

Doing Business in Costa Rica

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Costa Rica.



Background

Brief introduction

Costa Rica is a republic located in the meridional part of Central America. Its boundaries are Nicaragua on the North, the Caribbean Sea on the East, Panama on the Southeast, and the Pacific Ocean on the South and West. The Cocos Island is located 480Km southwest of the Osa Peninsula, in the Pacific Ocean. It is part of the national territory. Costa Rica's area is 51,100 square kilometers, and its population is around four million nine hundred seventeen thousand inhabitants. The country's capital is San José. Settlements in Costa Rica date from year 5,000 B.C., but when compared with the great pre-Hispanic civilizations of the American continent, Costa Rican Indians were not many neither did they reach high levels of development.

The current constitution from November 7, 1949 defines Costa Rica as a democratic republic. With the abolition of the army in 1948, Costa Rica consolidates its tradition of peace and democracy that Costa Ricans have always had. The only security forces of Costa Rica are the Civil Guard and the Rural Assistance Guard.

Administration

The country's territory is divided in seven provinces: San José, the capital; Alajuela, Cartago, Heredia, Guanacaste, Puntarenas, and Limón. The Constitution forbids the establishment of an army, which places Costa Rica among the few countries of the world free of forces and military interests. The social order is efficiently guarded by the police force. The current political structure is divided in three main

powers: the Legislative Power (unicameral system) constituted by 57 congressmen, who are representatives elected for a four-year term and cannot be reelected for consecutive periods. The Executive Power includes the President, Vice-Presidents, and 18 Ministries whose ministers compose the Presidential Cabinet, and the Judicial Power, formed by the Supreme Court of Justice, a Constitutional Court which judgments are not open to appeal, courts of appeal, and the Criminal, Civil, and Special Courts. Each power operates independently from the others.

Every four years the country has popular elections to choose their President, their Congressmen, and their municipal representatives.

Population: 4.968.139 as of May 2018
Language: Spanish

Economic overview

The economy of Costa Rica is pretty stable and depends essentially on tourism and the export of agricultural products, such as coffee, banana, sugarcane, tropical fruits and flowers, among others. Even during the last years, the nontraditional products have grown dramatically. Corn, beans, vegetables, tobacco, and cotton are also cultivated. Livestock activity is composed by cattle, pigs, and horses, as well as poultry; meat is an important export product. Mining has just developed, although there are some important mineral deposits, their scarceness and inaccessibility make mineral deposits exploitation nonprofitable. The industry is composed by companies engaged in the manufacturing of foods, beverages, fabrics,

shoes, furniture, chemical products, pharmaceuticals, electric machines, and metal sheets. The monetary currency is the colon, divided in 100 cents. Costa Rica is one of the most industrialized countries of the region, and its lifestyle is high for the average of Latin America. Since 1950 the Central Bank has been in charge of the issuing monetary paper and coins, and it establishes the monetary policy of the country. Until February 2, 2015 maintained a system of bands exchange rate, which allowed the exchange rate was freely determined by the market; but within the limits set by the bands exchange rate. From that date, the Central Bank decided to migrate from a band exchange rate regime to a managed floating exchange rate. Under managed floating the exchange rate is determined by the market, but the Central Bank reserves the possibility of performing intervention operations in the foreign exchange market to moderate major fluctuations in the

exchange rate and prevent deviations which would be consistent with the behavior of the variables that explain its tendency of medium and long term.

Transport infrastructure

It is easily accessible by land, sea, and air. Visitors can travel through the Inter-American Highway, which is open all year round. Also, there are many airlines serving the country, and they use the Juan Santamaría Airport, in the central zone, and Daniel Oduber, in Liberia, Guanacaste. Since it is located in the Central American isthmus, Costa Rica has an easy access to faraway places of the world thanks to its ports in both oceans, which have a modern equipment in accordance with the international level demands, which is the case of Puerto Mohín, Puerto Limón in the Atlantic, and Caldera in the Pacific.



Choice of Legal Form



Limited liability company

In Costa Rica, with this company, shareholders respond only up to the extent of their contributions in the company. They can be named as shareholders wish, and the words "Sociedad de Responsabilidad Limitada" (Limited Liability Company) or only "Limitada" (Limited) should appear at the end of the name, abbreviated as follows: S.R.L., "Ltda.".

