

MEMO

To: PUBLIC
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TAXATION IN COSTA RICA

I. Income Tax

1. Costa Rica does not tax income derived from a foreign source.
2. All of the following are subject to income taxation:
 - Legal entities, the facto corporation, professional companies, and state enterprises which operate in the country;
 - Branch offices, subsidiaries, or agencies of any non-resident which operates in the country;
 - Trusts;
 - Inheritances (as long as remaining indivisible);
 - Individuals residing in Costa Rica regardless of nationality;
 - Individuals hired in a professional occupation;
 - Physical and legal entities not specifically mentioned and engaged in profit-making activities in Costa Rica.

II. Taxable Income

1. Taxable income is based upon net income, thus becoming necessary to establish the corresponding gross income of the tax paying entity.
2. Costa Rican Laws defines “gross income” as the total income and profits earned in the country during the taxable year, which includes earning from the following:
 - Real property,
 - Investment of capital and other business activities
 - Any increase in net worth during the taxable year, which cannot be justified by declared or registered income.
3. Excluded from the gross income are the following:
 - Income derived as a result of contracts or agreements made on goods or capital located abroad, even for contracts negotiated in C.R.
 - Capital gains obtained from the transfer of real or personal property so long as this income does not constitute a habitual transaction;
 - Donations in cash or kind;

- Revaluation of fixed assets (except depreciable fixed assets, though, depreciation allowances may be considered if approved by the tax administration);
- Profits, dividends, participation and any other form of distribution of benefits credited to the taxpayer;
- Inheritances, legacies, community properties;
- Prizes from national lotteries;
- Approved charitable donations.

III. Deductions

1. Allowable deductions are those necessary to produce taxable income, such as:

- Costs: Any costs incurred, which are necessary to produce the income, may be deducted (i.e. raw materials, parts, components, or services needed to produce the goods or services);
- Salaries: Wages, bonuses, gifts, benefits actually paid out are deductible as long as the income tax of the recipient has been withheld and paid to the Treasury;
- Taxes: Any taxes levied against the goods or services or transactions carried out in the ordinary course of business;
- Insurance Premiums: Insurance Premiums for policies, which cover fire, theft, earthquake, or similar risks;
- Interest: No reduction allowed for interest payable to shareholders of limited liability companies;
- Bad Debts: If related to the transactions in the ordinary course of business of the taxpayer and all legal efforts have been exhausted to collect the debt;
- Depreciation: Apply to the exhaustion, wear and tear, or obsolescence of property, which is used in the trade or business. The Tax Law specifies the maximum depreciation amounts allowed;
- Business Losses: Deductions are allowed for business losses. Losses incurred in one taxable year may be carried over for 3 years (5 years for agricultural enterprises);
- Social Security Contributions: Contributions established by law and paid to the employees are deductible;
- Board of Directors' Remuneration: Deductions are allowed for remuneration, wages, commissions, honoraria, paid to members of the board of directors located abroad;
- Payments to entities not domiciled in C.R.: Payments for technical support, financial, as well as for the use of patents, trademarks, franchise fees, or royalties are deductible. If payments are made to an agent or subsidiary of a firm which is permanently established in C.R. then the deduction cannot exceed 10% of the annual gross sales of that company;
- Travel Expenses: These may not exceed 1% of the gross income declared;
- Start up Expenses: Deductions are allowed for expenses necessary to initiate production of taxable income;
- Advertising: Advertising and sales promotion expenses inside C.R. or abroad are deductible;
- Casualty losses: Casualty and theft losses, which are not covered by insurance;
- Gifts made to the state.

IV. Corporate Income Tax

1. For Corporate entities the following tax table prevails:

- 10% on gross income up to 21,468,000
- 20% on gross income up to 43,183,000
- 30% gross income over 43,183,000

V. Tax on Corporate Assets

The Tax Adjustment Law introduced a 10% tax on the assets of corporations whose assets exceed 30,000,000.00. The law has several exemptions. An accountant should be consulted as to the application of this law on your particular situation.

VI. Tax on Capital

This tax is also known as the "Education and Culture Tax". Every legal entity (corporation) as well as its subsidiaries, or agencies of a foreign company, which are duly recorded in the Costa Rican Mercantile Registry, must pay an annual tax based on its net capital or equity (assets less liabilities), according to the following table:

- For net capital up to 250,000 — 750 per year (also applicable to negative capitals, i.e., liabilities higher than assets).
- For net capital of 250,001 and up to 1,000,000 — 3,000 per year.
- For net capital over 1,000,001 and up to 2,000,000 — 6,000 per year.
- For net capital over 2,000,001 — 9,000 per year.

VII. Annual Property Taxes

For the next five years, the property tax payment will be 60% of the appraised value of the property. Starting on year six, the municipality may set its own rate not to exceed 1%.

VII. Transfer Taxes

There is a 3% property transfer tax. This tax is based upon the registered value placed on the property transfer deed at the time of sale.

VIII. Tax on Distributed Profits / Dividends

Whenever a corporation distributes its profits as dividends, the following tax is applied:

- When the profits are distributed to corporation partners, the corporation, for payment to fiscal authorities must withhold a 15% tax.
- When dividends are distributed by a corporation whose shares are registered in an officially recognized stock exchange, a 5% tax must be withheld only if the shares were acquired through a stock exchange.
- If the partner is another corporation also subject to this withholding tax and with its capital duly registered in Costa Rica, the tax is not applicable.