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Real Estate

Mexico

Law and Practice

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1. General

1.1 Main Sources of Law

Mexico is composed of 31 states and Mexico City. The Federal Constitution enumerates the matters in which the federal Congress is authorised to make laws. The matters not expressly delegated to the Congress are deemed as reserved to each state. The law applicable to real estate and its ownership is that of the place where the real estate is located.

In combinations involving corporations (ie, mergers, purchase of shares) or trusts, typically the General Law of Commercial Companies, the Commercial Code and, in some cases, the Stock Market Law are applicable, and the parties are free to choose the court with subject-matter jurisdiction.

In general terms, the main laws applicable to real estate transactions, depending on the value and nature of the transaction, are:

- the Constitution;
- the Civil Code and tax laws of the relevant state where the real estate is located;
- the Income Tax Law;
- the Value Added Tax Law;
- the Foreign Investment Law;
- the General Law of Commercial Companies;
- the Stock Market Law;
- the General Law of Ecological Balance and Environmental Protection;
- the General Law of Securities and Credit Transactions; and
- the Federal Antitrust Law.

1.2 Main Market Trends and Deals

During the last 12 months, the main trends in the real estate market in Mexico have been the purchase and sale of assets by private equity funds and FIBRAs (REITs) and the arrival of new domestic and foreign investors to the market. Nowadays, a climate of certainty is beginning to permeate the country as a result of the entering into force of the trade agreement between Mexico, the USA and Canada (T-MEC). To date, it is estimated that tourism projects under way in the country exceed 2,700, with an approximate value of USD15 billion.

During this period, the most significant deals have been (i) the acquisition by Fibra Uno, in association with the Walton Street Capital investment fund, of a portfolio of 74 industrial buildings developed by Finsa for USD841 million; (ii) the acquisition of land in the Sea of Cortes for USD280 million (paid for with the Amero cryptocurrency); (iii) the purchase by Fibra Mty of a portfolio consisting of an urban development known as “Distrito La Perla” in Jalisco for a total of USD100.48 million; and (iv) the allocation by FIBRA Macquarie Mexico of USD22

million for the construction of properties, expansions and renovations in its portfolio.

On the other hand, Wyndham Hotels has announced its expansion plan to reach 100 establishments, which will involve an investment of between USD150 and USD200 million; Nestlé will invest USD700 million to modernise its 17 factories in Mexico; and Fibra Prologis announced that it will acquire ten properties for MXN8,300 million in Mexico City, Monterrey and Ciudad Juarez.

1.3 Impact of Disruptive Technologies

New technologies have impacted all business sectors in Mexico and the real estate industry is no exception.

Investors in the sector have found new ways to invest thanks to the use of blockchain technology, decentralised finance (DeFi) and proptech that have allowed the expansion of potential acquisition portfolios, and the creation of marketplaces where fractions of properties are acquired and even mortgage debt is fragmented. Furthermore, blockchain technology has been acknowledged by the real estate industry because it brings transparency to transactions, reducing risks and processing times. The real estate sector has even acknowledged the potential of the blockchain technology to eliminate unnecessary costs for the acquirers in the not too distant future, such as expenses to obtain no liens certificates, formalisations before notaries public and registration on public property registries. The implementation of smart contracts and the strengthening of electronic commerce in the country has also had an effect on the way of doing business in the sector.

Lenders specifically have benefited from the implementation of new technologies through risk assessment allowing algorithmic processes and data analysis, while in the construction and development sector, contech has benefited the players through the introduction of collaborative software, improvements in financial management and, in general, reducing construction costs and making processes more efficient.

Considering that in March 2018 the Law to Regulate Financial Technology Institutions, also known as the Fintech Law, was published in Mexico, which gives these types of technologies a legal framework, and that on January 22nd the Mexican National Banking and Securities Commission (CNBV) granted the first authorisation for a financial technology company (specifically an electronic payment fund institution) to start operating in terms of the law, an increase in the number of technology companies that will seek to enter the market is to be expected, including the real estate market; however, the authors do not expect, within the next 12 months, a significant change in the

way of doing business in the sector derived from the use of these technologies.

1.4 Proposals for Reform

As of today, there are no reform proposals or initiatives that could significantly impact real estate investment, ownership or development in Mexico.

2. Sale and Purchase

2.1 Categories of Property Rights

The Mexican Civil Codes provide several property rights to be acquired: full ownership, usufruct (which is the real and temporary right to enjoy the property of others and, therefore, grants the right to receive all the fruits, whether natural, industrial or civil, produced by the property) and other minor rights can also be acquired, such as use or certain easements. Furthermore, it is possible to enjoy any of the aforementioned rights through a trust as beneficiary.

Another type of property provided in terms of the provisions of Article 27 of the Constitution and the Agrarian Law in Mexico is the *ejidal* property, which is subject to a special regime.

2.2 Laws Applicable to Transfer of Title

The law applicable to transfer of title, if the transfer is considered as a commercial act by the Commercial Code, is the Civil Code of the relevant state where the real estate is located. If at least one of the parties is a merchant (including real estates for industrial purposes, offices, retail and hotels), the applicable law would be the Commercial Code and the Civil Code of the relevant state where the real estate is located.

In combinations involving corporations (ie, mergers, purchase of shares) or trusts, the laws applicable to transfer of title are the Commercial Code, the General Law of Commercial Companies, the Stock Market Law and the General Law of Securities and Credit Transactions.

For the transfer of title of agrarian property, the applicable law would be the Agrarian Law.

