is known as Pledge without dispossession, or *Prenda sin transmisión de posesión*.
106. LNICT art. 346.
107. Id. art. 352.
108. Id. art. 323.
109. LCI, art. 46, XV; Stock Market Act, §22, IV (d). Institutional stockbrokers may only be a party to a trust if its is directly related to its financial services and operations.
110. LNICT art. 346.
111. Id. art. 399.
112. LNICT art. 395.
113. Id. art. 401.
114. Id. art. 402.
In transactions where the secured property is real estate, the Guaranty of Trust must be granted in a public deed before a Mexican Notary Public and recorded before the Public Register where the real estate is located.

The most striking difference between a Guaranty of Trust and traditional forms of secured transactions in Mexico, is that with a Guaranty of Trust it is possible to execute and foreclose against the secured property extra-judicially. In general terms, the parties must first obtain an appraisal of the secured property, and then the property is delivered to the trustee or the beneficiary (creditor or lender) before a Public Notary, who must draft the public record as well as an inventory of the property. The trustee or beneficiary may then sell the property. Instead of requiring judicial authority for the execution of the secured property, the “authority” in this extra judicial procedure is the Public Notary, who has special powers such as to delivering the settlor a notice of delivery of the property.

However, these amendments also introduce a new special summary procedure before Commercial Law courts. Thus, the involvement of the courts continues to be a characteristic of secured transactions in Mexico. In case of controversy regarding demand of payment, the amount claimed by the beneficiary or creditor, or delivery of secured property, the parties would not be able to execute the secured property extra judicially.

H. Real Estate Property as Collateral in the U.S.

1. Mortgage and Deed of Trust

Similarly to the scenario under Mexican law, in the U.S., a mortgage is a contract through which specific property is secured for the performance of an act without a change of possession. The mortgagee does not have the right of possession over the property. Additionally, every transfer of an interest in property, other than through a trust, with the purpose of being a security for an act, is a mortgage.

In the U.S., a mortgage that includes a power of sale has a similar legal effect, and operates in a similar manner, as a deed of trust. In general terms, both the mortgage and the deed of trust are used by the parties in a real estate transaction to provide security for the performance of an obligation.

Through a deed of trust, generally the settlor transfers the property to the trustee, who in turn holds the title as security for the performance of the obligation of the settlor. Although under a deed of trust the legal title is given to the trustee, it is only for purposes of securing the performance of the settlor's obligation, as a lien on

115. Id. art. 407.
116. Id. art. 410.
117. Id. art. 1414 bis.
118. Id. art. 1414 bis 3.
119. Id. art. 1414 bis 1.
120. Id. art. 1414 bis.
121. CAL. CIV. CODE §2920(a).
122. Id. §2924.
123. See MILLER & STARR, 4 CALIFORNIA REAL ESTATE, NATURE AND REQUIREMENTS OF SECURITY INSTRUMENTS §10:1, et seq. (3rd Ed.).
124. Id.
the property. In consequence, the trustee does not acquire the powers of an owner, because the rights and powers incidental to ownership, such as rights of possession, maintenance, encumbrance, and transfer belong to the settlor.

Even though the term "trustee" is used in deeds of trust, the trustee of a deed trust is not a "trustee" as in other common law trusts, but rather an agent with limited powers. There is no designation of trustee, but rather an agency for the purpose of selling the property upon default of the settlor.

Regarding the form and terms of mortgages and deeds of trust, both must be in writing. Mortgages must contain the name of the mortgagor and the mortgagee, and the trust deed must name the settlor, trustee, and beneficiary. Both must include a description of the secured property. A mortgage and a deed of trust may be recorded; however, recordation of these documents is not required for the validity of the documents between the parties. However, as in Mexico, recordation is needed to establish priority over subsequent purchasers of the property and liens.

Even though the Mexican hipoteca and the U.S. mortgage and deed of trust share common principles and objectives, in the U.S. the authorized agent in the mortgage and/or deed of trust has the power to manage and/or sell the property, and the parties may also authorize this agent to execute either document.

2. Power of Sale and Foreclosure

Perhaps the most striking difference between Mexican and U.S. law regarding secured transactions with real estate property is the sale process of the secured property. As we had previously discussed, in Mexico, secured real property must be sold through a judicial sale. In contrast, in the U.S., the mortgage contract or deed of trust may grant the mortgagee or trustee a power of sale, as an alternative to court foreclosure. This power of sale is considered as a private power (as opposed to a statutory provision), and therefore, each document may establish different procedures to be followed.

In general, when the settlor defaults any obligation of the deed of trust, the beneficiary has the right to demand the trustee in writing to proceed with foreclosure of the deed of trust, based on the private power of sale. Next, the trustee, mortgagee or beneficiary prepares a written notice of default, to be delivered to the settlor or mortgagor. The purpose of this notice of is to inform the settlor or mortgagor of default, and the

127. CAL. CIV. CODE §2297.
129. CAL. CIV. CODE §2922.
130. Id. §2922.
131. CAL. CIV. CODE §1217, 2922, 2952.
133. C.C.D.F. art. 2981.
134. CAL. CIV. CODE §2932.
135. See MILLER & STARR, supra note 123 §10:1.
136. Id.
137. CAL. CIV. CODE §2924.
settlor or any successor to the settlor may cure default. The trustee must record the
notice of default. Once three calendar months have passed since its recordation, the
trustee may proceed with the sale of the property. Finally, the sale must be held within
the county where the real property is located, and it may be conducted by the trustee,
an officer of the trustee corporation, the attorney of the trustee, or an auctioneer hired
by the trustee. The sale must be conducted as an auction, and the property must be
sold to the highest bidder.

II. Conclusion

As the United States and Mexico become increasingly closer, both commercially and
diplomatically, the amount and scope of cross-border commercial leasing and real estate
transactions will inevitably increase. There are many issues and considerations that any
U.S. (or any non-Mexican company) should consider before it enters into a Mexican
commercial real estate transaction, even if only by way of a cross-border Guaranty of a
Mexican lease. Conversely, the Mexican real estate landowner must consider and analyze
the complicated international cross-border legal issues associated with any real estate
transaction it might make with a U.S. company.

At a minimum, the parties should have a careful understanding of what terms and
provisions they can freely and contractually agree to under any commercial lease, sale or
guaranty transaction, notwithstanding any default provisions of applicable law. Careful
legal planning can help minimize the international legal risks (and costs) associated with
Mexican commercial real property transactions.

The parties should always work with local Mexican counsel before initiating any
negotiation, and should carefully review not only the principal contracts, such as a lease
agreement or a loan, but also the secondary contracts, such as a guaranty of payment or
other forms of securing obligations. An important aspect of our practice is to provide
our clients the necessary elements to deal with these cross-border legal issues.

