



PLANNING FOR THE HNW DUAL-CITIZEN (U.S. – MEXICO) CLIENT

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AGENDA

- A. Working with the HNW Mexican Family**
- B. Preliminary Issues and Concepts**
 - 1) Mexico's concept of Tax Residency**
 - 2) Mexico's taxation of inheritances and gifts**
 - 3) Mexico's taxation of non residents**
- C. Trusts and Fideicomisos**
 - 1) U.S. Trust: Definition and its different modalities from a Mexican international tax perspective**
 - 2) Mexican Fideicomiso: Definition and its different modalities from a Mexican domestic perspective from a U.S. international tax perspective**
 - 3) Example of use of Trusts and Fideicomisos in Crossborder Planning Structures**

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Typical Client Scenarios when Working with HNW Mexican Families

- Some key common characteristics of Mexican HNW clients:
 - Sophisticated and accustomed to high standards of living
 - Close-knit family environments
 - Loyal to trusted advisors
 - Well connected
 - “Six (three?) degrees of separation”
 - Value confidentiality and quality service over efficiency
 - Not very sophisticated or educated with regard to personal financial and wealth planning affairs
 - Traditionally keep assets off-shore primarily as defensive wealth preservation strategies
 - Hard rooted to local community –social and family circles. Not likely to emigrate

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Typical Client Scenarios when Working with HNW Mexican Families

- Typical composition of HNW Mexican families:
 - 1G, 2G and 3G Mexican citizens and residents
 - 1G Mexican citizen and resident, 2G and 3G dual citizens, Mex and/or US residents
 - 1G with one USC, 2G USC
 - 1G US residents and 2G USC or US residents (immigrated family)

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Current Issues Affecting HNW Mexican Families

- Domestically:
 - Personal safety/Confidentiality
 - New “leftist” political regime perceived as a threat to private property and investment
 - Peso depreciation
 - Potential Inheritance/estate and gift tax
- Internationally:
 - Confidentiality
 - Estate Taxes
 - Complex probate procedures
 - Adverse US political climate against Mexicans
 - Complex probate procedures

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Common and Current Planning Strategies

- Top 5 common planning objectives:
 1. Confidentiality
 2. US Estate Tax protection
 3. Succession Planning
 4. Asset protection
 5. Mexican income tax efficiency
- ❖ Planning against potential Mexican estate/inheritance tax is starting to be a priority.

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Common and Current Planning Strategies

- Planning Structures and Strategies for Financial Assets
 1. Confidentiality
 2. US Estate Tax protection
 3. Succession Planning
 4. Asset protection
 5. Mexican income tax efficiency
- ❖ Planning against potential Mexican estate tax is starting to be a priority.

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Common and Current Planning Strategies

- Estate Planning for Mexican assets:
 - Traditionally:
 - Will / Notary led probate
 - Full and partial (nude property/remainder interest) gifts
 - Limited use of trusts and Fideicomisos
 - Currently (specially because of potential Tax on inheritances):
 - Full and partial (nude property/remainder interest) gifts
 - Mexican Fideicomisos (with completed gift of property)
 - Limited use of US and other CL jurisdiction (UK, NZ, Bahamas, Jersey) trusts

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Special Planning Issues for Dual Citizens

- Use of Mexican Fideicomiso:
 - US reporting requirements (3520, 8938, FBAR, etc.)
 - Throw back tax exposure
 - Possible US estate tax exposure
 - Limited duration
 - Definition and determination of Income for US tax purposes

- Use of US Trusts:
 - Alignment of taxpayer for both US and Mexican tax purposes to avoid double taxation
 - Funding of special Mexican assets (e.g., Real Estate)
 - Avoiding foreign trust status or trust inadvertently converting from domestic to foreign (e.g., structure of Protector committees)
 - Mexican special tax reporting
 - Additional Mexican tax on certain aspects of Mexican source income (e.g., dividends, rents)

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Cultural Aspects to Consider when Working with Mexican HNW Clients

- Express how important confidentiality is from day one
- Invest time and resources building the relationship
- Do not assume financial and tax literacy
- Take Apples and Pears approach when explaining concepts
- Try to provide Spanish translations of key documents (summaries are also great)
- Don't try to speak Spanish if you are not fluent
- Look them in the eye
- Take them out to lunch (1pm the earliest) or dinner (7pm the earliest), couple of hours and wine likely
- Try to visit them
- Hugs and kisses (on the cheek, only one) are ok
- Little gifts (e.g., chocolates, corporate items) are very appreciated

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Preliminary Issues and Concepts – Mexican Tax Residency