2.3 Effecting Lawful and Proper Transfer of Title

In Mexico, the legal forms of acquiring property are usucapion, accession, succession by cause of death and by transfer, whether onerous (such as a sale and purchase agreement) or gratuitous (such as a donation agreement). The most common way to acquire property is by entering one of the following acts.

- A sale and purchase agreement in terms of the provisions of Article 2248 of the Civil Code for Mexico City, pursuant to

which there is a sale and purchase agreement when one of the contracting parties agrees to transfer the ownership of a thing or a right, and the other in turn agrees to pay a certain price in money for it.

- A trust agreement in terms of the provisions of Article 381 of the General Law of Securities and Credit Transactions, pursuant to which, by virtue of a trust, the trustor transfers to a trust institution (trustee) the property or ownership of one or more goods or rights, as the case may be, to be used for lawful and determined purposes, entrusting the realisation of such purposes to the trust institution itself. If an administration trust is executed, the trustee would keep the ownership of the good or right and the beneficiary would be considered as the holder of the trust rights.
- Other combinations involving corporations (mergers or purchase of shares).

All transfers of title of real estate in Mexico are registered in the Public Registry of Property of the state where the real estate is located.

Protection of bad title is usually included in the purchase agreement as an indemnity. Although title insurance is available in Mexico, it is not common to purchase insurance to cover contractual liability as a result of breaches of the seller's representations and warranties in an acquisition agreement. Typically, the indemnity is backed by an escrow holdback, a price adjustment or a combination of the two.

2.4 Real Estate Due Diligence

Buyers usually carry out real estate due diligence through their legal advisers. The matters usually involved in real estate due diligence are as follows.

- Ownership – to be performed by attorneys. Encumbrances on the real estate (including liens and some litigation aspects) may be identified through the Public Registry of Property where the real estate is located. A real estate folio will be requested from the above-mentioned registry for this purpose. It is also advisable to request evidence of the payment of real estate taxes and utilities for the past five years. In certain cases, a search must be conducted to determine the possible existence of agrarian problems. In the case of agrarian properties there are other aspects to be reviewed, such as the records of the property in the Agrarian Registry.
- Corporate – to be performed by attorneys. Liens on the company (such as bankruptcy) may be identified through the Public Registry of Commerce of the area where the company is located. A commercial folio will be requested from the Public Registry of Commerce for this purpose.
- Agreements – to be performed by attorneys. The scope of the review of agreements in the context of a real estate

business combination (ie, merger, purchase of shares) varies depending on the structure of the transaction. Assuming the transaction is the direct purchase of a real estate, the review should cover at least the last sale-purchase agreement that transferred the property of the real estate and the chain of title; any agreement that may affect the property, such as lease and sublease agreements, and commodatum, usufruct and easements; federal zone concessions; credit agreements, if the real estate is subject to a mortgage or any encumbrance on the property; agreements regarding services, maintenance, repair or supply of assets or utilities; franchise agreements; insurance policies; and management, and licence and operation agreements.

- Environmental – to be performed by attorneys and environmental specialists for Phases I and II.
- Tax matters – to be performed by tax advisers.
- Disputes – to be performed by attorneys.
- Surveys usually under American Land Title Association standards – to be performed by professional surveyors.

2.5 Typical Representations and Warranties

The most common representations and warranties agreed in sale and purchase agreements are related to the legitimate ownership of the real estate, non-existence of liens or limitations affecting the real estate (including archaeological limitations), no pending payments in relation to it (including due to tax matters), no environmental or land use issues, permits and no agrarian backgrounds. If the ownership will be acquired through combinations involving corporations (mergers or purchase of shares), representations and warranties on the good standing of the company are usually included.

2.6 Important Areas of Law for Investors

No information has been provided in this jurisdiction.

2.7 Soil Pollution or Environmental Contamination

While it is usual to include in the purchase agreements that the seller will be held responsible and guarantees environmental liability in favour of the purchaser, the latter, as owner, will also be responsible before the environmental authority for the environmental status of the land and its remediation.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

In terms of the provisions of the Constitution, the municipalities in Mexico are the entities authorised to regulate zoning and planning matters following certain guidelines established by the federal Congress and the states. Thus, analysis of the applicable laws (zoning and planning) is required to determine which is the land use of a certain real estate. At the federal level, the applicable provisions might be found in the National Development

Plan, at the state level in the State Partial Development Plans and at the municipal level in the Municipal Development Plans, the Urban Development Plans that determine the main land use of the urban centres and, sometimes, the Detailed Plans. To confirm the land use of a given real property, the purchaser must request from the seller the land use zoning certificate and the relevant land use licence issued by the competent authority.

In environmental matters, there is the General Ecological Partial Plan at the federal level that regulates the use of land to protect the environment and promote sustainable development, the State Ecological Partial Plans and, sometimes, sectorial programmes for agricultural, territorial and urban development and in matters related to protected natural areas. Additionally, there are ecological reserves that include areas for the protection of various plant and animal species. These reserves, in legal terms, limit human action in them.