Share capital shall be represented by nominative shares that cannot be transferred through endorsement. According to the Costa Rican Code of Commerce, share capital is divided in shares of one hundred colones or multiples of a hundred.

The articles of incorporation should state the complete share capital amount and the amount paid by each shareholder, at least one fourth of it, so that in order to increase capital, the same rules used for its constitution are applicable.

Shareholders are entitled to the same number of votes than the shares they own. From liquid profits, 10% should be destined to the creation of a legal reserve, until reaching 20% of share capital.

The company should be managed by one or more managers or sub-managers, and they can be company's shareholders or not related to it.

No dividends can be paid or allocations made to shareholders, but only on realized and liquid profits.

General partnership

This type of partnership is practically not used in Costa Rica; however, it is established in the Code of Commerce. Its main characteristics are: shareholders are secondarily but jointly and severally liable on capital obligations.

Trade name will be formed with the name or last name of one or more shareholders, adding the word “compañía” (company). If a person not related to the company agrees on having his/her name and last name included in the trade name, this person shall be subject to the joint and several liability that corresponds to a shareholder. A shareholder cannot assign his/her right in the company without the express consent of the others.

Limited partnership

It refers to the company formed by general partners to whom representation and management corresponds and by limited partners

The manager and sub-manager are appointed among the limited partners, and the former should manage the partnership. The articles of incorporation should state who are the general and limited partners, as well as the contribution of each partner to share capital.

Liability of general partners is similar to that of limited partners; however, in case of limited partners, liability does not go beyond the capital contributed.

This company can be dissolved due to the general partner’s death, bankruptcy, impossibility to manage, in case the company is constituted by more than one partner. However, when there is more than one partner, this situation can be prevented in the articles of incorporation, so the company can continue to operate. The use of this corporation is inexistent in our country.

Representative office/branch

The companies’ branches are obligated to have an unlimited power of attorney in the country. The articles of incorporation shall state: a) purpose of the branch and capital assigned to it b) parent company’s purpose, capital, complete name of representatives or administrators and term; c) express declaration acknowledging that the representative, or the branch, are subjected to the Laws and courts of Costa Rica regarding all acts or contracts entered into or which take place in the country, and they expressly waive to the laws of their domicile, and d) proof that the grantor has sufficient legal representation to do so. Branches should register with the Commercial Section of the Public Registry in Costa Rica.

Independent business

In our country, Costa Rican citizens can have a business under their name and perform commercial activities.

Offshore entities

This type of entity is generally used by financial groups and is established abroad, at a site previously authorized by the General Superintendence of Financial Entities (SUGEF). These institutions cannot perform operations in colones for they should only act as correspondent banks of a local bank. They are subject to the legislation and supervision of the country where their juridical headquarters are located.

Subsidiary

According to the regulations established in the Code of Commerce, a subsidiary should have an unlimited attorney-in-fact in the country and register with the Commercial Section of the Public Registry in Costa Rica. As in the case of the branch, articles of incorporation articles of incorporation must state: a) purpose of the subsidiary and capital assigned to it b) parent company's purpose, capital, complete name of representatives or administrators and term; c) express declaration acknowledging that the representative, or the subsidiary, are subjected to the Laws and courts of Costa Rica regarding all acts or contracts entered into or which take place in the country, and they expressly waive to the laws of their domicile, and d) proof that the grantor has sufficient legal representation to do so.

Corporation

This type of company is the one used the most in Costa Rica. In this kind of entity, share capital is divided in shares, and shareholders are obligated to pay their contributions. The name is chosen freely, but it should be different from any other existing company and must be followed by the words "Sociedad Anónima" or "S.A."

To create a corporation, there should be, in the first place, at least two shareholders, and each of them shall subscribe at least one share. Each of the subscribed shares must be paid in cash, and at least 25% should be paid at the moment the company's articles of incorporation are entered into. Liability is limited, which means that shareholders assume no liability before third parties beyond the capital contributed. From net profits of each tax year, five percent should be used to create a legal reserve fund, and obligation that shall cease when the fund reaches twenty percent of capital stock.