III. Appendix A. U.S. Tax Implications of Foreign Investment
in U.S. Real Estate

There are several different reasons why non-U.S. citizens (e.g., Mexican citizens or
Mexican companies) might want to "own" real estate in the United States.

First, an individual may want to own real property in the U.S. for personal and/or
recreational purposes. Many non-U.S. citizens own homes in California and through the
U.S., either directly as individuals or indirectly through domestic or foreign entities.

Second, ownership in U.S. real estate may satisfy specific business objectives of a
foreign company. For instance, a Mexican company that exports goods to the U.S. may

138. Id. §2924 c, (a)(1).
139. Id. §2924.
140. Id. §§2924g(a), 2924a.
141. Id. §2924g(a).
142. For purposes of this discussion, "ownership" will usually refer to most types of real estate
interests (e.g., leasehold interests in real estate, direct ownership, corporate ownership, etc.).
want to develop a distribution and/or warehousing network in the U.S. Also, a company may want to open a sales office (or offices) in the U.S. to help market its goods or services in the U.S. or other parts of North America.

A foreign investor should carefully plan for the tax consequences of U.S. real estate investments because of the complex legal framework of foreign real estate investments. Foreign investors should consider several important factors before investing, acquiring, or selling U.S. real estate. The following is a list of some of these considerations:

- Will the real estate generate income?
- Does the investor want only a debt interest in the real estate, an equity interest, or some combination of both?
- Should a corporation, partnership, trust, or an individual acquire the real estate?
- Should the entity be domestic, foreign, or some combination of both?
- Should the real estate be leveraged significantly, through medium-term or long-term financing to obtain the tax benefits of interest expense paid? If so, should the financing come from the U.S. or outside the U.S.?
- If a foreign corporation owns U.S. real estate, should it make an election to be taxed like a domestic U.S. corporation in relation to its U.S. real estate investment?
- What U.S. tax returns must be filed, and what information must be disclosed to the IRS regarding the foreign investors? Can the investment be restructured to avoid some of these reporting requirements?

These questions cannot be adequately answered until the economic and business objectives of a particular foreign investor are carefully examined. Why invest in U.S. real estate? Does the foreign investor want to lease real estate or purchase real estate? Does the foreign investor want capital appreciation or annual income from the real estate investment? Does the foreign investor need initial "income tax losses" to offset against other sources of U.S. income? How long does the foreign investor want to own an interest in real estate?

This overview cannot answer all these questions. However, it is designed to provide a framework of some of the more significant tax issues that should be considered before a foreign individual or company invests in U.S. real estate.

A. STATE AND LOCAL TAXATION APPLICABLE TO FOREIGN INVESTORS WHO INVEST IN U.S. REAL ESTATE

This article focuses upon U.S. federal income taxes applicable to foreign investors of U.S. real estate. In addition, States (e.g., California, Arizona, Texas, and Florida) commonly impose income taxation along with local (e.g., County and City of San Diego) property taxes. For instance, California tax law requires buyers to withhold 33% of the total sales price of California real estate owned by non-California persons (including non-U.S. sellers of real estate).143 California escrow agents also have a duty to inform buyers of this California withholding tax obligation.144 The withholding tax, like FIRPTA

143. CAL. REV. & TAX. CODE §18662 (e)(1)-(2).
144. Id.
(see below) is not a final tax, but merely a collection mechanism to be used against the final income tax. California individual and corporate tax rates, that may apply, range up to as much as 9.4 percent. See the FIRPTA discussion below for a comparative analysis of federal income tax treatment and withholding taxes.

In addition to State income taxation (and the withholding tax mechanisms that may apply), there are typically local property taxes that will apply to a transfer or sale of real estate. In California, for instance, the California Constitution and tax code provides that all property in California that is not free from tax under federal or California law is subject to taxation “in proportion to its value.” The maximum ad valorem real property tax rate in California is one percent of the “full cash value.” Finally, California counties and cities may also apply a local documentary transfer tax on the transfer of real property.

B. Special Federal Income Tax Rules Applicable to Foreign Investors Who Invest in U.S. Real Estate

There are several unique rules applicable to non-U.S. citizens, non-U.S. residents and foreign companies that own real estate situated in the U.S. Congress passed most of this legislation some 20 years ago, known as the Foreign Investment in Real Property Tax Act (“FIRPTA”).

Generally, a non-U.S. citizen (e.g., a Mexican citizen who resides in Mexico or outside the U.S.) who does not have (1) U.S. source income or U.S. source income “effectively connected” with a trade or business, and (2) does not stay in the U.S. for

145. Cal. Const. art XIII, §1, provides in relevant part as follows:
   (a) All property is taxable and shall be assessed at the same percentage of fair market value.
   (b) All property so assessed shall be taxed in proportion to its full value.
   Cal. Rev. & Tax Code §201 further provides: “All property in this State, not exempt under the laws of the United States or this State, is subject to taxation under this code.

146. Cal. Const. art XIII A, §1(a) and Cal. Rev. & Tax Code §§93 and 95–100.

147. The amount of the tax is based on the consideration or value of the real property transferred. The county rate is fifty-five cents ($0.55) for each five hundred dollars ($500) of value, and the noncharter city rate is one-half of the county rate and is credited against the county tax due. Cal. Rev. & Tax Code §11911(c). Charter cities may impose transfer taxes at a rate higher than the county rate. Cal. Const. art. XI, §5.

148. There are special “residency” rules for individuals that apply for income tax purposes. A U.S. resident for tax purposes might not be a U.S. resident for immigration or other legal purposes. Whenever the word U.S. “resident” or “non-resident” or “foreign investor” is used in this presentation, it is only referring to the applicability of the U.S. tax laws—and not immigration laws, or any other legal purposes. The U.S. tax laws define a U.S. tax resident based upon the number of days spent in the U.S., the lawful permanent residency of the individual in the U.S. (i.e., whether they have a “green card”), or based upon an election made by the taxpayer.

149. The tax rules relating to U.S. source and effectively connected income from a U.S. trade or business are impacted significantly by tax treaties between the U.S. and other countries. For example, the U.S./Mexico Tax Treaty requires that a Mexican resident usually have a “permanent establishment” in the U.S. before being taxed in the U.S. on its business activities.
“183” days per year, does not have to pay taxes to the U.S. government. Consequently, prior to the enactment of FIRPTA, a foreign investor could purchase real estate in the U.S. (e.g., a bare tract of land that had development potential) for US $100,000 and sell it for US $300,000. The U.S. would generally not tax the Mexican citizen on the US $200,000 gain. If a U.S. citizen were to have that same US $200,000 gain, it would have to pay income tax on the gain. Congress passed FIRPTA because it thought foreign investors were receiving more favorable tax treatment on some of their U.S. real estate investments than U.S. residents.