It is not common to enter into specific development agreements with relevant public authorities in order to facilitate a project but it may happen if the authority is interested in a specific project because of its size or its impact in the urban development.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Mexican government is authorised, both at the federal and local levels, to expropriate the property of individuals for public utility purposes. Causes of public utility include the establishment, operation or conservation of a public service; the opening, expansion or alignment of streets; the construction of roads, bridges, paths and tunnels to facilitate urban and suburban traffic; the beautification, expansion and sanitation of towns and ports; the construction of hospitals, schools, parks, gardens, sports fields or airfields; the construction of public infrastructure; and the provision of public services. The expropriation procedure begins with a declaration of public utility by the authority, which shall be published in the Federal Official Gazette and, where appropriate, in a local newspaper, and the owners of the property and rights to be affected shall be personally notified in order to respect their right to due process. If applicable, after the process of filing evidence and allegations, the judge will issue the corresponding resolution and, subsequently, the Federal Executive will decree the relevant expropriation, which shall be published again in the Federal Official Gazette. The pertinent decree, jointly with the appraisal in which the amount of the compensation will be fixed, shall be notified to the interested parties, who may then go to court. The price established as compensation shall be equal to the commercial value of the property and in no case may be less than the fiscal value shown in the cadastral or collection offices. Once the expropriation has been decreed, the authority is authorised to immediately occupy the property. The applicable law – ie,

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the Expropriation Law – also provides for the existence of temporary occupation, total or partial, and the simple limitation of ownership rights, which may be decreed for reasons of public utility.

On the other hand, the National Law on Ownership Extinction regulates the extinction of ownership in favour of the state through the federal government and the states, as appropriate. In terms of the provisions of the law, the product, instrument or material object of some of the following crimes can be subject to extinction of ownership: crimes provided under the Federal Law against Organized Crime; kidnapping; crimes involving hydrocarbons, oil and petrochemicals; crimes against health; human trafficking; crimes involving corruption acts; concealment; crimes committed by public servants; theft of vehicles; and those contemplated in the Federal Criminal Code with respect to operations with resources of illicit origin and extortion.

2.10 Taxes Applicable to a Transaction

In acquiring real estate, if it is done through a direct purchase of assets, various taxes and rights must be paid, namely (i) the Property Acquisition Tax, which normally must be paid by the purchaser and varies depending on the state where the property is located; however, it is usually in the range of 2% to 6%; (ii) the value added tax (VAT), on the value of the constructions (unless it is a residence), which must be paid by the purchaser and is calculated at a rate of 16%; and (iii) the income tax, which must be paid by the seller and is calculated according to the profit obtained from the sale of the property. Certain deductions are available (ie, proven cost of acquisition, certain investments in construction, improvements and extensions, notary expenses and commissions and mediations). Finally, there are registration fees that the purchaser must pay to the public registry and for obtaining certificates (no liens certificates, no tax debts certificate, etc) prior to the closing.

The taxes to be paid are withheld by the notary public before whom the transaction is formalised when the seller is an individual.

If a purchase is performed through shares acquisition, only income tax will be generated.

2.11 Legal Restrictions on Foreign Investors

In principle, foreigners can acquire real estate in Mexico with the exception of those properties located within the restricted zone, which is a strip of 100 kilometres wide along the border and 50 kilometres inland from the beaches. However, foreigners may participate with 100% of the equity of corporations that may acquire real estate all over the country, including in the restricted zone, provided in this case that the property will not

be used for residential purposes, unless it is built or acquired for resale to the public.

However, a foreigner can own the property located in the restricted zone through a trust, by holding beneficiary rights, which will grant to the beneficiary practically all the benefits of an owner.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are generally financed by a loan facility whose terms and conditions will depend on the creditworthiness of the borrower and the collateral available.

There are different financing options for the acquisition of large real estate portfolios or companies holding real estate. In addition to a loan facility with collateral (mortgage, pledge, etc) there are other options, such as acquiring the seller's debts or swapping shares; it will depend on the transaction and the parties involved.

3.2 Typical Security Created by Commercial Investors

A commercial real estate investor who is borrowing funds typically creates or enter the securities requested by lenders. Lenders usually request mortgages, trusts, shares pledge, FF&E pledge (furniture, fixture and equipment), cash deposits for a certain period of interest or principal payments.

Lock boxes, trusts or other forms of cash control may also be requested by the lender. Depending on the nature and function of the real estate, the borrower may create reserves for maintenance, insurance and improvements.

The most common equity financing provisions include the following:

- equity financing – the amount of investment versus the participation percentage on the company's equity;
- access to books and records of the company;
- reporting and covenants;
- expected return for equity;
- the right to appoint directors or top managers; and
- the limitation regarding the use of the investment, restricted to certain projects or purposes.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

There are no restrictions on granting securities over real estate to foreign lenders.

The acquisition of a real estate by foreign lenders as a consequence of an enforced mortgage could be restricted considering the real estate location and its use.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The granting of security over real estate does not cause taxes; it is only necessary to pay notary public fees for the formalisation of the security and registration fees to the Public Registry of Property. Notary public fees and rights to be paid usually vary from state to state, depending on the value of the property. Enforcement of a security over real estate will cause the same taxes mentioned herein regarding its acquisition. Please refer to

2.10 Taxes Applicable to a Transaction.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are not any special legal rules or requirements that must be complied with before an entity can give valid security over its real estate assets. In order to grant valid securities, a corporation must comply with the regulations included in its by-laws, including avoiding ultra vires acts.

3.6 Formalities When a Borrower Is in Default

In the event of default by the borrower, the lender must initiate a foreclosure legal procedure. Securities granted through trusts will follow the rules established in the relevant trust agreement.

The priority of the security granted to the lender is usually evidenced in the document through which it was granted. When there are other creditors of the borrower secured by the same asset, the judge will order that they be notified of the existence of the lawsuit or procedure so that they may appear. As has been indicated, the typical real estate collateral is structured through mortgages or security trusts and the formalities/procedures vary on each of them.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible for existing secured debt to become subordinated to newly created debt by agreement of all the parties involved. Furthermore, there are certain legal obligations that have preference in relation to pending debt or pending securities like taxes and labour obligations, under certain circumstances and with certain limitations.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over real estate cannot be held liable under environmental laws for any pollution of the real estate if it did not cause it. In terms of the provisions of the Federal Environmental Liability Law, the individual or legal entity that with its action or omission directly or indirectly damages the environment shall be liable and must repair the damage, or where repair is not possible, shall be liable for environmental compensation.

