Costa Rica

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1.0 OVERVIEW

The Costa Rican tax system is based on the principle of territoriality, according to which only income received from a source within Costa Rican territory, or income that involves the use of the country's infrastructure, is taxed.

The Simplified Tax Regime applies to very small taxpayers, with simple businesses or economic activities. Taxpayers eligible for this regime pay a lower tax rate. Conversely, taxpayers with high incomes or large, complex businesses are classified as “large taxpayers” or “large territorial companies.” These taxpayers typically pay a higher rate.

Separate tax administrations handle ordinary taxpayers, Simplified Tax Regime taxpayers and large taxpayers. Each geographic region also has its own tax administrations for each category of taxpayer.

2.0 LEGAL SYSTEM

The Costa Rican Code of Tax Norms and Procedures contains general regulations concerning national taxes. Additionally, there are special laws and bylaws, such as the Income Tax Law and the General Sales Tax Law, as well as their associated regulations.

3.0 TAXATION AUTHORITIES

The main authority on tax-related matters is the Ministry of Finance, which is divided into the General Customs Administration and the General Tax Administration. The latter is responsible for the collection of taxes, and it is further subdivided into several divisions, among which are the regional tax administrations.

4.0 BUSINESS VEHICLES

Non-residents may choose to incorporate a Costa Rican business vehicle (legal entity) to conduct business in Costa Rica, or to operate directly through a foreign entity with or without setting up a permanent establishment locally. Costa Rican business vehicles are partnerships, either a limited liability company (SRL) or a limited (SA). Although it is legally possible to set up a trust to conduct business in Costa Rica, the structure is rarely used due to its complexity.

4.1 Partnerships

The fiscal treatment of SAs and SRLs is essentially the same. From a tax standpoint, there is only one difference between them: Loans granted to stakeholders of an SRL are not deductible to determine the taxable income, as they are deemed comparable to dividends. Therefore, these kinds of loans to stakeholders are subject to a 15% withholding, whereas loans granted to stakeholders of an SA can be deductible.

For income tax purposes, the relevant criterion is the location of the source of income.

4.2 Corporations

An SA can be owned by local or foreign persons or legal entities and can be managed by local or foreign persons. If none of the directors are Costa Rican citizens, a resident agent must be appointed. The resident agent will be a licensed attorney residing in Costa Rica who is authorized to receive all communications addressed to the directors.

It is necessary that the entity has a nominative capital stock represented by shares. The capital stock may be paid in cash, kind or letters of exchange, among other methods.

4.3 Limited liability corporations

In the case of an SRL, there is a condition protecting current stockholders in the event a stockholder wishes to sell its shares of stock, consisting of a right of first refusal for current stockholders to purchase the stock being sold. A general stockholders meeting must be held in order to authorize the sale of the shares.

As previously mentioned, there are no major differences in the fiscal treatment of an SA or an SRL, with the exception of the treatment of loans granted to stakeholders.

4.4 Foreign corporation (with or without a Costa Rican branch)

A foreign corporation that carries out business in Costa Rica is subject to taxes in respect of such income. Moreover, Costa Rican legislation provides that certain activities carried out by a non-resident constitute commercial activities subject to taxes in Costa Rica.

Should the foreign corporation be domiciled in a country that has entered into a double taxation treaty with Costa Rica, it may be exempted or granted differential rates, with the exception of foreign corporations operating through a permanent establishment, in which case income is generally subject to taxes in Costa Rica.

Costa Rican legislation taxes remittances abroad (to non-domiciled persons or entities) at rates that vary depending on the nature of the payment.

5.0 FUNDING A LOCAL SUBSIDIARY

5.1 Equity financing

5.1.1 Contributions for shares

If an investment is made in a Costa Rican entity in exchange for shares, the amount of the investment is added to the entity's "stated capital" account. Subject to certain adjustments, a corporation's stated capital is generally the same as its paid-up capital for tax purposes.

5.1.2 Contributions without taking additional shares

When an equity contribution is made by a shareholder in an entity incorporated in Costa Rica, a general shareholders meeting must be held in order to document the interest in increasing the capital stock by modifying the value or amount of existing shares. From a tax perspective, this is the best option.