- Mexican Tax Residents are taxed on world wide income
- Mexican Tax Residency is based on facts and circumstances:
 - Taxpayer’s primary home
 - Taxpayer’s center of vital interest: majority of income and economic activities
 - US- Mexico Tax Treaty Article 4 Tie Braker applies
 - Mexican nationals are presumed tax residents
 - Notice of termination of residency- No annual tax return required

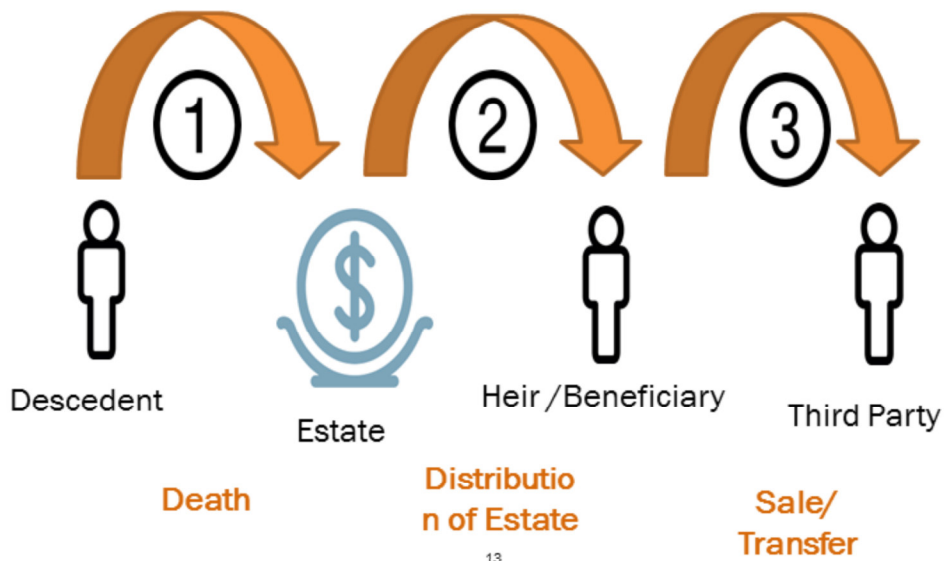
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Preliminary Issues and Concepts – Mexican Taxation of Inheritances and Gifts

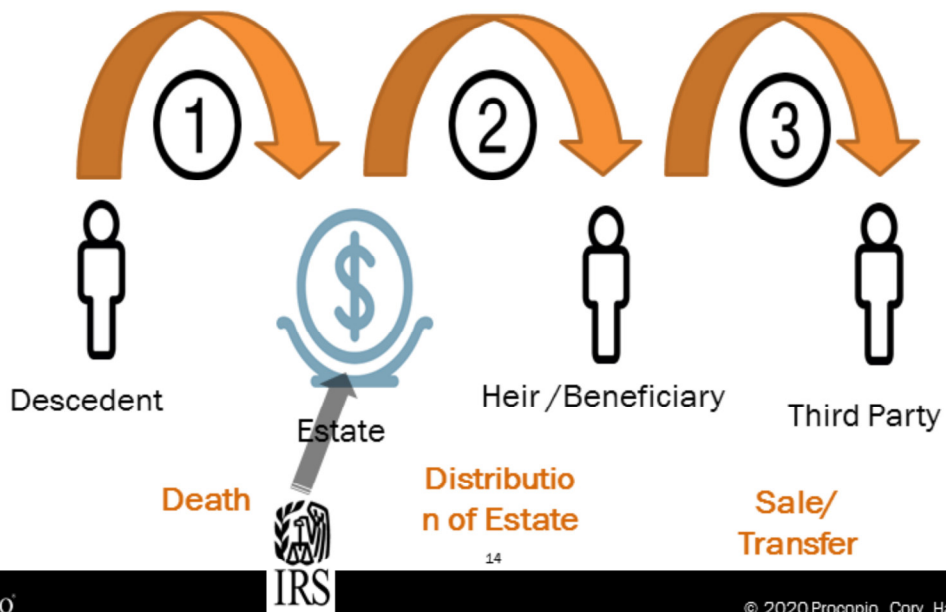
- Mexico does not have an estate tax
- Inheritance and bequests are not taxable to recipient regardless of relationships
 - Except if **Non Resident** heir and property is **Mexican Real Estate** or **Shares of Mexican Company** or Company owning Mexican Real Estate
 - Carry over basis
- Gifts are generally taxable as income to the donee except among ascendants – descendants and among spouses
 - Gifts to **Non Residents** are exempt with the exception of Gifts of Mexican Real Estate or Shares of Mexican companies to donees who are not descendants or a spouse of the donor
 - Carry over basis