3.9 Effects of Borrower Becoming Insolvent

Security interests created by a borrower in favour of a lender cannot be considered as void just because the borrower becomes insolvent. Mexican laws only provide that securities granted by the borrower affecting its creditors might be considered void, at the request of the creditors, if it results in the borrower's insolvency and the claim is prior to the relevant granting.

3.10 Consequences of LIBOR Index Expiry

Normally agreements provide a substitute index in the case of non-availability of LIBOR. If such alternative index is not provided, legal interest rates – ie, 6% pursuant to the Commercial Code – will be applicable.

4. Planning and Zoning

4.1 Legislative and Government Controls Applicable to Strategic Planning and Zoning

In Mexico the municipalities are the entities authorised to regulate planning and zoning matters following certain guidelines established by the federal Congress and the states. At the federal level, the applicable provisions might be found in the National Development Plan, at the state level in the State Partial Development Plans and at the municipal level in the Municipal Development Plans, the Urban Development Plans that determine the main land use of the urban centres and, sometimes, the Detailed Plans.

4.2 Legislative and Government Controls Applicable to Design, Appearance and Method of Construction

For the legislative and governmental controls typically applicable to the design, appearance and method of construction of new buildings or refurbishment of an existing building, please refer to **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law** and construction regulations.

4.3 Regulatory Authorities

In relation to the regulation of the development and designated use of individual parcels of real estate, please refer to **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**.

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The most common requirements provided by the plans in the above-mentioned section include the protection and good use of its natural resources, the correct implementation of services, integration to the environment, and the sense of belonging of the place towards its inhabitants. On the other hand, the most common legal restrictions provided by said ordinances are the prohibition of urbanisation in certain areas, the surfaces that must be left free of construction, areas of restrictions of railway facilities, drinking water, drainage, electricity, telecommunications and roads.

4.4 Obtaining Entitlements to Develop a New Project

In order to be legally entitled to develop a new project and to carry out a major refurbishment, it is necessary to obtain, at a local level, a construction licence to be able to build, extend, modify, repair, install, demolish, dismantle a work or installation, put up walls and excavate. Also, in certain cases, building permits with the authorities for historical monuments and archaeological zones are required.

Considering that the regulation of construction matters is the responsibility of each state, it is necessary to analyse each local construction regulation to determine the rights of third parties to object to construction projects. In principle, third parties right is the obligation of the developer to hire insurance covering civil liability for damages. Furthermore, in certain projects where there is the need to obtain an Environmental Impact Authorisation, there is involvement of third parties and in some cases where neighbours are heard, or a public consultation procedure is initiated. Finally, third parties can file appeals against the issuance of construction licences.

4.5 Right of Appeal Against an Authority's Decision

An appeal for review is available against the refusal to grant a construction licence for any type of work, orders for demolition, repair or vacancy or other decisions arising from construction regulations. Likewise, nullity and amparo proceedings may be initiated.

4.6 Agreements with Local or Government Authorities

Agreements with the authorities or with utility suppliers are usually required in the following areas: (i) for the provision of public services such as electricity, drinking water and sewage; (ii) for the development of destination areas for infrastructure, urban equipment, green areas and roads for real estate developments; and (iii) concessions (such as ZOFEMAT and port authorisations).

4.7 Enforcement of Restrictions on Development and Designated Use

Failure to comply with the restrictions on development and designated use are sanctioned by each state or municipality depending on the location of the real estate and on the relevant violation. Sanctions usually include the temporary suspension of the project, cancellation of the authorisations granted, closure of the project, fines and arrest for up to 36 hours.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The most common vehicles for the acquisition of real estate in Mexico are commercial companies and the most frequently used are the stock company (*sociedad anónima*) and the limited liability company (*sociedad de responsabilidad limitada*), both of variable capital. These are the most widely used forms because they have perfect patrimonial autonomy.

The stock company is composed by shareholders whose liabilities are limited to the amount of their contributions. Its capital is represented by negotiable certificates and it is the only form of corporation whose shares may be traded on the stock exchange.

The LLC is composed of partners whose liabilities are limited to the amount of their contributions. For the transfer of shares and the admission of new partners, the consent of the partners representing the majority of the capital stock is necessary. LLCs are often used by US residents because they can be treated as transparent entities for US tax purposes.

Another vehicle widely used in Mexico to acquire real estate is the FIBRA (REITs), which is typically used because it is considered a tax pass-through entity and it allows more flexible structuring of real estate combinations than that which may be achieved through a corporation. However, because of recent changes to the tax laws, certain tax benefits previously available to all FIBRAs are now limited to publicly traded FIBRAs. FIBRAs are investment vehicles listed on the Mexican Stock Exchange (BMV) for the acquisition and construction of real estate for leasing. Trust certificates are offered to the general public through a public offering in the stock market. Holders of trust certificates issued by a FIBRA will be entitled to receive dividends at least once a year for at least 95% of the result of the immediately preceding fiscal year.

There are some more structures currently used for this type of transaction, such as real estate investment companies (SIBRAs), development capital certificates (CKDs) and investment project fiduciary securitisation certificates (CERPIS).