The contribution can also be made as additional paid-up capital, which does not increase the capital stock but must be made for a short term.

5.1.3 Distribution of paid-up capital

A corporation is allowed to make refunds of its paid-up capital to a non-resident shareholder without incurring Costa Rican withholding tax. In contrast, withholding tax must be paid on the distribution of profits that have not been converted into declared capital stock.

5.2 Debt financing

5.2.1 Withholding tax implications

Costa Rican corporations are permitted to borrow funds from related third parties, which must be very well-documented with a contract and a real guarantee. Should the lender be based abroad, interest will be subject to a 15% withholding tax.

The remainder of the payment (amortization) is not subject to withholding.

The withholding tax rate can be reduced or eliminated based on an applicable double taxation treaty.

5.2.2 Thin capitalization

There are no thin capitalization rules in Costa Rica.

5.3 Stamp tax

A stamp tax of 0.5% must be paid on most documents used in courts or public offices and for many private transactions, including deeds and mortgages, among others.

6.0 CORPORATE INCOME TAX

Costa Rica's income tax system is based on the territoriality principle. Therefore, only Costa Rican–sourced income is subject to income tax in Costa Rica, regardless of the taxpayer's nationality, domicile or place of incorporation.

Income from Costa Rican sources consists of income derived from services rendered, capital used and properties located within Costa Rica. Income tax rates are applied as set forth below.

6.1 Income tax rates

Income tax rates for both companies and individuals are calculated on a progressive scale depending on gross income. In case of legal entities, income tax ranges from 10% to 30%. For individuals, it ranges from 10% to 25%.

Corporations generating Costa Rican–sourced income are generally subject to a 30% income tax. Small companies are entitled to lower tax rates.

Deductions include all necessary expenses for the production of taxable income.

Currently, the ordinary fiscal period begins on October 1 of a year and ends on September 30 of the next year (12 months). Starting January 2020, all entities will have a calendar-year fiscal period, from January 1 to December 31.

6.2 Capital gains

Capital gains are now taxed at a 15% rate. Capital gains are defined as income derived from the transfer of moveable goods or real-property assets. In the case of taxpayers whose normal activity is the sale of real property, those gains would be subject to income tax. Also, if the taxpayer sells an asset subject to depreciation and has effectively depreciated the asset, the capital gain would be subject to income tax.

6.3 Corporate/legal entity tax

All legal entities must pay annual corporate tax in January of each year. “Legal entities” include all of the following companies that are registered with the Registry of Legal Entities of the National Registry, or will be registered in the future:

i. Mercantile companies

ii. Branches or representatives of foreign companies

iii. Limited individual companies of responsibility.

A new legal entity must pay taxes proportionally as of the filing of its deed of incorporation with the National Registry.

Tax rates range from 15% to 50% of a “base salary” (an amount statutorily determined by the government to calculate certain fines and penalties), depending on certain conditions of the entity and its income.

6.4 Income tax exemptions

Government, municipal and decentralized government entities, religious institutions, cooperatives and nonprofit organizations are exempt from paying income tax.

Some sources of income are also exempted from the payment of income tax, including capital contributions, income from assets or capital located outside Costa Rica, inheritances, lottery winnings and donations received by authorized entities.

6.5 Dividend tax

Dividends paid to local and foreign companies and individuals are subject to a 15% withholding tax.

7.0 CROSS-BORDER PAYMENTS

7.1 Transfer pricing

Costa Rica’s transfer pricing regulation sets forth the rules to be observed by economic groups (both national and international) in establishing the conditions under which their operations will be regulated. It creates an obligation for Costa Rican entities that are members of economic groups to file an informative declaration in which they report the structure of their group and the conditions or methods that were observed to determine the conditions of their operations.

This implies the need for the entities to have a transfer pricing study performed, which determines the methods used to set the conditions and the reasons for the prices agreed among the related entities for their transactions, which are different from those agreed upon with independent parties.

The regulation provides for the conditions that must be verified to confirm that an entity is part of an economic group and, therefore, its transactions with the other related entities must comply with the rules.

The framework principle of transfer pricing is also defined, which is the principle of free competition, according to which the terms and conditions of those transactions that take place between members of the same economic group must be meet the same terms and conditions as transactions between independent parties.