Foundation

The trust entity is regulated by the Costa Rican Code of Commerce in articles 633 to 662.

According to article 637 of such Code, the trustee can be any individual or corporation who is capable of acquiring rights and assuming obligations. In the case of companies, articles of incorporation should clearly state that they are empowered to receive the trusted property by agreement or will.

Audit Requirement



According to the Costa Rican legislation, the following entities must audit their financial statements at least once a year:

- Government banks
- Government banks created by special laws
- Private banks
- Non-banking financial entities
- Credit unions.
- Savings and loan associations
- Brokerage houses
- Investment fund companies
- Companies that publicly trade securities
- Complementary pension fund companies

- Other pension regimes created by special laws
- Large business taxpayers

Requirements and thresholds

Sometimes, financial entities also demand their debtors to submit audited financial statements when the debt exceeds certain threshold, which varies according to the financial entity regulations.

Taxation



Corporation tax

In Costa Rica, according to the current Income Tax Law, Law No. 7092, corporations pay, as a general rule, 30% on its profits. Corporations must annually file tax returns, in which taxpayers state their taxable income and deductible expenses according to law; the result obtained is the yearly taxable income, to which 30% tax is applied.

Small companies rate

There is regime for “small companies”, which are those companies whose annual gross income is not above ₡53.113.000. Their tax rate is based on a progressive scale that for the 2018 period is the following:

2018 Period	Rate
₡ 53.113.000	10%
₡106.835.000	20%
On the excess ₡106.835.000	30%

According to the **Gross Income** amount declared by the taxpayer, the corresponding payable tax is calculated from the chart above, and it is applied to the taxable liquid income.

Individuals with profitable activities

If an individual decides to have a business of its own or in the case of independent professionals, such as lawyers, private

accountants, certified public accountants, medical doctors, etc., tax on profits should be calculated based on the following table for tax on profits:

	2018 Period	Rate
Net Income		
Up to	₡3.549.000	Exempt
Over the excess of	₡3.549.000 up to ₡5.299.000	10%
Over the excess of	₡5.299.000 up to ₡8.840.000	15%
Over the excess of	₡8.840.000 up to ₡17.716.000	20%
More than	₡17.716.000	25%

(Taxpayer must file form D-101, Sworn Income Tax Return).

Payment of such tax must take place within the first ten working days of the month following the one in which the payment, withdrawal, or credit of dividends was made, and the paying company becomes the withholding agent.

Dividend payments

The payment of dividends is established in article 16, 17, 18 and 19 of Income Tax Law of our country, levying first all the dividends paid in money, in kind, or in non-nominative shares of the company, the individuals domiciled in Costa Rica and abroad, and the corporations domiciled abroad, at a general rate of 15%. A rate of 5% is applied to those dividends distributed by corporations whose stock is registered with the National Stock Exchange, and besides, such stock had been acquired through such Institution.

Branch profits tax

Branches in Costa Rican pay taxes, just as corporations do, at a rate of up to 30% on profits.

Moreover, the profits remitted to the parent company are taxed at a 15%-rate, according to article 19 of the Costa Rican Income Tax Law. The Company that makes the payment acts as withholding agent.

Personal income tax (pay as you earn)

Since our Income Tax Law is based on an individual structure, it levies income from independent work, pensions, retirements,

or other remunerations for personal services. Tax rates to such remunerations are the following (each tax period modifies the chart):

	2018 Period	Rate
	Up to ¢ 799.000	Exempt
	Over the excess of ¢ 799.000 up to ¢1.199.000	10%
	More than ¢1.199.000	15%

The employee does not have to file the tax return; therefore, the employer must monthly withhold such tax, report it and pay it to the tax authorities.

Capital gains tax

Non-customary capital profits are usually not taxed (understanding as "customary" the activity to which a person or company mainly and mostly dedicates, which is publicly and frequently performed, and to which most of the time is devoted). However, those profits originating from depreciable fixed assets are specifically taxed. In this case, for calculating tax on the companies' profits, it is necessary to calculate what they declare at a rate of 30% when dealing with large companies and the corresponding rate when dealing with small companies.