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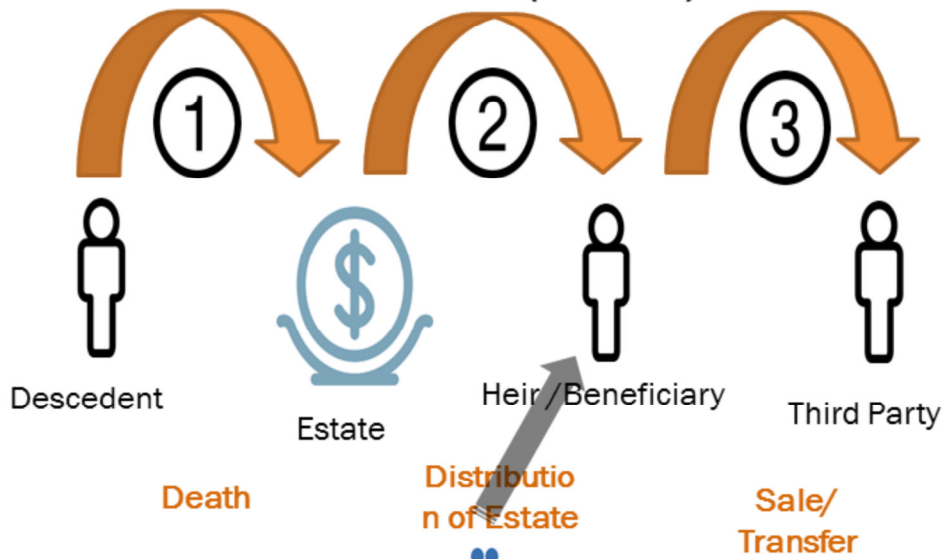
Transfer of Assets upon Death



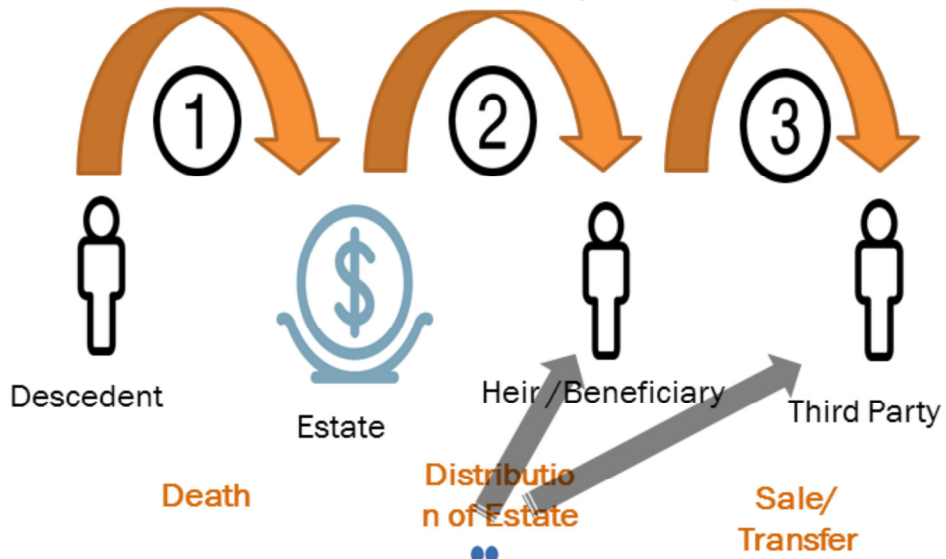
Estate Tax



 **Income Taxation of Inheritances MX**
-Residents (current)



Income Taxation of Inheritances MX - Non Residents (current)



Mexican Tax Treatment of a U.S. Trust

Pre 2020:

- Until 2019, U.S. Trusts and income derived by Mexican tax residents through a U.S. Trust were generally subject to anti deferral rules (REFIPRES) under Title VI of the Mexican Income Tax Law (MITL)
- Tax was calculated under a schedular system and taxed at a flat 30% rate
- Timing of taxation was generally tied to control of beneficiary or related parties with regard to the distribution of trust income: potential for deferral.
- Trusts were generally considered transparent but definition of transparency had flaws that could potentially not apply to U.S. Trusts (e.g., a grantor trust where income is attributed not to beneficiaries but to the grantor).
- Generally considered different from fideicomisos and therefore the non recognition rules of Article 14 of the Mexican Tax Code would not apply.