FIRPTA created a completely different tax method by which non-U.S. residents are taxed upon their gains derived from ownership in U.S. real estate. FIRPTA also imposes a mandatory withholding mechanism by which part of the tax must be withheld by the buyer (or third party withholding agent) immediately upon the sale or disposition of the U.S. real property interest.

1. Imposition of Taxes Under FIRPTA

A tax cannot be imposed unless there is a sale or other disposition of a U.S. Real Property Interest (USRPI) under FIRPTA. Any direct ownership interest in real property located in the U.S. or the U.S. Virgin Islands (as well as certain ownership interests in corporations, partnerships, and estates which own real property that is located in the U.S. or the U.S. Virgin Islands) is a USRPI. “Real property” is defined by IRS Regulations (and not by local laws such as California or New York law), and includes undeveloped land, crops and minerals that are not severed or extracted from the ground, permanent structures, such as improvements and buildings that are inherently permanent, and certain personal property that is particularly associated with real property.

Although the definition of “real property” for purposes of a USRPI is expansive, a so-called “pure creditors’ interest” is not deemed a USRPI. A pure debt interest in U.S. real estate such as a mortgage (which is an example of a debt interest) does not create a USRPI. Instead, the foreign lender who takes a mortgage against the U.S. real estate would be subject to a withholding tax on the interest income received unless the loan is structured as portfolio interest. Therefore, debt “investments” in real estate often

The U.S./Mexico Tax Treaty, however, does not significantly alter the way Mexican citizens are taxed on their gains from the sale of U.S. real estate (other than the application of the branch profits tax). Not all U.S. Tax Treaties are the same, and therefore each foreign investor should exercise whether there exists an applicable tax treaty within the U.S.

150. USRPI also includes any interests in a “U.S. real property holding corporation” (USRPHC). A USRPHC is any domestic U.S. corporation that, if at any time during the past five years during which a foreign person held shares of the corporation, its USRPI’s fair market value equaled or exceeded 50 percent of the aggregate value of the corporation’s USRPIs, its real property located outside the U.S., and its other trade or business assets.

151. If 50 percent of a partnership’s assets are U.S. real property, or 90 percent or more of its assets are made up of USRPIs, cash, and cash equivalents, then an interest in the partnership attributable to the partnership’s USRPIs will be subject to FIRPTA with certain limitations.

152. I.R.C. §897(c).
155. Qualifying portfolio interest is not subject to U.S. withholding tax.
provide a more desirable means by which a foreign investor can “invest” in U.S. real estate to avoid the application of FIRPTA.

The exact investment arrangement should be carefully planned. If a foreign investor were to take a disguised “equity” ownership interest (as opposed to a pure creditor’s interest or other non-USRPI), then the IRS might take the position that the gains derived by the foreign investor should be subject to the FIRPTA tax.

For example, assume MEXICOMPANY, S.A. lends Mr. Martinez US $500,000 pursuant to a promissory note to purchase undeveloped real estate in San Diego, and MEXICOMPANY, S.A. takes back a security interest in the real estate (i.e., a mortgage). Assume further, that the terms of the promissory note require Mr. Martinez to pay MEXICOMPANY, S.A. 50 percent of the appreciation of the real estate based upon annual appraisals of the undeveloped property. This type of loan arrangement would likely be deemed an “equity kicker” and thus would likely require MEXICOMPANY, S.A. to pay FIRPTA tax upon the sale or exchange of the promissory note.

2. Rate of Tax on Disposition of USRPI

If a Mexican resident individual disposes of a USRPI, then he or she probably would be subject to a maximum 20 percent capital gains tax rate (assuming the property was a capital asset in the hands of the Mexican resident). If the real estate was not a “capital asset,” then the tax rate could be between 12 percent and 38.6\(^{156}\) percent.\(^{157}\) A USRPHC or foreign corporation that disposes of a USRPI will be subject to graduated tax rates upon the disposition, which may include tax rates at the highest marginal corporate rate of 35 percent upon reaching $10 million taxable income.

There are other business forms which should be considered before acquiring real estate in the U.S. For instance, there are some benefits that can be obtained if a limited liability company owns the real estate, depending upon the type of real estate, the objectives of the investors, and whether a foreign income tax credit is available in the foreign investor’s home country.

---

\(^{156}\) This 38.6 percent rate applies to non-corporate foreign partners. Foreign corporate partners are subject to a 35 percent rate. Further, the Economic Growth and Tax Relief Reconciliation Act of 2001 (2001 Tax Act) reduces the 38.6 percent withholding tax rates applicable to foreign persons (formerly 39.6 percent in the year 2000) in accordance with the following schedule:

<table>
<thead>
<tr>
<th>Year</th>
<th>Marginal Tax Rates</th>
<th>Marginal Tax Rates</th>
<th>Marginal Tax Rates</th>
<th>Marginal Tax Rates</th>
<th>Marginal Tax Rates</th>
<th>Highest Marginal Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>N/A</td>
<td>15%</td>
<td>28%</td>
<td>31%</td>
<td>36%</td>
<td>39.6%</td>
</tr>
<tr>
<td>2001</td>
<td>Rebate</td>
<td>Unchanged</td>
<td>27.5%</td>
<td>30.5%</td>
<td>35.5%</td>
<td>39.1%</td>
</tr>
<tr>
<td>2002–2003</td>
<td>10%</td>
<td>Unchanged</td>
<td>27%</td>
<td>30%</td>
<td>35%</td>
<td>38.6%</td>
</tr>
<tr>
<td>2004–2005</td>
<td>10%</td>
<td>Unchanged</td>
<td>26%</td>
<td>29%</td>
<td>34%</td>
<td>37.6%</td>
</tr>
<tr>
<td>2006–2010</td>
<td>10%</td>
<td>Unchanged</td>
<td>25%</td>
<td>28%</td>
<td>33%</td>
<td>35%</td>
</tr>
</tbody>
</table>

\(^{157}\) Plus, a foreign individual may be subject to the so-called alternative minimum tax (AMT) upon the disposition of the USRPI.
Additionally, a foreign investor may avail himself or herself of certain tax-free transfers of USRPI, to avoid or defer the payment of any FIRPTA taxes as follows, depending upon the factual circumstances of each investment:

- Like kind exchanges.\footnote{I.R.C. §1031.}
- Exchanges of stock for stock in the same corporation.\footnote{I.R.C. §354.}
- Liquidations of a subsidiary into a parent corporation.\footnote{I.R.C. §332.}
- Transfers to a controlled corporation.\footnote{I.R.C. §351.}
- Exchanges of stock in certain reorganizations, corporate spin-offs, split-offs, and split-ups.\footnote{I.R.C. §§354 and 361.}
- Certain distributions of property by a partnership.\footnote{I.R.C. §§721 and 731.}

Unfortunately, the applicability of the above tax-free provisions is strictly limited to their express application of USRPIs and foreign investors, as provided for in the FIRPTA regulations.\footnote{Treas. Reg. §1.897-6T(a)(2).}

3. **Election by Foreign Corporation to be Taxed as Domestic Corporation**

A qualifying foreign corporation can elect to be treated like a domestic corporation regarding any disposition or sale of a USRPI. Only certain foreign corporations (e.g., a Sociedad Anónima de Capital Variable) are eligible to make this election.\footnote{The foreign corporation must (1) be a USRPHC, (2) hold a USRPI, and (3) must be entitled to nondiscriminatory treatment under a treaty with the U.S. The Mexico/U.S. Tax Treaty will qualify a Mexican corporation (e.g., a Sociedad Anónima de Capital Variable or a Sociedad Anónima) as a qualifying entity for purposes of the election.} The foreign corporation must also obtain consents from all of its shareholders to make such an election. This election can provide a number of tax planning opportunities (especially with respect to the application of the U.S. estate tax) depending upon the use and future disposition of the U.S. real estate.

