



Investment in Costa Rica

Contents

Chapter I:	Country Outline	1
	Geography and Climate	1
	History and Government	2
	Population and Language	5
	Education	6
	Currency and Foreign Exchange Regulations	7
	Cost of Living	8
	Infrastructure Advantages	8
Chapter II:	Forms of Business Organization	11
	Corporations	11
	Limited Liability Companies (LLCs)	14
	Limited Partnerships and General Partnerships	15
	Other Business Entities through which Business May Be Conducted	15
	Transfer of Legal Domicile to Costa Rica	16
Chapter III:	Offshore Corporations	19
Chapter IV:	Agency	21
Chapter V:	Trusts	25
Chapter VI:	Corporate Taxation	27
	Territoriality Principle	27
	Tax Year	27
	Income Tax	27
	General	27
	Losses	28
	Rates	29
	Tax Returns	29
	Tax Payment	29
	Withholding Taxes on Foreign Remittances	29
	Dividends	30
	Other Withholdings	31
	Income Taxes	31

Financing	31
Non-domiciled companies	31
Transportation and Communications	31
Reinsurance	32
Media	32
Capital Gains Tax	32
Transfer Taxes	32
Sales (Value-Added) and Excise Taxes	32
Rates	33
Tax payment	33
Real Estate Taxes	33
Rates	33
Computation and payment	33
Stamp Taxes	34
Education and Culture Stamp Tax	34
Local Taxes	34
Import Duties	34
Tourism	35
Forestry	35
Mining	35
Surface taxes	35
Taxes	36
Tax Evasion: Felonies and Misdemeanors	36
Tax Treaties	36
Chapter VII: Individual Taxation	37
Income Tax	37
Individuals with Business Activities	37
Employees	38
Definition of Resident	39
Taxation of Benefits	39
Partnerships	39
Tax Amendment	39
Chapter VIII: Labor Regulations	41
Description of the Labor Force	41
General Labor Principles	41
Fundamental Rights	41
Foreign Labor	42

	Employment Contracts	42
	Termination of Employment	42
	Severance Benefits	43
	Christmas Bonus	43
	Vacation	43
	Maternity and Sick Leave	44
	Occupational Risk Insurance	44
	Wages	44
	Overtime	44
	Social Security System	44
	Employee Protection Law	45
Chapter IX:	Intellectual Property	47
	Infringement of Intellectual Property	49
Chapter X:	Foreign Investment	51
	Attitude towards Foreign Investment	51
	Export-Related Operations	52
	Free Trade Zone Incentive System	52
	New investments	53
	Tax incentives	53
	Independent handling of foreign currency	54
	Services provided by Free Trade Zone operators	55
	Special Drawback Incentive System	56
	Payment of Environmental Services	57
	Agriculture Incentives	58
Chapter XI:	Tourism and Real Estate	59
	Tourism	59
	Tourism Incentives	60
	Environmental Regulations	61
	Real Estate Transactions	62
	National Public Registry	62
	Transfer procedure and closing costs	64
	Buying real estate through a corporation	65
	Advantages	65
	Disadvantages	66
	Papagayo Gulf	67

Chapter XII: Banking	69
Overview of the Banking System	69
State Banks	69
Private Banks	70
Non-Banking Financial Entities	70
Services Available	70
Other Stock Exchanges and Public Offerings	71
Pension Funds	72
Chapter XIII: The Central America-Dominican Republic- United States Free Trade Agreement	73
Chapter XIV: Energy Market and Regulations	75
Background	75
Current Regulatory Environment	76
CAFTA	77
Chapter XV: Insurance	79
Chapter XVI: Government Contracting	81
Coverage	81
Exceptions	82
Government Contracting Principles	83
On the Bidders	84
Representation	84
Procedures	85
Determination of Procedures	85
Public Tender	86
International Public Tender	88
Bid by Invitation	88
Restricted Tender	89
Auction	89
Direct Contracting	90
Appeals	91
Objections	91
Appeals	92
Motion for Reconsideration	93
On Contracts	93
Rights and Obligations	94

Chapter I: Country Outline

Geography and Climate

Costa Rica is a beautiful country that is both peaceful and democratic by nature. It is strategically located in the southernmost part of Central America, near the Panama Canal, and has direct access to the West Indies. More specifically, it borders on the north with Nicaragua, on the south with Panama, on the east with the Atlantic Ocean, and on the west with the Pacific Ocean. The two coasts are just hours away from each other, with a total distance of only 200 miles (320 km). Costa Rica's neighbors, Panama and Nicaragua, are just a 30-minute flight away, and it takes only 2.5 hours to reach Miami by plane.