Land tax

Territorial tax in Costa Rica is called Tax on Real Estate, which levies land and facilities or fixed and permanent constructions existing in the municipal jurisdiction. Such tax is administered by the municipalities established in each county. Rate is 0.25%, which is applicable on the cost of the real estate registered with each municipality. It is an annual tax, and the tax period starts on January 1 and ends on December 31 of each year.

Value added tax

There is not a specific value-added tax.

Sales taxes

Costa Rica establishes a general sales tax for merchandises sold in the local market, which is 13% on sales or transfers made, specifically on services stipulated by the Law, such as: restaurant, clubs, bars, and other similar ones, as well as motels, boarding houses and other temporary guesthouses; telephone service, electricity, car repair shops, customs agencies, advertising services, and others.

Sales tax operates under the concept of the difference between the tax paid in previous stages and the tax charged in the sales invoice; however, this system does not only operate for commercial companies as to resold merchandises, and for industrial companies, credit is only on those acquisitions incorporated on

the production of merchandise, including taxed services. As to the companies offering taxed services, tax credit is only recognized when it is incorporated to the taxed credit. The tax credit is not recognized when rendering exempted services. In regards to exports, sales abroad are not taxed and tax credit is recognized to them that is to say, sales tax paid in equipment, industrial machinery, raw material, and consumables incorporated in the production of merchandises to be exported.

This tax is determined according to the monthly sworn return, which is determined by subtracting to the tax debit (tax charged to clients for taxed merchandise sales) the tax credit (tax paid in previous stages).



Local taxes

The most important local taxes are the following:

Municipal Permit (“Patente”) Tax

Any person who wishes to perform a profitable activity should have a municipal permit, which will be obtained by paying the municipal permit tax. This tax must be paid during all the time such profitable activity took place or during the time such permit has been granted. This tax is local; therefore, a specific rate applies for each county municipality.

Tax on constructions

Any division of a property for sale should have express permission from the municipality, as well as any work related to the construction performed, whether provisionally or permanently. Tax corresponds to 1% on the cost of constructions.

Tax treaties

There are no international tax treaties in Costa Rica, only information exchange treaties with the United States of America.

Transfer pricing rules

In Costa Rica was published Transfer Pricing Regulations (Decree No. 37898-H Transfer Pricing Provisions, published in Gazette 176 on Friday, September 13, 2013); also, the Dirección General de Tributación (tax authority) declared that the transfer prices were fully applicable in Costa Rica through Directive No 20-2003 denominated “Tax Treatment of Transfer Prices according to the Normal Market Price”. To this end, it made an extension of the interpretation, according to the economic reality allowed by article 8 of the Tax Code. From fiscal year 2015, will be the first informational declaration for large taxpayers and large land companies, as well as for free zone companies; For the other companies are not obliged to make the informative declaration, but they are obliged to carry out the study of transfer prices.

Allowances



Depreciation

The Costa Rican Income Tax Law only allows two methods: a) straight-line b) sum-of-the-years' digits. In the Regulation to the Law, there is a chart for each of the assets. In case an asset is not included in the chart, it must be requested to the Tax Authority (Dirección General de Tributación)

Investment allowance

By provisions established by the National Supervisory Board of the Financial System (CONASSIF), investments are valued at market value, which can result in profits or losses in their valuation. Yields are subject to 8% tax, withholding at the source.

Employment



Social security/unemployment taxes

Employer's Social Contribution

CCSS

Invalidity, Old Age, Death (employer)	5.08%
SEM (emploer)	9.25%

Other Institutions

Asignaciones Familiares	5.00%
Banco Popular (employer's share)	0.25%
IMAS	0.50%
INA	1.50%

Employee Protection Law

Banco Popular (employer's share)	0.25%
Labor Capitalization Fun (Gradual, Transitory VIII-Employee Protection Law (LPT))	3.00%
Complementary Pension Fund	1.50%

According to Labor Code, two weeks of paid vacations shall be granted for every 50 weeks of uninterrupted work.

Employment of foreign personnel

Foreigners do not have any impediment to work in Costa Rica, as long as they have the respective permit of the Immigration Authorities (Dirección General de Migración). Professionals should provisionally incorporate to the corresponding professional association.