Mexican Tax Treatment of a U.S. Trust

New treatment per 2019 Mexican Tax Reform:

- During the last part of 2019, Mexico enacted a mayor tax reform with important International effects.
- Legislative process includes references to Trusts comparing them to fideicomisos which provides support that references by the tax law (e.g., the non recognition provisions under Article 14 of the Mexican Tax Code) to fideicomisos should be extended to include Trusts.
- Two new articles were introduced into the MITL that pertain to Mexican taxation of Trusts. Articles 4A and 4B

Mexican Tax Treatment of a U.S. Trust

- **Article 4A:**
 - Effective as of 1/1/2021
 - Mexican sourced payments to Trusts will be considered as if paid to a foreign non-transparent entity (Title V of the MITL withholding rules would apply)
 - Trust that are managed on a day to day basis within Mexico will be considered as Mexican resident corporation (worldwide income @30%)
 - Application of U.S. – Mexico Tax Treaty rules (when available) prevail. (e.g., MAP on Transparent entities).

Mexican Tax Treatment of a U.S. Trust

New treatment per 2019 Mexican Tax Reform:

- **Article 4B:**
 - Effective as of 1/1/2020
 - Trusts are generally “disregarded” for Mexican tax purposes and Mexican resident beneficiaries are taxed as if directly deriving the income of the Trust, regardless of actual distribution and contingency.
 - Income is taxed at regular tax rates applicable to type of income:
 - For Individuals: ordinary income @35%, capital gains of listed securities @10%, dividend from Mx Corps @5%
 - For entities: 30% corporate rate
 - Tax Credit available for both domestic and foreign taxes.

Mexican Fideicomiso

- Mexican legislator was initially inspired by U.S. Trust concept ((*Fideicomiso, naturaleza del*”, *Sala Auxiliar, Séptima Época, Semanario Judicial de la Federación*)).
- “Legal Definition”: Article 381 of the General Law of Securities and Credit Operations: “by virtue of the *fideicomiso*, the *fideicomitente* transmits to a fiduciary institution the property or title to one or more goods or rights to be destined to licit and determined purposes, providing the institutional trustee with a mandate thereof.
 - Generally regarded as a contract
 - *Fiduciario* has limited liability when acting in good faith
 - Only financial institutions (mainly banks) can act as *fiduciario*.

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Mexican Fideicomiso

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Mexican Fideicomiso

Common types of Fideicomisos:

- **Business Fideicomiso** (Fideicomiso Empresarial): regulated by Article 13 of the MITL).
 - Used to carry on trade or business activities
 - Semi – transparent for Mexican tax purposes as it flows through income but limits flow through of losses
 - Likely a “foreign partnership” for U.S. tax purposes, in some cases could be classified as a “foreign corporation” depending on the language of the fideicomiso as it relates to liability of beneficiaries

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Mexican Fideicomiso

Common types of Fideicomisos:

- **Guaranty Fideicomiso** (Fideicomiso de Garantía):
 - Similar to a “deed of trust” or “escrow agreement” where the property is used to guarantee an obligation of the creator (fideicomitente) in favor of the beneficiary. (e.g., sometimes used in lieu of a mortgage or a pledge)
 - Since generally the fideicomitente has a right of reversión, it is generally transparent to the fideicomiente (similar to a “grantor trust”)
 - Likely a “trust” for U.S. tax purposes

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Mexican Fideicomiso

Common types of Fideicomisos:

- **Testamentary Fideicomiso (Fideicomiso Testamentario):**
 - Primarily used to avoid probate but recently popular to shield against a potential "inheritance", "estate" or "wealth" tax.
 - If revocable, taxed to fideicomitente.
 - If irrevocable, may be deemed an exempt gift to beneficiaries who are the spouse or descendants of fideicomitente. Income flows through to beneficiaries.
 - Likely a "foreign trust" for U.S. tax purposes. Need to review fideicomiso in detail to determine if it should be treated as a grantor or non grantor trust.

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Mexican Fideicomiso

Common types of Fideicomisos:

- **Control Fideicomiso** (Fideicomiso de Control):
 - Primarily used to establish shareholder type agreements and/or succession mechanisms (or both).
 - If revocable, generally taxed to fideicomitente.
 - If irrevocable, it may be deemed an exempt gift to beneficiaries who are the spouse or descendants of fideicomitente. Income flows through to beneficiaries.
 - Likely a “foreign trust” for U.S. tax purposes but depending on the business terms of the fideicomiso, it may be classified as either a “foreign partnership” or even a “foreign corporation” for U.S. tax purposes.