A Mexican investor in U.S. real estate should be cautious of the potential application of the U.S. estate tax regarding the ownership of the U.S. real estate upon the foreign individual owner's death. A Mexican citizen who owns real estate directly, as an individual, will be subject to the U.S. estate tax upon his or her death. The current estate tax rates range from 18 percent to 50 percent.\footnote{I.R.C. §2001(c).} These highest rates were modestly reduced from 55 percent beginning in 2002. The "taxable estate" of nonresidents who are not domiciled in the U.S. includes property situated within the United States. Property situated in the U.S. includes, among other things, U.S. real estate, most...
personal property physically located in the U.S., certain debt obligations, and stock in a U.S. corporation.167

4. Withholding Requirements Under FIRPTA

Upon the sale or other disposition of a USRPI by a foreign person, the transferee (e.g., the buyer) generally must withhold 10 percent of the total amount realized from the sale and not just from the taxable gain. Also, if there is an installment sale over a period of time, the 10 percent withholding requirement is imposed upon the total amount realized at the time of the sale (and not over the term of the payments).169 A U.S. partnership, estate, or trust that disposes of a USRPI is generally subject to a

167. I.R.C. §2104. The Tax Act not only reduced the highest marginal income tax rates, but also modified slightly the estate tax rates as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Estate Tax Life Time Exemption Equivalent</th>
<th>Estate Tax Exemption Equivalent</th>
<th>Highest estate and gift tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>for Non-U.S. Citizens with Foreign Domicile</td>
<td>For U.S. Citizens or U.S. Domicile</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>US $60,000</td>
<td>US $1 million</td>
<td>50%</td>
</tr>
<tr>
<td>2003</td>
<td>US $60,000</td>
<td>US $1 million</td>
<td>49%</td>
</tr>
<tr>
<td>2004</td>
<td>US $60,000</td>
<td>US $1.5 million</td>
<td>48%</td>
</tr>
<tr>
<td>2005</td>
<td>US $60,000</td>
<td>US $1.5 million</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>US $60,000</td>
<td>US $2 million</td>
<td>46%</td>
</tr>
<tr>
<td>2007</td>
<td>US $60,000</td>
<td>US $2 million</td>
<td>45%</td>
</tr>
<tr>
<td>2008</td>
<td>US $60,000</td>
<td>US $2 million</td>
<td>45%</td>
</tr>
<tr>
<td>2009</td>
<td>US $60,000</td>
<td>US $3.5 million</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>Estate Tax—Repealed</td>
<td>Estate Tax—Repealed</td>
<td>N/A</td>
</tr>
<tr>
<td>2011</td>
<td>Gift Tax Rate</td>
<td>Gift Tax Rate—Maximum Rate</td>
<td>35%</td>
</tr>
</tbody>
</table>

168. "Realized" is a technical tax term, and generally refers to all consideration paid or received in a transaction. Assume a Mexican resident owns undeveloped real estate in California with a fair market value of $2 million. Assume further, that the real estate has an outstanding mortgage of $1.75 million. If a buyer is willing to pay the Mexican real estate owner $100,000 in cash, promise to pay $150,000 pursuant to a promissory note, and assume the outstanding mortgage of $1.75 million, the total amount "realized" equals $2 million (and not $100,000, the amount of cash received). The Mexican resident who sold the real estate became $2 million richer, because he received (1) $100,000 of cash, (2) a promise purportedly worth $150,000, and (3) was relieved of an outstanding debt of $1.75 million. Assuming the Mexican resident's tax basis in the property was $1.8 million, there would have been a taxable gain under FIRPTA of $200,000 (the amount realized of $2 million less the tax basis of $1.8 million).

169. A buyer of a USRPI should be aware of an installment sale where the total 10 percent withholding requirement exceeds the amount of the initial payment upon closing of escrow. The buyer could actually be in a position of paying a greater amount to the government than is actually received by the foreign seller at the time of the sale.
38.6 percent withholding tax to the extent such gain is allocable to a foreign partner or beneficial owner of the entity.\textsuperscript{170}

This 38.6 percent rate applies to non-corporate foreign partners. Foreign corporate partners are subject to a 35 percent rate. See the above referenced highest marginal tax rates pursuant to the 2001 Tax Act that continues to reduce the individual rate through the year 2006.

Foreign corporations must withhold 35 percent of the gain recognized with respect to any distributions of a USRPI to the corporations' shareholders.\textsuperscript{171} A qualifying foreign corporation can make an election under Section 897(i) to be taxed as a USRPHC and not be subject to any withholding tax requirement, and instead, be taxed like a domestic corporation.\textsuperscript{172} This can provide a number of unique planning opportunities depending upon the type of real property held and its use.

Most States within the United States also have their own withholding tax mechanism upon the sale of real estate located within a particular State. For instance, California imposes a withholding tax of 3 1/3 percent withholding tax on the gross sales price.\textsuperscript{173}

C. Special Tax Treaty Provisions (e.g., U.S./Mexico Tax Treaty)

Most tax treaties have special provisions relating to the ownership of “immovable property” in the U.S. by a resident of the other treaty country (and vice versa). For instance, the U.S./Mexico Tax Treaty allows the U.S. to tax Mexican residents on their income, profits and gains from U.S. real estate (and vice versa). There is usually no maximum tax rate restriction imposed by a treaty with regard to FIRPTA taxes and tax treaty residents will normally continue to be subject to gains from the sale or disposition of any U.S. real property interests under FIRPTA in the same manner as persons that cannot utilize a U.S. tax treaty. Therefore tax treaties usually have little impact upon the application of FIRPTA, other than defining “immovable property,” which normally does not conflict with the definition of real property as defined under the FIRPTA rules.