Payroll taxes

Tax rates on salaries are the following (with each tax period, the chart is modified):

	2018 Period	Rate
Up to	¢ 799.000	Exempt
Over the excess of	¢ 799.000 up to ¢1.199.000	10%
More than	¢1.199.000	15%

The employee does not have to file the tax return; therefore, the employer has to the obligation to make monthly withholding of such tax, report them and pay them to the Tax Authorities.

Withholding Taxes



Interest

Interests borne by securities in local currency (colones) are taxed at the source with 15% tax on them, without any deduction. If securities are traded at the National Stock Exchange, tax is reduced to 8%.

Securities in foreign currency issued by the government or by the government banks are exempted from this tax, and the securities issued in foreign currency issued by Banco Popular y de Desarrollo Comunal and the National Banking System for housing.

Royalties

People domiciled outside the territory and receive royalties from Costa Rican sources are taxed with a tax on remittances abroad at a 25%-rate.

Dividends

These are taxed at a 15%-rate when shares have not been acquired at the National Stock Exchange and at a 5%-rate when acquired at the National Stock Exchange and traded there.

Miscellaneous



The Tax Reform bill is currently waiting to be passed by the Congress. If approved, the Costa Rican tax legislation will have a radical change.

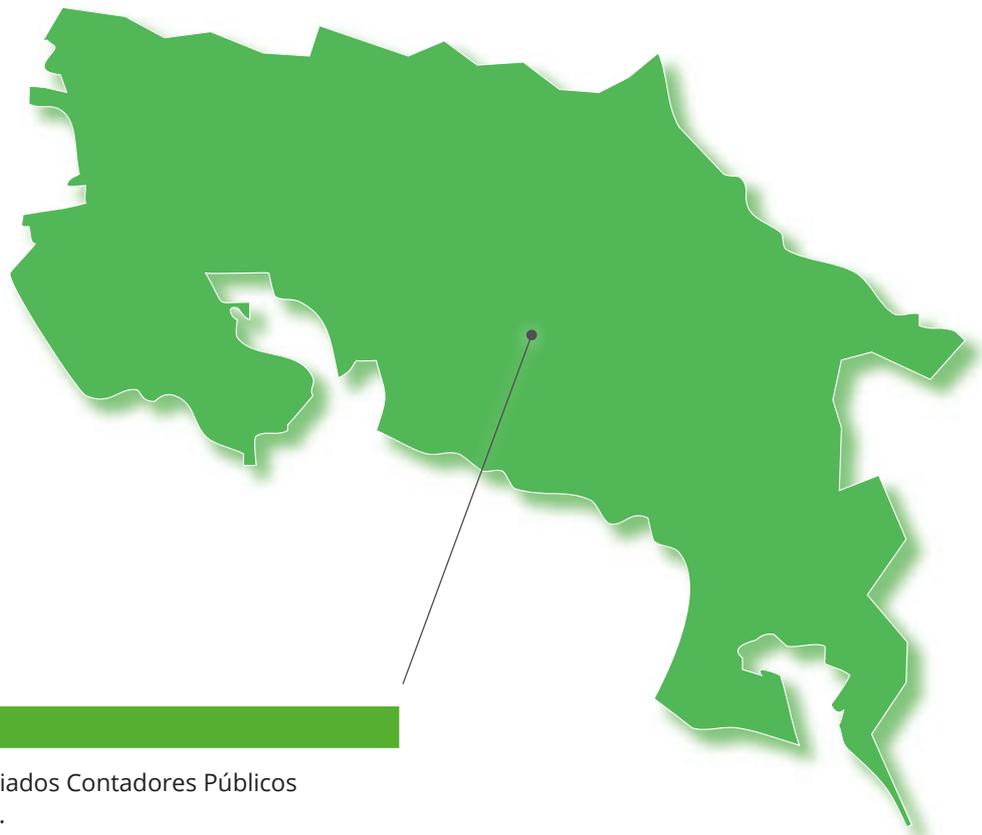
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If you are setting up a business in Costa Rica, the members of DFK International can help you to achieve this efficiently. You will receive practical advice on business issues, tailored to meet your objectives, from experienced business advisers.

For further information on the services available from the DFK member firms in Costa Rica please see overleaf.



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