The country covers an area of approximately 19,730 square miles (51,100 km²). It is politically divided into seven provinces: San José, Heredia, Alajuela, Cartago, Puntarenas, Guanacaste, and Limón. The capital city is San José, which is situated in the country's Central Valley. The surrounding mountains of volcanic origin provide both a beautiful landscape and protection from strong winds.

The dry season runs from December to April, and the rainy season runs from May to November. Although Costa Rica is a relatively small country, its geographical position creates a variety of microclimates, such as cool mountains, dry beaches on the Pacific coast, and the tropical climate of the Atlantic coast. Nonetheless, temperatures are moderate in most areas, particularly the Central Valley (San José). The average annual temperature is 70°F (20.0°C), with a high of 76.8°F (24.9°C) and a low of 61.3°F (16.3°C).

Summary:

Location:

Between 8° and 11° north latitude and between 83° and 86° west longitude; six hours west of the Greenwich Meridian (-6 hours GMT)

Area:

Approximately 19,730 square miles (51,100 km²)

Capital:

San José

Other major cities:

Alajuela, Cartago, and Heredia

Coastal cities:

Limón on the Atlantic coast, and Puntarenas and Liberia on the Pacific coast

History and Government

Christopher Columbus discovered Costa Rica in 1502 on his fourth and final voyage to the New World when he arrived on a small island just off the coast of what is now the Caribbean port city of Limón. It was Columbus who gave the name “Costa Rica,” or “rich coast,” to the fertile land he encountered. In later years, Spain would colonize Costa Rica, as it did most of Mexico, Central America, and South America.

During the colonial period, trade declined and primarily involved the other colonies. However, Costa Rica continued to be a Spanish colony governed by Guatemala City. On September 15, 1821, Costa Rica won its independence from Spain, and the gradual arrival of non-Spanish Europeans opened up the country to trade with the outside world.

Costa Rica is a free and independent democratic republic with a representative government that is divided into three distinct and independent branches: the executive, legislative, and judiciary. The Costa Rican constitution also provides for establishment of an elections commission, which is responsible for ensuring the legitimacy of presidential and congressional elections. The presidential term is four years and election is by direct majority vote.

Costa Rica is one of the most stable and peaceful democracies in Latin America and the world. The democratic state was first established in 1821, and has continued un-

til the present with only brief interruptions. The national army was abolished in 1948, which is another element that has contributed to the stability and peace of Costa Rica. Additionally, legislation to sustain permanent neutrality in international conflicts was enacted in 1983. As a result of the country's peaceful nature, many international organizations have offices in Costa Rica, including several United Nations agencies. Costa Rica has been nominated twice for a Nobel Peace Prize, and this prestigious award was bestowed upon former president Oscar Arias in 1987.

The current Constitution of November 1949 guarantees respect for human rights.

The president of the Republic in office is Dr. Abel Pacheco, whose term runs from May 8, 2002 to May 8, 2006.