However, for foreign corporate owners, the tax treaties (as well as the nondiscriminatory treatment under the Section 897(i) election explained above) sometimes impact the U.S. branch profits tax, or the application of the federal withholding tax, upon disposition of the real estate. For example, the U.S./Mexico Tax Treaty limits the amount of the branch profits tax that can be imposed by the U.S. government on the U.S. profits of

\textsuperscript{170} Treas. Reg. §1.1445-5(c)(1).
\textsuperscript{171} I.R.C. §1445(e)(2).
\textsuperscript{172} Article 6 of the U.S./Mexico Tax Treaty defines real property broadly and in reference to the laws of the country in which the real property is located. Therefore, the laws of the U.S. need to be examined to determine exactly what constitutes real property as set forth in Treas. Reg. 1.897-1(b). As was explained above, the federal tax regulations define “real property” for purposes of FIRPTA and not local laws, such as California State law. Notwithstanding the local laws of each country, “immovable property” is defined by the Tax Treaty as including unharvested agriculture and forestry situated in the U.S. or Mexico, and property which is an accessory to immovable property, including equipment used in agriculture and forestry, and rights to mineral deposits and other such natural resources.
\textsuperscript{173} CAL. REV. & TAX. CODE §§18662, 18668 and 19183.
a Mexican corporation (e.g., from its U.S. real estate investment enterprises) to a 10 percent (and sometimes as low as 5 percent) tax on the "dividend equivalent amount." This U.S./Mexico Tax Treaty rate is significantly less than the non-treaty branch profits tax rate equal to 30 percent of the dividend equivalent amount of the foreign corporation for the taxable year.

Accordingly, Income Tax Treaties can provide unique planning opportunities for foreign corporate owners of U.S. real estate, provided a U.S. income tax treaty is applicable.

In summary, all foreign investors who are contemplating investing in U.S. real estate should carefully consider and plan the legal structure utilized for this U.S. investment because of the unique U.S. tax laws applicable. If not carefully planned, a foreign investor can unwittingly expose himself, herself or itself to unnecessary U.S. income tax, gift tax and/or estate tax, especially in light of the complicated U.S. real estate taxation regime of FIRPTA.
IV. Appendix B. California’s Standard Form CLTA Policy

 SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B AND THE CONDITIONS AND STIPULATIONS, COMMONWEALTH LAND TITLE INSURANCE COMPANY, a Pennsylvania corporation, herein called the Company, insures, as of Date of Policy shown in Schedule A, against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of:

1. Title to the estate or interest described in Schedule A being vested other than as stated therein;
2. Any defect in or lien or encumbrance on the title;
3. Unmarketability of the title;
4. Lack of a right of access to and from the land;
5. The invalidity or unenforceability of the lien of the insured mortgage upon the title;
6. The priority of any lien or encumbrance over the lien of the insured mortgage, said mortgage being shown in Schedule B in the order of its priority;
7. The invalidity or unenforceability of any assignment of the insured mortgage, provided the assignment is shown in Schedule B, or the failure of the assignment shown in Schedule B to vest title to the insured mortgage in the named insured assignee free and clear of all liens.

The Company will also pay the costs, attorneys' fees and expenses incurred in defense of the title or the lien of the insured mortgage, as insured, but only to the extent provided in the Conditions and Stipulations.

IN WITNESS WHEREOF, Commonwealth Land Title Insurance Company has caused its corporate name and seal to be hereunto affixed by its duly authorized officers, the Policy to become valid when countersigned on Schedule A by an authorized officer or agent of the Company.

Attest:  

By:

COMMONWEALTH LAND TITLE INSURANCE COMPANY

EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of:

1. Any law, ordinance or governmental regulation (including but not limited to building or zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating to (i) the occupancy, use, or enjoyment of the land; (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; (iii) a separation in ownership or a change in the dimensions or area of the land or any part of which the land is or was a part; or (iv) environmental protection, or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.
2. Any governmental police power not excluded by (a) above, except to the extent that a notice of the exercise thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.
3. Rights of eminent domain unless notice of the exercise thereof has been recorded in the public records at Date of Policy, but not excluding from coverage any taking which has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.
4. Defects, liens, encumbrances, adverse claims or other matters:
   (a) whether or not recorded in the public records at Date of Policy, but created, suffered, assumed or agreed to by the insured claimant;
   (b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under this policy;
   (c) resulting in no loss or damage to the insured claimant;
   (d) attaching or created subsequent to Date of Policy; or
   (e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the insured mortgage or for the estate or interest insured by this policy.
5. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.
6. Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.
11. PAYMENT OF LOSS.

(a) No payment will be made without producing this policy for endorsement of the payment unless the policy has been lost or destroyed, in which case proof of loss or destruction shall be furnished to the satisfaction of the Company.

(b) When liability and the extent of loss or damage have been finally fixed in accordance with these Conditions and Stipulations, the loss or damage shall be payable within 30 days thereafter.

12. SUBROGATION UPON PAYMENT OR SETTLEMENT.

(a) The Company's Right of Subrogation.

Whenever the Company shall have settled and paid a claim under this policy, all right of subrogation shall vest in the Company unaffected by any act of the insured claimant.

The Company shall be subrogated to and entitled to all rights and remedies which the insured claimant would have had against any person or property in respect to the claim had this policy not been issued. If requested by the Company, the insured claimant shall transfer to the Company all rights and remedies against any person or property necessary in order to perfect this right of subrogation. The insured claimant shall permit the Company to sue, compromise or settle in the name of the insured claimant and to use the name of the insured claimant in any transaction or litigation involving these rights or remedies.

If payment of an account on a claim does not fully cover the loss of the insured claimant, the Company shall be subrogated (a) as to an insured owner, to all rights and remedies in the proportion which the Company's payment bears to the whole amount of the loss, and (b) as to an insured lender, to all rights and remedies of the insured claimant except that the insured claimant shall have recovered its principal, interest, and costs of collection.

(b) The Company's Rights Against Non-Insured Dollars.

The Company's right of subrogation against non-insured dollars shall exist and shall include, without limitation, the rights of the insured to indemnities, guarantees, other policies of insurance or bonds, notwithstanding any terms or conditions contained in those instruments or policies or bonds applicable to the subrogation claims.

The Company's right of subrogation shall not be asserted by the holder of an insured mortgage by an action against an assignee described in Section 11(a) of these Conditions and Stipulations who acquires the insured mortgage as a result of an indemnity, guaranty, guarantee, or policy of insurance. Any payment or discharge of an insured mortgage under this policy, notwithstanding Section 11(a) of these Conditions and Stipulations.

13. ARBITRATION.

Unless prohibited by applicable law, either the Company or the insured may demand arbitration pursuant to the Title Insurance Arbitration Rules of the American Arbitration Association. Arbitration matters may include, but are not limited to, any controversy or claim between the Company and the insured arising out of or relating to this policy, any service of the Company in connection with its issuance or the breach of a policy provision or other obligation. All arbitrable matters when the Amount of Insurance is $1,000,000 or less shall be arbitrated at the option of either the Company or the insured. All arbitrable matters when the Amount of Insurance is greater than $1,000,000 shall be arbitrated at the option of the Company or the insured. The decision of the arbitrator in any such arbitration shall be final except as provided herein.