Covered entities are required to perform a transfer pricing study to prove compliance with the principles of free competition in their transactions.

7.2 Tax on remittances abroad

Costa Rican–sourced income paid to beneficiaries domiciled abroad is subject to withholding tax in Costa Rica. Applicable tax rates depend on the type of income:

i. Dividends: 15%

ii. Interest, commissions and other financial expenses: 15%

iii. Technical assistance: 25%

iv. Payments for the use of patents, supplies of formulas, trademarks, privileges, franchises and royalties: 15%.

Some types of Costa Rican–sourced income are considered "special cases." Examples include interest and commissions on loans invested or used in Costa Rica, and income generated by the export of goods.

8.0 PAYROLL TAXES

Employees' salaries and wages exceeding the amount set out by law are subject to income tax at rates ranging from 0% to 25%. Employers must act as withholding agents of this tax.

9.0 INDIRECT TAXES

9.1 Value-added tax (VAT)

The current general sales tax will become a value-added tax (VAT) starting July 1, 2019, charged on the sale, import or transfer of goods and provision of all services (except specific exemptions, such as private education and public transportation).

The taxpayer is any individual or company who, on a regular basis, sells merchandise or provides services subject to sales tax. These include imports.

The current sales tax in Costa Rica is 13%, with reduced rates for certain goods and services. The tax is levied on all merchandise and services. Certain products are exempt from the general sales tax, such as basic food items. The current sales tax will be replaced by a VAT of 13%.

9.2 Selective consumption tax

Selective consumption tax applies the stage of commercialization, at the industrial level or upon an import's entry into the country. It is intended to reduced demand for articles whose consumption is considered non-essential or dispensable.

The tax applies only to specific list of products, which includes, among others, beer, wine and liquors; paints and coatings; cigarettes; haircare products (e.g., shampoos and hair conditioners); deodorants and perfumes; detergents and soaps; pneumatic tires and engines; refrigerators and freezers; washers; automotive vehicles and motorcycles.

9.3 Property transfer tax

The transfer tax is equivalent to approximately 1.5% of the highest of the transfer price or the property's registered value. Eligible taxpayers must declare, at least every five years, the value of their property to the municipality where it is located.

The tax period runs from January 1 to December 31. Payments may be made on an annual, semiannual or quarterly basis.

9.4 Tax on luxury residences

Luxury residential properties valued at more than CRC 121 million are subject to the Solidarity Tax for the Strengthening of Housing Programs, a progressive tax that ranges from 0.25% to a maximum tax rate of 0.55%. This tax is paid annually.

10.0 OTHER TAXES

10.1 Property tax

Property taxes will be equivalent to 0.25% of the property's registered value. This tax is paid annually to the municipality in which the property is located.

10.2 Operation permit tax

Any lucrative activity that is exercised in a municipal territory must have an operation permit, which is obtained by paying a tax. The tax regularly applies to a combination of gross and net income. Rates vary by municipality. This tax must be paid for as long as the lucrative activity is carried out or the license is held.

11.0 TAX INCENTIVES

11.1 Free Trade Zones

The Free Trade Zone Regime (RZF) is the pillar of Costa Rica's export strategy and investment promotion. It consists of a series of incentives and benefits granted by the Costa Rican government to companies seeking to make new investments in the country. Incentives may include exemptions from certain taxes as high as 100%.

Companies that can apply to the Free Trade Zone Regime include the following:

i. Service export companies

ii. Scientific research companies

iii. Strategic sectors or companies

iv. Significant suppliers

v. Services or manufacturing projects.

11.2 Tourism Incentives Law

This law grants incentives and benefits that promote the development of important tourism programs and projects, for services such as the following:

i. Hotel services

ii. Air transport for domestic and international tourists

iii. Water transport for domestic and international tourists

iv. Receptive tourism of travel agencies that are exclusively dedicated to this activity

v. Renting of vehicles to domestic and international tourists.

One benefit granted by this law is the exemption from all taxes and surcharges applied to the import or local purchase of articles necessary for installing or operating new companies, the offer of new services and the construction, expansion or renovation of real property. Motor vehicles and fuel are not eligible for this exemption.