There are 18 ministries in Costa Rica:

- Ministry of Government and Police Forces
- Ministry of Agriculture and Livestock
- Ministry of Science and Technology
- Ministry of Foreign Trade
- Ministry of Culture, Youth, and Sports
- Ministry of Economy, Industry, and Commerce
- Ministry of Public Education
- Ministry of the Treasury
- Ministry of Justice
- Ministry of the Presidency
- Ministry of Public Works and Transportation

- Ministry of National Planning and Economic Policy
- Ministry of Foreign Affairs
- Ministry of Public Health
- Ministry of Public Security
- Ministry of Labor and Social Welfare
- Ministry of Housing
- Ministry of Environment and Energy

The following government institutions deal with the economy, commerce, and trade:

- Central Bank of Costa Rica
- Foreign Trade Corporation
- Costa Rican Coalition for Development Initiatives (CINDE)
- Union of Chambers (UCCAEP)
- Chamber of Industries (CICR)
- Chamber of Commerce
- Chamber of Retailers
- Chamber of Exporters (CADEXCO)
- Costa Rican-North American Chamber of Commerce (AMCHAM)
- Costa Rican Foreign Trade Promoter (PROCOMER)
- Costa Rican Tourism Board (ICT)

Population and Language

Costa Rica is a small Central American country with a low population density. As of 2004, total population was approximately 4,248,508 inhabitants. Nearly 59% of the population lives in urban areas in and around San José, with the remaining 41% of the population inhabiting rural areas. Population density is approximately 83.1 inhabitants per km² and average family size is 4 to 5 members.

Costa Ricans refer to themselves as “Ticos”, an affectionate name derived from their penchant for adding the diminutive “-tico” to all sorts of words. A large majority of Costa Ricans are of European (largely Spanish) descent. Whites and mestizos (people of Spanish and Native American ancestry) account for approximately 96% of the population, while the small Black community is concentrated on the Atlantic coast and is largely of Jamaican origin. About 50% of the population is defined as rural.

In general, Costa Ricans are friendly and courteous. When doing business, it is important to remember that Costa Ricans often place greater importance on politeness, conversation, and relationships than on punctuality.

As a result of the country’s highly specialized work force, large transnational companies have relocated to Costa Rica. The majority of the working population (approximately 86%) is employed by the private sector, while the remaining 14% works in public sector jobs. The unemployment rate for 2004 was 6.5%. All employers in all sectors are required to pay at least the legal minimum wage. In general, only inexperienced workers receive the minimum wage, given that experience, training, and demand for workers usually result in higher salaries.

Although Spanish is the official language in Costa Rica, a large percentage of the population speaks English. Other foreign languages are also spoken, albeit to a lesser extent. This is the result of public and private educational systems in which the study of a foreign language is mandatory. Although English is often used in professional and business settings, the official language for all legal proceedings is Spanish. Official translators certified by the Ministry of Foreign Affairs must translate all documents required by government authorities.

Roman Catholicism is the official religion. However, the Constitution guarantees freedom of religion.

Summary:

<i>Population (2004):</i>	<i>4,248,508 inhabitants</i>
<i>Female population:</i>	<i>49.1 %</i>
<i>Male population:</i>	<i>50.9%</i>
<i>Population density:</i>	<i>83.1 inhabitants/km²</i>
<i>Growth rate (2004):</i>	<i>1.5% annually</i>
<i>Ranking in the Human Development Index (2003):</i>	<i>4th in Latin America, 47th in the world</i>
<i>Literacy rate:</i>	<i>95.5%</i>
<i>Life expectancy at birth:</i>	<i>78 years</i>
<i>Homes with drinking water:</i>	<i>99%</i>
<i>Population covered by health services:</i>	<i>90.4%</i>
<i>Population with access to telephone service:</i>	<i>92%</i>
<i>Telephone lines per 100 persons:</i>	<i>58</i>
<i>Official language:</i>	<i>Spanish</i>
<i>Number of universities:</i>	<i>67: 4 public and 63 private</i>
<i>Labor force:</i>	<i>1.7 million</i>

Education

The low illiteracy rate of 4.5% is due to mandatory primary and secondary education. Primary and secondary education is free, and attendance is compulsory between the ages of 6 and 13. For 2003, approximately 536,104 pupils were enrolled in 3,904 public primary schools, and approximately 284,841 students attended 580 public and private secondary schools. Private schools include world-class institutions with a cultural emphasis on the United States of America, United Kingdom, France, Germany, and Israel. Costa Rica has both public (which charge a nominal tuition) and private universities. The prominent Universidad de Costa Rica, located in San José, is a public university that was founded in 1843 and has an annual enrollment of approximately 29,000 students. The country also has numerous technical and vocational institutions. The average Costa Rican is educated, has a working knowledge of English, and the potential for learning a trade or skill.