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Mexican Fideicomiso

Common types of Fideicomisos:

- **Restricted Zone Fideicomiso** (Fideicomiso de Zona Reestringida):
 - Also known as “Mexican Land Trust (MLT)”
 - Used to hold title to real estate in the Mexican coastal and border zones by non mexican investors who are restricted to holding it in fee simple by the Mexican constitución.
 - They are generally irrevocable and income (e.g., rental income and capital gains) is taxed at the beneficiary level.
 - In 2012 the IRS issued PLR 201245003 where it concluded that because a MLT only holds title to the property and transfer the title at the direction of the beneficiary, it should not be considered a “trust” for U.S. tax purposes.

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Trust

- Treas. Reg. § 301.7701-4(a)
 - “an **arrangement**
 - created either by a will or by an inter vivos declaration
 - whereby **trustees** take title to property
 - for the purpose of protecting or conserving it for the beneficiaries
 - under the ordinary rules applied in chancery or probate courts. ...
- Generally speaking, an arrangement will be treated as a trust ... if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who ... are not associates in a joint enterprise for the conduct of business for profit.”

Business Entity

- **Business Entity**: “is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner ...) that is not properly classified as a trust”. Treas. Reg. § 301.7701-2(a).

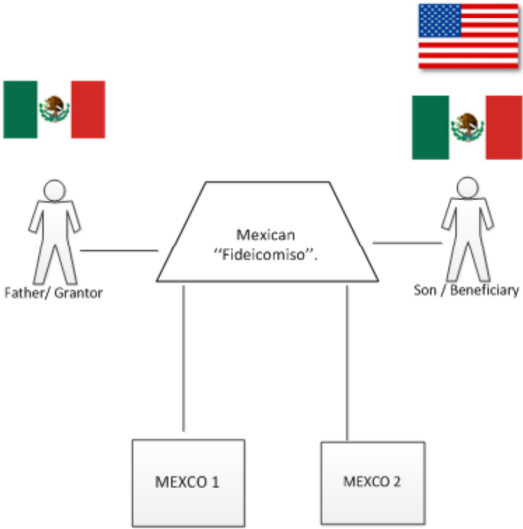
Trust v. Business Entity

- **Business Trust:** Treas. Reg. § 301.7701-4(b).
 - “generally are created by the beneficiaries
 - simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships
 - However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership.”

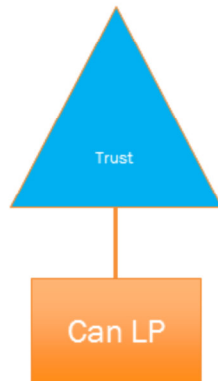
Trust v. Business Entity

- **PLR 200302005.**- Stiftung classified as a trust.
- **TAM 2009-012.**- Liechtenstein Anstalt classified as a business entity; Liechtenstein Stiftung classified as trust.
- **Rev. Rul. 2013-14.**- Mexican *fideicomiso* for holding real property in restricted zone classified as agency agreement (no Form 3520).

U.S. Person as beneficiary of Foreign Trust



Case Study (1) - Structure based on FLFs

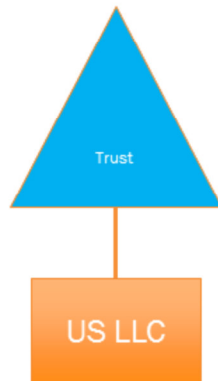


Assumption: Not managed in Mexico

- Fully Transparent for Mexican tax purposes
- Income and Expenses flow to Mex Resident Beneficiary
 - Problem with deductions
 - Currency exchange gains on year end accrual basis
- Access to “special” regimes
 - 10% tax on Capital Gains (Bolsa)
 - Credit of Mx Corporate Tax
 - FTC
 - 35% top marginal rate

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Case Study (2) - Structure based on FLF and FTE

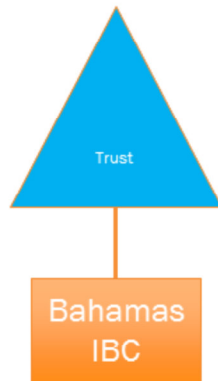


Assumption: Not managed in Mexico

- Fully Transparent for Mexican tax purposes
- Income and Expenses flow to Mex Resident Beneficiary as Net Income from LLC
 - 10% tax on dividends? Not clear
 - Currency exchange gains on year end accrual basis
- No Access to “special” regimes
- FTC
- 35% top marginal rate

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Case Study (2) - Structure based on FLF and CFC



Assumption: Not managed in Mexico

- Fully Transparent for Mexican tax purposes
- CFC rules apply. Control? Active business?
- Income and Expenses flow to Mex Resident Beneficiary as Net Income from IBC
- 10% tax on dividends
- No Currency exchange gains (functional currency)
- No Access to "special" regimes
- FTC
- 45% top marginal rate

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