5.2 Main Features of the Constitution of Each Type of Entity

Mexican companies must be incorporated before a notary public or a commercial authorised person (*corredor público*). All of the constituent shareholders (or partners), or attorneys acting on their behalf, must be present upon the incorporation of the company. For the incorporation it is required to previously obtain a permit to use the company's name and indicate the domicile, purpose, amount of the authorised capital and its division into shares (or equity membership); also, the internal rules of the company governing shares (or equity membership), the transfer and issuing of shares, calling, holding, proceedings, quorum and powers of general meeting, appointment, removal, conduct and powers of attorney of directors or sole administrator and auditors, the payment of dividends and the dissolution and liquidation of the company. The by-laws containing all the above information may be drafted by a lawyer or by the same notary public or commercial public notary who will incorporate the company.

To constitute a FIBRA, the parties must have at least 70% of their assets invested in real estate, be engaged in the purchase or construction of real estate to be leased, and distribute among the holders at least 95% of the tax result of the previous year.

SIBRAs operate in similar terms to FIBRAs; however, they are commercial companies incorporated under Mexican law instead of trusts. As with FIBRAs, real estate developers receive some tax benefits for using a SIBRA as a financing and structuring mechanism for their project.

CKDs are securities that are issued through an irrevocable trust. Initial patrimony is formed with the proceeds of the placement and is used to invest in or to finance Mexican companies, either directly or indirectly, through various investment vehicles. CKDs are designed to allow the flow of resources to finance projects that consume resources in the short term and generate long-term flows.

CERPIS are similar to CKDs; however, only qualified investors can own CERPIS.

5.3 Minimum Capital Requirement

For the stock company there is no mandatory minimum capital stock provided by law. Therefore the initial minimum capital stock is determined by the shareholders upon incorporation of the company.

For the limited liability company, there is also no mandatory minimum capital stock provided by law. The capital stock of the company will be divided in equity memberships, each of which must represent at least MXN1 or a multiple of said amount.

5.4 Applicable Governance Requirements

For the stock company, directors have the obligations imposed by the law and by the company's by-laws. They are jointly liable with the company for compliance with the legal and statutory requirements in relation to dividends paid to the shareholders; for the existence and maintenance of the system of accounting, control, recording, filing or reporting required by law; for the faithful execution of the resolutions of the general meeting of shareholders; and for the creation of the reserve fund required by law. Some other special liabilities are provided by law.

For the limited liability company, managers are liable for the appropriate use of the company's funds and, in general, for the correct administration of the company. They are also personally liable jointly with the company for the accuracy of the data contained in the partners' register of the company.

In general terms, a company's officers will be at least one director (who, in such a case, will act as sole administrator). Furthermore, stock companies shall designate one or more internal auditors. Directors or employees of a company cannot be internal auditors for that company. Limited liability companies are not obliged by law to designate an internal auditor but it may be appointed in their by-laws.

As to FIBRAs, they must comply with certain standards of corporate governance and best practices among the shareholders, the investor, management and technical committee, like all companies listed on the Mexican Stock Exchange.

5.5 Annual Entity Maintenance and Accounting Compliance

In Mexico there is no annual fee/tax for the simple existence of a company, therefore annual compliance costs of entities are very variable. Since companies are subject to periodic compliance with administrative and tax requisites, the maintenance cost shall depend on the nature, complexity, volume and frequency of the transactions and operations carried out.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Mexican civil law basically recognises four arrangements that allow a person to occupy and use a real property for a limited period of time, without buying it outright:

- the lease (*arrendamiento*), which is the agreement through which one of the parties grants to the other party the right to temporarily use or enjoy a property, and the other party commits to pay a certain price for such use or enjoyment;

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- the commodatum or free lease (*comodato*), which is the agreement through which one of the parties grants to the other party the free use of a property;
- the real right of occupation (*habitación*), which grants to the right-holder the faculty to freely occupy part of another person's house, for himself and his family members; and
- the real right of usufruct (*usufructo*), which is the real and temporary right to enjoy another person's property and to receive all the fruits, whether natural, industrial or civil, produced thereby.

6.2 Types of Commercial Leases

Mexican civil law recognises only one type of lease agreement, although specific rules are provided in the federal and state civil codes, depending on the purpose or location of the leased premises (residential, rural or urban properties).

6.3 Regulation of Rents or Lease Terms

Rents and lease terms are usually freely negotiable; however, there are certain legal provisions within the regulation provided by the federal and state civil codes that are binding and non-negotiable/waivable since they are considered as public interest provisions. They are usually provisions applicable to premises leased for residential purposes, although certain state civil codes may also provide broader restrictions. Revision of the set of rules provided by the applicable state civil code is always recommendable.

6.4 Typical Terms of a Lease

From a general perspective, the length of lease term is freely negotiable; however, it must be taken into account that the federal and state civil codes may contain provisions for minimum and maximum terms. For example, the minimum term of a lease agreement of a real property for residential purpose pursuant to the Civil Code for Mexico City is one year for both parties, and may be extended at tenant's will for up to one more year, under certain circumstances. Lease of real properties destined to commerce and industry, under the same code, cannot exceed 20 years. The landlord and tenant may freely determine if the term is binding and may even agree on penalties to be paid if the binding term is breached by any party.

The general rules contained in the federal and state civil codes establish that the landlord is liable for defects in the leased property that may prevent the use thereof, even if the landlord was not aware of them or they occurred during the lease term, provided that they are not a consequence of the tenant's negligence. On the other hand, the tenant is responsible for those minor repairs needed for the use of the leased property. The standard provisions are that the tenant must maintain the structure of the property and carry out the extraordinary maintenance of the real property, while the ordinary maintenance is usually

the responsibility of the tenant, who must return the property in the way it was when it was delivered, except for ordinary wear and tear arising from its use. Also in this case, parties may freely negotiate allocation of responsibilities associated with maintenance.

The frequency of rent payments may be freely determined by the parties. Payment on a monthly basis is standard.