The parties may agree in writing that the arbitrator shall be selected by the parties.

The law of the situs of the land shall apply to any arbitration under the Title Insurance Agreement.

A copy of the Rules may be obtained from the Company upon request.

14. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT.

(a) This policy is limited to and in all respects only applies to an insured lender as such, as provided in Section 11(a) of these Conditions and Stipulations.

15. SEVERABILITY.

In the event any provision of the policy is held invalid or unenforceable under applicable law, the policy shall be deemed not to reduce that provision and all other provisions shall remain in full force and effect.

16. NOTICES WHERE SENT.

All notices required to be given to the Company and any statement in writing required to be furnished the Company shall include the number of this policy and shall be addressed to: Century Affairs Department, P.O. Box 27557, Richmond, Virginia 23227-7557.
V. Appendix C. California’s Standard Form CLA Policy Owner’s Policy of Title Insurance

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B AND THE CONDITIONS AND STIPULATIONS, COMMONWEALTH LAND TITLE INSURANCE COMPANY, a Pennsylvania corporation, herein called the Company, insures, as of Date of Policy shown in Schedule A, against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of:

1. Title to the estate or interest described in Schedule A being vested other than as stated therein.
2. Any defect in or lien on or encumbrance on the title;
3. Unmarketability of the title;
4. Lack of a right of access to and from the land.

The Company will also pay the costs, attorneys’ fees and expenses incurred in defense of the title, as insured, but only to the extent provided in the Conditions and Stipulations.

IN WITNESS WHEREOF, COMMONWEALTH LAND TITLE INSURANCE COMPANY has caused its corporate name and seal to be hereunto affixed by its duly authorized officers, the Policy to become valid when countersigned by an authorized officer or agent of the Company.

EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys’ fees or expenses which arise by reason of:

1. (a) Any law, ordinance or governmental regulation (including but not limited to building and zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating to (i) the occupancy, use, or enjoyment of the land; (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; (iii) a separation in ownership or a change in the dimensions or area of the land or any parcel of which the land is or was a part; or (iv) environmental protection, or the affect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.
   (b) Any governmental police power not excluded by (a) above, except to the extent that a notice of the exercise thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.
2. Rights of eminent domain unless notice of the exercise thereof has been recorded in the public records at Date of Policy, but not excluding from coverage any taking which has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.
3. Defects, liens, encumbrances, adverse claims or other matters:
   (a) created, suffered, assumed or agreed to by the insured claimant;
   (b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under this policy;
   (c) resulting in no loss or damage to the insured claimant;
   (d) attaching or created subsequent to Date of Policy;
   (e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the estate or interest insured by this policy.
4. Any claim, which arises out of the transaction vesting in the Insured the estate or interest insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors’ rights laws, that is based on:
   (a) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or
   (b) the transaction creating the estate or interest insured by this policy being deemed a preferential transfer except where the preferential transfer results from the failure:
      (i) to timely record the instrument of transfer; or
      (ii) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

Valid only if Schedules A and B and Cover are attached

ORIGINAL
1. DEFINITION OF TERMS.

The following terms when used in this policy mean:

(a) "insured": the insured named in Schedule A, and, subject to any rights hereunder that would have accrued to the insured those who succeed to the interest of the named insured by operation of law as distinguished from purchase, including, but not limited to, heirs, distributees, devisees, transferees, personal representatives, next of kin, or corporate or fiduciary successors.

(b) "insured claimant": an insured claiming loss or damage.

(c) "knowledge" or "known": actual knowledge, not constructive knowledge or notice which may be imputed to an insured by reason of the public records as defined in this policy or any other records which impart constructive notice of matters affecting the land.

(d) "land": the land described or referred to in Schedule A, and improvements affixed thereto which by law constitute real property. The term "land" does not include any property beyond the lines of the area described or referred to in Schedule A, nor any right, title, interest, estate or easement in abutting streets, roads, avenues, alleys, lanes, ways or waterways, but nothing herein shall modify or limit the extent to which a right of access to and from the land is insured by this policy.

(e) "mortgage": mortgage, deed of trust, trust deed, or other security instrument.

(f) "public records": records established under state statutes as Date of Policy in the county where the property is located. The term includes matters recorded in any real property for purchasers for value and without notice. With respect to Section 6 (i) of the Exclusions From Schedule B, "public records" shall also include environmental protection liens filed in the records of the clerk of the United States district court for the district in which the land is located.

(g) "unmarketability of the title": an alleged or apparent matter affecting the title to the land, not excluded or excepted from coverage, which would entitle a purchaser of the estate or interest described in Schedule A to be released from the obligation to purchase by virtue of a contractual condition or easement of marketability title.

2. CONTINUATION OF INSURANCE AFTER CONVEYANCE OF TITLE.

The coverage of this policy shall continue in force as of Date of Policy in favor of an insured so long as the insured retains an estate or interest in the land, or holds an indebtedness secured by a purchase money mortgage given by a purchaser from the insured, or only so long as the insured shall have liability by reason of covenants of warranty made by the insured in any transfer or conveyance of the estate or interest. This policy shall not continue in force in favor of any purchaser from the insured of either (i) an estate or interest in the land, or (ii) an indebtedness secured by a purchase money mortgage given to the insured.

3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT.

The insured shall notify the Company promptly in writing (i) in case of any litigation or dispute which is subject to the right of the insured to object for reasonable cause, or (ii) of any defect, lien or encumbrance or other matter insured against by this policy, or (iii) if the title to the estate or interest, as insured, is rejected as unmarketable, shall give the Company notice within 10 days of the rejection of the title. The Company shall have the right to require any party to file a proof of loss or damage under this policy, or any party to file a proof of loss or damage under any other insurance policy which may be required by the Company in order to prevent prejudice to the insured.

4. DEFENSE AND PROSECUTION OF ACTIONS; DUTY OF INSURED CLAIMANT TO COOPERATE.

(a) Upon written request by the insured and subject to the options contained in Section 6 of these Conditions and Stipulations, the Company, at its own cost and without unreasonable delay, shall provide for the defense of an insured in litigation in which any third party asserts a claim adverse to the title or interest as insured, but only as to those stated causes of action alleging a defect, lien or encumbrance or other matter insured against by this policy. The Company shall have the right to select counsel for the insured, subject to the right of the insured to object for reasonable cause, to represent the insured as to those stated causes of action and shall not be liable for and will not pay the fees of any other counsel. The Company may enter a general appearance for its own expense, or by the insured in the defense of those causes of action which affect matters not insured against by this policy.

