

## **Do You Need to Report Your Real Estate Fideicomiso as a Foreign Trust?** **The IRS Told One Taxpayer: No!**

If you are one of the many U.S. people who own real estate in Mexico's "restricted zone" (that is, you have a Mexican beach house), you know that you aren't allowed to hold the property in your name. Instead, some large Mexican bank is holding the property in its name for you under a "fideicomiso" contract. Unfortunately, "fideicomiso" means "trust" in Spanish, and so there has been a lot of discussion recently about whether these types of fideicomisos must be reported to the IRS on foreign-trust Forms 3520 and 3520-A, which have huge, scary penalties associated with them.

I am a U.S. attorney who specializes in the taxation and compliance of foreign trusts, and I have always concluded that these Mexican real-estate fideicomisos are not reportable on Forms 3520 and 3520-A. I was fortunate to have a client who asked me to obtain a Private Letter Ruling from the IRS on his behalf last year, and the IRS agreed with my conclusion that a Mexican real-estate fideicomiso isn't reportable (see PLR 201245003, released November 9, 2012).

One of your co-readers in Puerto Vallarta thought it might be helpful for me to briefly lay out the legal reasoning that supported the IRS's conclusion in PLR 201245003 so that you can come to your own conclusion about your real-estate fideicomiso. So here it is.

Section 301.7701-4(a) of the U.S. Treasury Regulations provides that a "trust . . . refers to 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." This Regulation further provides that "an arrangement will be treated as a trust under the Internal Revenue Code 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 the beneficiaries who cannot share in the discharge of this responsibility." In short, an arrangement will be considered a trust only when the so-called trustee has a real fiduciary duty to protect and conserve the property for a beneficiary. If the "trustee" has no such duty, and if the "beneficiary" is in fact responsible for the protection and conservation of the property, then, for purposes of federal income tax law, a trust has not been created.

Under Revenue Ruling 92-105, 1992-2 C.B. 204, which deals with Illinois land trusts under Section 1031 of the Internal Revenue Code, the Service ruled that a trust was not created for federal income tax purposes where the trustee's only role was to hold legal title to real property with no other powers or responsibilities with respect to the property, and where the beneficiary had the exclusive right to direct the trustee's actions with respect to the property, to control the property's management, and to directly receive the earnings and proceeds derived from the property. In addition, the beneficiary described in this Revenue Ruling was personally obligated to pay all taxes and liabilities relating to the property. As a result, the Service ruled that, for purposes of federal income tax law, no trust was established.

Taken together, Treas. Reg. §301.7701-4(a) and Rev. Rul. 92-105 lead to the conclusion that simply calling something a "trust" does not create a trust for federal income tax purposes if: (1) the trustee merely holds legal title to real property and is not subject to a fiduciary duty to protect and conserve the property; (2) the beneficiary has the exclusive right to control the trustee's actions with respect to the property; and (3) the beneficiary has the exclusive right to the earnings and proceeds derived from the property, and is personally obligated to pay all taxes and liabilities related to the property.

It's my guess that you will be able to apply the guidance provided by Treas. Reg. §301.7701-4(a) and Rev. Rul. 92-105 to your own fideicomiso and conclude that it's not a trust for federal tax purposes, and that, therefore you are deemed to hold the underlying real property directly. Therefore, you should feel comfortable not filing Forms 3520 and 3520-A for your fideicomiso (or filing "final" forms if you have been filing).

The typical disclaimers regarding this not being legal advice apply, so feel free to give me a call or send me an e-mail if you feel the need to discuss your fideicomiso in particular.

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