6.5 Rent Variation

Mexican civil law does not provide binding or automatic updates of the rent. The matter can be freely negotiated by the parties. It is standard for rent to be updated on a yearly basis by applying the same percentage of the increase of the National Consumer Price Index published in the Federal Official Gazette by the National Institute of Statistics and Geography (plus some additional points, in certain cases). In lease agreements of premises located in commercial malls, it may be agreed that the tenant must pay (in addition to or instead of the monthly fixed rent) also a variable rent, calculated as a percentage of the net sales performed by the tenant.

6.6 Determination of New Rent

The matter is freely negotiable by the parties. It is standard that the agreed percentage of the increase will be applied on the basis of the monthly rent in force at the end of the agreed period (usually on a yearly basis, although semi-annual increases are also possible, but less frequent).

6.7 Payment of VAT

VAT is payable on the rental of real properties for commercial purposes. Rents payable under lease agreements for residential purposes are not subject to VAT. VAT is also applicable to rent for residential purposes when the leased premises include furniture.

6.8 Costs Payable by Tenant at Start of Lease

It is quite customary for payment of the first month of rent to be in advance plus the payment of a security deposit (usually one or two months of rent) to be kept by the landlord as a guarantee of compliance by the tenant with its obligations under the agreement. In commercial leases (mainly those of commercial malls) the landlord (or previous tenant) may also request a one-time payment of a goodwill or key money, the amount of which will usually depend on the standards and success of the mall.

6.9 Payment of Maintenance and Repair of Communal Areas

Costs and expenses associated with the maintenance and repair of (common) areas used by several tenants are usually charged to and paid by same tenants to the landlord or to the manager of the building or the mall, as the case may be, as condominium

quotas or common area maintenance fees. Condominium or mall regulations usually establish the way such quotas are allocated among the co-owners/users of the common areas. Leases of premises located in a commercial mall may also provide for payment of a certain amount or percentage of the rent as advertising/marketing fees. Such fees and quotas are usually payable on a monthly basis.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunications that serve a property occupied by several tenants are usually paid on a pro rata basis and reflected in the condominium quotas or common area maintenance fees that the tenant eventually pays to the landlord or directly to the manager of the condominium or the mall.

6.11 Insuring the Real Estate that is Subject to the Lease

There is no provision contained in the federal or state civil codes on this matter. Tenants are usually required to hire an insurance policy covering civil liability and fire, the latter being a tenant's liability under the federal and state civil codes. Insurance coverage for the property of the leased premises is usually hired by the landlord; however, in commercial and industrial leases, the tenant may also sometimes be held responsible to hire and pay for an insurance coverage for the property, including earthquake and flood. Insurance coverage of the common areas is usually included in the condominium quota or common area maintenance fees charged to the tenant.

6.12 Restrictions on Use of Real Estate

Pursuant to the federal and state civil codes, the tenant must use the leased property only for the agreed use or pursuant to the nature and destination thereof. Violation of such provision is grounds for termination of the agreement by the landlord. Lease agreements usually contain such provision and also specify that use of the leased premises must be made in accordance with the permitted use of land corresponding to the leased property.

6.13 Tenant's Ability to Alter and Improve Real Estate

Pursuant to the federal and state civil codes, the tenant may not vary the form of the leased property without the express consent of the landlord. If such provision is breached, the tenant is held responsible for restoring the leased property to its original status and paying the damages eventually caused to the landlord. Usually improvements are paid by the tenant; however, legal provisions establish that the landlord must pay for them if the tenant was authorised to perform said improvements and if the landlord agreed to pay for them, or if they are useful or urgent improvements.

6.14 Specific Regulations

Premises to be used for commercial, industrial, offices or retail purposes are generally subject to the same set of rules. The federal and state civil codes contain a specific set of rules for residential and rural properties as follows.

- Properties intended for residence purposes – specific rules are provided in the federal and state civil codes to address, among others, hygiene and health conditions; minimum term of lease; preferential right of a tenant to acquire the leased property or to enter into a new lease; and currency for payment of the rent. Rules applicable to residential leases are usually considered of public order and social interest and therefore they are not waivable.
- Rural property – specific rules are provided in the federal and state civil codes to address, among others, the term for payment of rent, the rights of the tenant in the event of lack of productivity of the leased property and the minimum term of the lease.

6.15 Effect of Tenant's Insolvency

The Law on Commercial Insolvency (*Ley de Concursos Mercantiles*) provides that a tenant's commercial insolvency does not terminate the lease agreement. However, the conciliator appointed for the insolvency procedure may opt to terminate the agreement, in which case, the compensation agreed in the agreement for such case must be paid to the landlord or, failing that, an indemnity equal to three months' rent, for early termination.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

The forms of securities most commonly requested by landlords to ensure compliance with the obligations of tenants under lease agreements are

- a security deposit (*depósito*), usually equal to one or two months' rent;
- a personal surety (*fianza*), which is the commitment undertaken by an individual or company to comply with a tenant's obligations, if the tenant fails to do so;
- a bond policy, through which a specialised bond institution guarantees the fulfilment of the obligations of a tenant;
- a letter of credit; and/or
- the joint and several obligation by a third party (*obligado solidario*).

6.17 Right to Occupy After Termination or Expiry of a Lease

As a general rule, a tenant is not entitled to keep occupying the leased property after the termination of the lease agreement and the landlord is entitled to enforce eviction. However, if the

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tenant keeps occupying the property without opposition by the landlord, the lease agreement will continue for an undetermined period of time. In such case, any party will be able to terminate the agreement at any time through prior 30 days' written notice to the other party in the case of residential property. Prior notice will be of one year in the case of rural, commercial or industrial properties.