(b) The Company shall have the right, at its own cost, to institute and prosecute any action or proceeding or to do any other act which in the opinion of any necessary or desirable to establish the title to the estate or interest, or to enforce any of the Company's other rights, or to compel the insured to perform any of the duties imposed upon him by this policy. The Company may take any appropriate action under the terms of this policy to prevent loss or damage to the property, and shall not thereby concede liability or waive any provision of this policy. If the Company shall exercise its rights under this paragraph, it shall do so diligently.

(c) Whenever the Company shall have brought an action or interpleaded a dispute as required by the provisions of this policy, the Company may pursue any litigation to final determination by a court of competent jurisdiction, and expressly reserve the right, in its sole discretion, to appeal from any adverse judgment or order.

(d) In all cases where this policy permits or requires the Company to procure or provide for the defense of any action or process, the insured shall secure to the Company the right to so prosecute or provide defense in the action or process, and all expenses, and permit the Company to use, at its option, the name of the insured for this purpose. Whenever requested by the Company, the insured, at the Company's expense, shall give the Company all reasonable and (ii) in any action or proceeding, securing evidence, obtaining witnesses, procuring or defending the action, or proceeding, negotiating settlements, and (iii) any other lawful act which in the opinion of the Company may be necessary or desirable to establish the title to the estate or interest as insured. If the Company is prejudiced by the failure of the insured to furnish the required cooperation, the Company's obligations in the insured under the policy shall be suspended or terminated, unless the insured shall, within 60 days after notice of the Company's prejudice, in the opinion of the Company, take such action as is necessary to remove the prejudice, and at the request of the Company, in the Company's reasonable judgment, furnish to the Company all information necessary to the enforcement of the title or interest as insured.

5. PROOF OF LOSS OR DAMAGE.

In addition to and after the notices required under Section 3 of these Conditions and Stipulations have been provided the Company, a proof of loss or damage shall be tendered to or sworn to by the insured claimant shall be furnished to the Company within 90 days after the insured claimant ascertained the facts giving rise to the loss or damage. The proof of loss or damage shall describe the place of loss or damage in such reasonable detail as the Company may require, and shall state, in the Company's reasonable judgment, the amount of the loss or damage, the Company is prejudiced by the failure of the insured claimant to perform any required acts, and (ii) any other act which in the opinion of the Company may be necessary or desirable to establish the title to the estate or interest as insured. If the Company should be prejudiced by the insured claimant's failure to furnish the required cooperation, the Company's obligations in the insured under the policy shall be suspended or terminated, unless the insured shall, by the proof of loss or damage, within 60 days after notice of the Company's prejudice, in the opinion of the Company, furnish to the Company for examination and inspection, evidence of the amount of the loss or damage, which evidence must be satisfactory to the Company. If the Company, in the opinion of the Company, is prejudiced by the failure of the insured claimant to render the information required of the insured, by the proof of loss or damage, the Company, in the opinion of the Company, may extend the period of time allowed for the furnishing of the information.

6. OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY.

In case of a claim under this policy, the Company shall have the following additional options:

(a) To Pay or Tender Payment of the Amount of Insurance.

(b) With the Insured Claimant.

(c) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(d) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(e) Upon the exercise of the options of the Company, all liability and obligations to the insured under this policy, other than to make the payment required, shall terminate, including any liability or obligations to defend, prosecute, or continue any litigation, and the policy shall be surrendered to the Company for cancellation.

Upon the exercise of the options of the Company, all liability and obligations to the insured under this policy, other than to make the payment required, shall terminate, including any liability or obligations to defend, prosecute, or continue any litigation, and the policy shall be surrendered to the Company for cancellation.

(f) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(g) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(h) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(i) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(j) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(k) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(l) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(m) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(n) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(o) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(p) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(q) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(r) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(s) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(t) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(u) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(v) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(w) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(x) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(y) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(z) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.
7. DETERMINATION, EXTENT OF LIABILITY AND COINSURANCE.

This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the insured claimant who has suffered loss or damage by reason of matters insured against by this policy and only to the extent herein described:

(a) The liability of the Company under this policy shall not exceed the least of:

(i) the Amount of Insurance stated in Schedule A; or,
(ii) the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect, lien or encumbrance insured against by this policy.

(b) In the event the Amount of Insurance stated in Schedule A at the Date of Insurer is less than 80 percent of the value of the insured estate or interest at the time of determination the payment under this policy shall be reduced.

(c) In the event the Amount of Insurance stated in Schedule A is less than 50 percent of the value of the insured estate or interest at the time of determination the payment under this policy shall be further reduced as provided in paragraphs (i) and (ii). This policy shall be subject to the following:

(i) where no subsequent improvement has been made, as to any partial loss, the Company shall only pay the loss pro rata in the proportion that the amount of insurance at Date of Policy bears to the total value of the insured estate or interest at Date of Policy; or,

(ii) where a subsequent improvement has been made, as to any partial loss, the Company shall only pay the loss pro rata in the proportion that 120 percent of the Amount of Insurance stated in Schedule A bears to the sum of the Amount of Insurance stated in Schedule A and the amount expended for the improvement.

8. APPOINTMENT.

If the land described in Schedule A consists of two or more parcels which are not used as a single site and a loss is established affecting one or more of the parcels but not all, the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to any partial losses which exceed, in the aggregate, 10 percent of the Amount of Insurance stated in Schedule A.

(c) The Company will pay only those costs, attorneys' fees and expenses incurred in accordance with Section 4 of these Conditions and Stipulations.

9. LIMITATION OF LIABILITY.

(a) If the Company establishes the title, or removes the alleged defect, lien or encumbrance, or cures the lack of a right of access to or from the land, or cures the claim of unmarketability of title, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

(b) If the event of any litigation, including litigation by the Company or by the insured, the Company shall have no liability for loss or damage unless there has been a final determination by a court of competent jurisdiction, and disposition of all appeals therefrom, adverse to the title as insured.

c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the insured in settling any claim or suit prior to the written consent of the Company.

10. REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY.

All payments under this policy, except payments made for costs, attorneys' fees and expenses, shall reduce the amount of the insurance thereon.

11. LIABILITY NONCUMULATIVE.

It is expressly understood that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge on the estate or interest described in Schedule A, and the amount so paid shall be deemed a payment under this policy to the insured owner.

12. PAYMENT OF LOSS.

(a) No payment shall be made without producing this policy for endorsement of the payment unless the policy has been lost or destroyed, in which case proof of loss or destruction shall be furnished to the satisfaction of the Company.

(b) When liability and the extent of loss or damage has been finally fixed by action or agreement, these Conditions and Stipulations, the loss or damage shall be payable within 30 days thereafter.

13. SUBROGATION UPON PAYMENT OR SETTLEMENT.

(a) The Company's Right of Subrogation.

