

Manifesting is simply recording the amount you spent on your construction, or remodel, in order to add this to your cost basis. Adding to your cost basis is the key to reducing your Capital Gains Tax. Proper documentation and manifesting your construction is a vital part of building your new home.

Why do you need to manifest your construction? When you sell your home, the manifested cost plus the cost of your lot stated in your Trust (Title), will be used to determine the basis for Capital Gains Tax.

If you have not manifested your construction, Mexican Tax Law will not recognize your construction costs and you will not be able to use them as a deductible expense. All your receipts, cancelled checks and bank statements will not help, unless you have completed your manifestation.

Before You Begin Construction

Decide how to structure your financial arrangements with your contractor. The two main choices are cost plus and a fixed bid.

With cost plus, you pay the contractor for the cost of materials, plus a fee of 12 percent to 20 percent. Using this method, you will need to keep excellent records in order to prove all your expenses. With cost plus, you are responsible for paying the Social Security Tax for every person working on your home — your contractor is not.

Each time you pay the contractor, he must provide you with a legal Mexican Invoice, called a *factura*. Each factura must be in your name and will include a 10 percent sales tax called IVA Tax. Without the facturas, nothing you spend is deductible as an expense in Mexico.

With a fixed bid contract, the contractor quotes you a flat fee to build your home. A fixed bid will include all labor, materials, social security, etc. It is all-inclusive. When using the fixed bid process, you put the burden of record keeping on the contractor and you do not have to pay the 10 percent Mexican IVA Tax each time you make a payment. You will still need to receive a factura from the contractor for each payment; however, the factura should reflect the amount of the payment due with no 10 percent sales tax (IVA Tax).

IVA Tax is basically a sales tax and Mexican Tax Law states there is no IVA Tax for the construction of a personal residence, provided the contractor is providing an all-inclusive bid. Again, the fixed bid process is much less labor intensive for you and puts the majority of the record keeping on the contractor.



Manifesting Your Construction

Recording the Cost of Your New Construction

TIP: When using fixed bid, make certain the contractor is in agreement to provide you with a factura for each payment with no 10 percent sales tax added. Have this in writing in your construction contract.

Pulling a Building Permit

The building permit is the first step to manifesting your property correctly. You will need the permit both to start construction and to finish the construction. The permit is pulled from the government office called Obras Públicas, meaning Public Works. Normally, the contractor will pull this permit. There are two things you need to watch for: make sure the building permit is pulled in the same name as the beneficiary named in your Trust, and make sure the building permit represents the approximate amount of the construction the contractor has proposed to do.

The fee for the building permit is based on the estimated value of your construction. In an effort to reduce this fee, some contractors will report a lower construction amount when pulling

the permit. This is a huge mistake. You will want your construction costs recorded accurately, so your cost basis will be accurate for capital gains.

Letter of Termination of Works

When construction is finished, and you are ready to manifest your construction, you will need to take your building permit to the Obras Públicas office with a letter stating the amount you spent and that you have finished your construction. You or your contractor can write the letter. With this letter, you will request an official statement of completion called an *Aviso de Terminación de Obra*, which means a Letter of Termination of Works. This letter will state the amount you spent on your construction, which should be in accordance with the amount stated on the building permit. This letter is the document that actually establishes your construction cost basis for the tax office.

Social Security

Social security is a very serious issue in Mexico. A lien can be placed on your home or it can be sold to force payment if these taxes are not paid. When you receive your Letter of Termination of Works, Obras Públicas will send a copy to the social security office. They will compare this amount with what you or your contractor has paid to social security during construction. If the amount of social security taxes paid corresponds to the amount of your construction, you will receive a letter from social security called a *Carta de Razonabilidad de Pago*, meaning a Letter of Reasonability of Payment. This letter is very important, as it is your protection to prevent any future claims for non-payment of social security taxes.

Once you have your Letter of Termination of Works and your letter from social security, you simply take these to the Tax Office, called the Catastro Office. They will record the value and add it to the cost reflected on your Trust document. Once completed, you have successfully manifested your construction and established an accurate tax basis for your property.

If you do not have a Trust, you should not begin construction. Without the Trust document, you cannot pull a building permit in your name and you run the risk of not being allowed to deduct your land cost or construction cost when you sell.

Remember: Annual property taxes are relatively low in Mexico — capital gains taxes are not. Registering an artificially low number will cost you much, much more in the long run.

Always get your Trust. Always record the real value of your purchase. Always purchase U.S. Title Insurance. Always manifest your construction.

This article is an overview of the manifestation regulations currently in place for individuals. The information is intended for individuals, not corporations. Over time, these regulations can change, so it is important to make sure the process outlined here is still in effect by contacting a certified accountant or Mexican Notary.

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