6.18 Right to Assign Leasehold Interest

A tenant may not sublease the leased property or portion thereof or assign the tenant's rights without the consent of the landlord. If the tenant breaches such rule, they will be jointly liable with the subtenant for damages. If the landlord, without fair reason, objects to the sublease that the tenant rightfully asks for, the tenant may enforce the termination of the agreement.

6.19 Right to Terminate Lease

Pursuant to the federal and state civil codes, the landlord is entitled to terminate the lease in the following cases:

- failure by the tenant to pay the rent;
- failure by the tenant to destine the property to the use agreed with the landlord;
- if the tenant subleases the property without the landlord's consent;
- in the case of material damages to the leased property attributable to the tenant; and
- if the tenant modifies the form of the leased property without the express consent of the landlord.

On the other hand, the tenant is entitled to terminate the lease (i) if the landlord does not keep the leased property in good condition; (ii) in the case of total or partial loss of the leased property; and (iii) due to the existence of hidden defects or flaws in the property, prior to the lease and unknown to the tenant.

Parties may also agree on events of default different than or in addition to those provided by the law.

6.20 Registration Requirements

Normally the civil codes of the various states require that a lease agreement must be made in writing.

The federal and state civil codes may provide certain registration requirements. The Civil Code for Mexico City, for example, establishes that lease agreements of real property must be recorded in the Public Registry of Property when they are entered for a term longer than six years or when advanced payments of more than three years of rents are made.

6.21 Forced Eviction

The landlord is entitled to terminate the lease agreement and to start a procedure to enforce eviction when a termination cause provided by law or the lease agreement occurs. The duration of the eviction process may vary depending on the peculiarity of the case, but on average it may last one to two years.

6.22 Termination by Third Party

Expropriation of the leased property for public utility and judicial sale are grounds for termination. The landlord and tenant are entitled to receive an indemnification by the competent authority. The landlord will be indemnified in accordance with the expropriation decree. The tenant will be indemnified with the amount of six months of rent (provided it has occupied the property for more than one year) as well as with the value of the improvements made during the last six months, provided they were needed.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common structures used in Mexico to price construction projects are (i) a unit-price construction agreement; (ii) a lump-sum construction agreement; and (iii) a refundable costs construction agreement.

(i) Unit-price construction agreement – the parties agree on a price per construction unit and the total value of the contract will be the sum of the units for the value of the unit. Each unit must also include a value that clearly represents the value of the contractor's remuneration. Under this system the client will generally require from the contractor the preparation of a list of units and values consisting of a list of the work units and the value of each of them.

(ii) Lump-sum construction agreement – the contractor receives only and exclusively the fixed price set in the contract, regardless of the expenses incurred during the execution of the project. In this way, the client significantly reduces the risks that may arise during the execution of the project as a result of changes in the prices of the products or services being hired, since the entire risk of the work is borne by the contractor until delivery. That means that the contractor has included in the lump sum price everything necessary to perform and complete the construction works according to the project and agrees that no extra items or costs shall occur to execute such construction works, except for those resulting from modifications and/or extensions authorised by the client.

(iii) Refundable costs construction agreement – the price that the contractor receives will be that resulting from the expenses that he has assumed in the execution of the project plus a profit.

The vast majority of Mexican construction contracts include a clause that allows the parties involved in the contract to modify the terms of the contract in terms of the works to be performed and price. Through this clause the client has the right to modify the quantities of work indicated in the contract, the quality of the materials used in the works, the dimensions or size of the works or the times in which the works must be executed. Likewise, the obligation of the contractor to comply with the variation orders that are delivered by the client is stipulated and the consequent variation of the construction project price.

7.2 Assigning Responsibility for the Design and Construction of a Project

In Mexico there are different methods used for assigning responsibility for the design and construction of a project and will depend on two situations, the first one if the contractor developed the design and engineering of the project; or not.

(i) If the contractor develops the design and engineering of the project, it will be fully responsible before the client for the correct construction of such project and for any defect, error, failure or malfunction or any flaw resulting from. Therefore, contractors shall guarantee to the client all construction works and activities performed hereunder for any kind of defects (including hidden defects), malfunctions, deficiencies and damages of any nature, including structural damages, defects, design and engineering errors, labour, raw materials, malfunctions on equipment and of installations, during the term of the construction agreement and commonly 12 months after the termination date of the construction (guarantee period). In the event that any defect is detected during the guarantee period, usually the contractor, at its own cost, must immediately cure any such defect.

(ii) If the contractor does not develop the design and engineering of the project, usually it will only be responsible before the client for the defects, errors, failures or malfunctions or any flaws resulting from, but shall not guarantee to the client defects on design and engineering errors, which are borne by the client. In this case the guarantee period is also applicable.

The above-mentioned responsibilities typically are allocated on specific responsibility and indemnifications clauses within the construction contract, by means of which the contractor agrees to indemnify and hold the client harmless, as well as its indemnified parties from any damage, claim, liability, obligation, loss, action, administrative proceeding, complaint, expenses, interest, fines and costs (including reasonable attorneys' costs

and expenses) in connection with the construction agreement, including the design and engineering, the construction works derived from any mis-statement or non-compliance with any statement, guarantee or obligation included in the construction agreement and its exhibits.

7.3 Management of Construction Risk

In Mexico there are several devices used to manage construction risk on a construction project. The most common ones are (i) bonds, (ii) insurance and (iii) guarantee fund; to cover any contractors responsibility and contingencies such as construction defects.

(i) Bonds – typically, the contractor grants the following bonds in almost all types of construction agreement.