Whenever the Company shall have settled and paid a claim under this policy, all right of subrogation shall vest in the Company unaffected by any act of the insured claimant.

(b) If the Company establishes the title, or removes the alleged defect, lien or encumbrance, or cures the lack of a right of access to or from the land, or cures the claim of unmarketability of title, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

(c) If the event of any litigation, including litigation by the Company or by the insured, the Company shall have no liability for loss or damage unless there has been a final determination by a court of competent jurisdiction, and disposition of all appeals therefrom, adverse to the title as insured.

c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the insured in settling any claim or suit prior to the written consent of the Company.

14. ARBITRATION.

Unless prohibited by applicable law, either the Company or the insured may demand arbitration pursuant to the Title Insurance Arbitration Rules of the American Arbitration Association. Arbitrable matters may include, but are not limited to, any controversy or claim between the Company and the insured arising out of or relating to this policy, any service of the Company in connection with its issuance or the breach of a policy provision or other obligation. All arbitrable matters when the Amount of Insurance is $1,000,000 or less shall be arbitrated as the option of either the Company or the insured. All arbitrable matters when the Amount of Insurance is in excess of $1,000,000 shall be arbitrated only when agreed to by both the Company and the insured. Arbitration pursuant to this policy and under the Rules in effect on the date the demand for arbitration is made at the option of the insured, the Rules in effect at Date of Policy shall be binding upon the parties. The award may include attorneys' fees only if the laws of the state in which the land is located permit a court to award attorneys' fees. A provision of the award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof.

The law of the situs of the land shall apply to an arbitration under the Title Insurance Arbitration Rules. A copy of the Rules may be obtained from the Company upon request.

15. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT.

(a) This policy together with all endorsements, if any, attached hereto by the Company is the entire policy and contract between the insured and the Company. In interpreting any provision of this policy, this policy shall be construed as a whole.

(b) Any claim of loss or damage, whether or not based on negligence, and which arises out of the status of the title to the estate or interest covered hereby or by any action asserting such claim, shall be reduced to this policy.

(c) No amendment of or endorsement to this policy can be made except by a writing endorsed hereon or attached hereto agreed to by either the President, a Vice President, the Secretary, an Assistant Secretary, or validating officer of a duly authorized signature of the Company.

16. SEVERABILITY.

In the event any provision of the policy is held invalid or unenforceable under applicable law, the policy shall be deemed not to include that provision and all other provisions shall remain in full force and effect.

17. NOTICES, WHERE SENT.

All notices required to be given the Company and any summons in writing required to be served on the Company shall be given to: Consumer Affairs Department. P.O. Box 27567, Richmond, Virginia 23261-7567.
VI. Appendix D. Application for Title Insurance on Mexico Land

LAWYERS TITLE INSURANCE CORPORATION

APPLICATION FOR TITLE INSURANCE ON MEXICO LAND

The following information and title documents are requested to process your application.

1. Copies of the following documents, standard for real property sales in Mexico, which can be supplied by the Seller and/or your Mexican attorney.
   - Property's current deed of title or conveyance (Escritura) filed with local Public Registry of Property (Registro Publico de Propiedad).
   - Certificate of Freedom of Liens and Encumbrances (Certificado de Libertad de Gravamenes) no older than 90 days issued by the corresponding Public Registry of Property (Registro Publico de la Propiedad).
   - Property tax and water payment receipts for the past 5 years, if available.
   - Property survey (if survey coverage is requested)

2. Name, Address, Telephone & Fax Numbers, and Contact for Proposed Insured(s):
   - Proposed Insured: ________________________________
   - Contact: _______________________________________
   - Address: ________________________________________
   - Phone: _________________________________________
   - Fax: ___________________________________________

3. Name, Address, Telephone & Fax Numbers, and Contact of attorney representing the Proposed Insured in the transaction:
   - Law firm: _______________________________________
   - Attorney: _______________________________________
   - Address: _______________________________________
   - Phone: _________________________________________
   - Fax: ___________________________________________

4. Name, Address, Telephone & Fax Numbers for current owner of property:
   - Name: _________________________________________
   - Contact: _______________________________________
   - Address: _______________________________________
   - Phone: _________________________________________
   - Fax: ___________________________________________
5. Description, size, location and use of the Real Property to be insured:
   Legal Description or address: ________________________________
   City/State in Mexico: ________________________________
   Use of the Real Property: ________________________________
   Size: ________________________________

6. Please briefly describe the proposed transaction, estate/interest to be insured, and whether the Real property will be purchased directly or through a stock purchase of a controlling entity.
   Type of transaction: ________________________________
   Estate to be insured: ________________________________
   Purchase of real property or stock: ________________________________

7. Is the Real Property currently held in a trust (fideicomiso)? If so, please provide Trustee's and Beneficiary's name and address.
   Trustee: ________________________________
   Address: ________________________________
   Phone: ________________________________
   Fax: ________________________________

   Beneficiary: ________________________________
   Address: ________________________________
   Phone: ________________________________
   Fax: ________________________________

8. When and where is the contemplated transaction scheduled to be completed? What is the title commitment due date?
   Location of closing: ________________________________
   Closing date: ________________________________
   Title Commitment due date: ________________________________

9. Policy(ies) requested (Please mark all that apply): US ____ Mexican ____
    Owner ____ Loan ____

10. Amount of Policy(ies):
    Owner: $ _____________
    Loan: $ _____________
11. Currency for Policy(ies): (Please mark the applicable selection which will determine the currency for the premium and any claims paid during the life of the policy).

   ____ US Dollars   ____ Mexican Pesos

12. Additional coverages requested by express agreement between the parties, and payment of an additional premium(s):

   ____ Direct Access in the U.S. (no charge)
   ____ Foreign ownership limitations
   ____ Metes and bounds (survey in a form acceptable to insurance company, not older than six months is required)
   ____ Other (please specify)

13. Special notes and/or instructions:

14. Applicant affirms that it has no knowledge of any adverse claim or disputes concerning the title other than matters which appear in the Public Registry of Property ("Registro Publico de Propiedad").

APPLICATION PLACED BY:

Signature: __________________________ Date: ______________

Print Name: __________________________ Title: ______________

Company: __________________________ Telephone #: ___________
Address: __________________________ Fax #: ________________
Email: __________________________

*RECEIPT OF THIS ORDER APPLICATION IS NOT A COMMITMENT OR CONTRACT TO ISSUE THE POLICY(IES) REQUESTED. It is merely the initial process by which the Company may make its own internal determination of insurability.

Please return this application to:

LAWYERS TITLE INSURANCE CORPORATION
Attn: Shirley A. Fryman
7557 Rambler Road, Suite 1200
Dallas, Texas 75231
214-346-7251
214-346-7253 FAX
sfryman@landam.com