- Down payment bond to guarantee the correct use of the down payment, in an amount equal to the full amount of the down payment. The down payment bond usually is effective until the full amount of the down payment is fully amortised.
- Performance bond in an amount equal to 10% of the price of the construction agreement to guarantee the complete performance of the construction works and to repair hidden defects and defective works, the timely completion of the construction of the project and any other contractor liabilities resulting from the performance of the construction works. The performance bond is usually effective during the performance and completion of the construction of the project.
- Guaranty and quality assurance bond, which is usually delivered simultaneously to the completion of the construction works in an amount equal to 10% of the construction works price and shall be effective for a one-year term from the delivery of the fully terminated construction works. This bond usually guarantees the payment of any hidden flaws or defects in the construction that may be generated after the termination and delivery of the construction works and any third-party claim.

(ii) Insurance – typically, the contractor contracts the following: a civil liability insurance for damages to client, to the construction works and third parties in their property and personal damages, and, in general, any risk inherent to the construction works, including constructions adjacent to or within the construction site, including personal damages and death, basic coverage for activities and real estate, subsoil installations, welding works, load and unload activities, demolition, machines used for work, foundations, propping and other works, sudden and non-foreseeable pollution. The insurance policy usually covers cross liability, error in design, employer's liability and damages to property.

(iii) Guarantee fund – from the amounts to be paid by the client to the contractor, clients usually withhold 5% of the total amount of each invoice, until having accrued a guarantee fund equivalent to 5% of the construction works price, in order to create a guaranty fund to guarantee compliance with the obligations of the contractor under the construction agreement. The guaranty fund is typically used by a client to correct any defect, responsibility or claim against the contractor that may result from the construction agreement, including the payment of liquidated damages of the agreement or in the event that the contractor fails to comply with any obligation established in the agreement, such as fines, penalties or any amount used to guarantee the hidden defects or defects of the construction works.

There is also the possibility of limiting the contractor's liability or capping it at a certain amount, which depends on the project and the specific negotiations.

7.4 Management of Schedule-Related Risk

Parties are allowed to agree that the owner is entitled to monetary compensation if certain milestone and completion dates are not achieved. The mechanisms usually used to manage this construction risk on a construction project in Mexico are penalties and bonds, including advance payment bonds (guarantee supplied by the party receiving an advance payment to the party advancing the payment) and performance bonds (surety bond issued by an insurance company or a bank guaranteeing satisfactory completion of a project by a contractor).

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The most common way owners seek to guarantee a contractor's performance of a project is to obtain performance bonds, including advance payment bonds; however, letters of credit, parent guarantees and escrow accounts are also considered as customary.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and/or designers cannot lien or otherwise encumber a property in the event of non-payment.

7.7 Requirements Before Use or Inhabitation

Local laws determine the requirements that must be met in order to inhabit a project after its construction; ie, in Mexico City it is necessary to obtain an authorisation for the use and occupation of the construction, for which it is necessary to present the construction licence, the construction logbook in which the progress of the executed works is registered and endorsed by an expert, and photographic reports, among others. Furthermore, it should be noted that the properties must

comply with regulations on safety, evacuation routes and civil protection, among others.

8. Tax

8.1 VAT

In acquiring real estate, if it is done through a direct purchase of the real estate, various taxes and rights shall be paid, including the VAT, on the value of the constructions (unless it is a residence), which shall be paid by the purchaser and is calculated at a rate of 16%.

8.2 Mitigation of Tax Liability

The most common method to defer transfer liability is the contribution of real estate that the trustors make to the trust and that will not be considered a sale for tax purposes, in accordance with the provisions of Article 14 of the Federal Tax Code, if they reserve the right to reverse the ownership of the real estate in their favour.

8.3 Municipal Taxes

In relation to private estate, there are no federal or local occupation taxes but fees, licences and permits might be required.

8.4 Income Tax Withholding for Foreign Investors

The taxes to be paid are withheld by the notary public before whom the transaction is formalised only if the seller is a foreign individual without a permanent establishment in Mexico.

Rental income from real estate is taxed in Mexico through income tax and value added tax in certain cases. The landlord shall pay it. Some exceptions are provided by law, such as the property tax. On 9 December 2019 some tax provisions were amended to include that in the resolutions in which the tenant is ordered to pay the rent that is due, the judicial authority shall require the landlord to prove that he has issued tax vouchers and, if the issuance of such receipts is not proven, the judicial authority shall inform the tax authorities.

8.5 Tax Benefits

Owners of real estate in Mexico are entitled to carry out tax depreciation of fixed assets, including land and buildings and deduction of some concepts of the income tax to be paid upon the income gained from its sale, such as the proven cost of acquisition, certain investments in construction, improvements and extensions, notary expenses and commissions and mediations.

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Cannizzo, Ortíz y Asociados, S.C. was established in Mexico City more than 40 years ago and is an excellent gateway for doing business in Mexico, thanks to its international education and experience, and a deep understanding of the Mexican reality. The firm, which currently has more than 25 attorneys, has special experience in the real estate and hospitality, M&A, infrastructure and business fields, where it has been one of the most active firms in Mexico. Some of the relevant recent work

performed by the firm includes the structuring and acquisitions of some of the most important mega developments in Mexico – such as Bosque Real, Malecon Americas and Puerto Cancun – and the acquisition and sales of more than 100 hotels in recent years, including Four Seasons of Mexico City, JW Marriott hotels Mexico City, Princess Acapulco, Fairmont Acapulco, Whyndham Cozumel, Barcelo Hotels and Hilton Los Cabos.

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MEXICO LAW AND PRACTICE

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