Currency and Foreign Exchange Regulations

The Costa Rican monetary unit is the colón (¢), which is divided into 100 céntimos. Under the current foreign exchange system, foreign currency can be freely held or converted into local currency and vice versa, with the exception of certain export proceeds.

The only limitation the Central Bank of Costa Rica places on transactions to convert non-export dollars to and from colones is that authorized agents must be used (e.g. private and State-owned banks, hotels, and most financial institutions).

The crawling peg system has been eliminated and the exchange rate is currently determined by a managed floating system, whereby the Central Bank of Costa Rica intercedes in the market to maintain stability. The system results in slight devaluations of the colón throughout the year. Under this system, the Central Bank of Costa Rica does not set the exchange rate. Rather, the parity of the colón with respect to the US dollar is determined in a free exchange market, under the supervision of the Central Bank of Costa Rica. Exchange rates are calculated based on the average of total exchange transactions executed by authorized entities as of 16:00 hours on the preceding day.

In 2004, annual imports and exports amounted to approximately US\$7,662,600 and US\$6,102,200, respectively. Chief exports included coffee, bananas, beef, textiles, and sugar. In the last few decades, Costa Rica has also become a prominent exporter of non-traditional products, such as textiles, pineapple, flowers, ornamental plants, vegetables, etc. Electronic micro-components have now become the leading line of exports (due to the arrival in Costa Rica of companies such as Intel and SDC), followed by textiles. Tourism leads foreign earnings in the services sector. In recent years, a large number of companies have developed hotels, resorts, and other tourism-related operations in the country due to its natural beauty and the warmth of the Costa Rican people. Principal imports in 2004 were goods, machinery, transportation equipment, chemicals, crude oil, and foodstuffs.

The United States of America, Germany, Guatemala, El Salvador, Mexico, Venezuela, and Japan were principal trade partners. Costa Rica's accession to the Central American Common Market in 1963 gave rise to major increases in regional trade, which has since declined. In 1995, Costa Rica helped establish the Association of Caribbean States (ACS). As a free trade organization, the ACS is comprised of the members of the Caribbean Community and Common Market (CARICOM), as well as 12 Latin American countries bordering the Caribbean. Costa Rica has also been an active member of GATT since 1990 and is a founding member of the World Trade Organization. Moreover, Costa

Rica has been granted preferential status in both the United States of America (Caribbean Basin Initiative - CBI) and Europe (Generalized System of Preferences). In addition, free trade agreements have been signed with Mexico, the Dominican Republic, Panama, Canada, and Chile. Likewise, on March 14, 2003, negotiations were concluded for a Free Trade Agreement between Costa Rica and CARICOM. Furthermore, the Central America Free Trade Agreement between the United States of America and Central America (CAFTA) has been negotiated and is pending ratification by the Costa Rican Legislature. Finally, the Free Trade Area of the Americas (FTAA) and a free trade agreement between Costa Rica and Panama are in the process of being negotiated.

Cost of Living

By international standards, the cost of living in Costa Rica is low, which by no means implies a lower standard of living. The gross domestic product per capita in 2004 was approximately US\$4,130. Inflation for 2004 was 13.1%.

Life expectancy in Costa Rica is 78 years, one of the highest life expectancies in the world. Additionally, the country has one of the lowest infant mortality rates (10.26 per 1,000) compared to other Latin American countries.

Infrastructure Advantages

Costa Rica enjoys a highly developed communications, power, and transportation infrastructure. The telecommunications system provides global direct dialing telephone services, as well as telex, telegram, facsimile, and data transmission services that are unsurpassed in Latin America.

Costa Rica is self-sufficient in terms of electrical supply. The Costa Rican Power and Telephone Company (ICE) is a government monopoly that controls several hydroelectric power plants that produce enough electricity to meet the country's needs. New power generation projects involving geothermal generators are currently being developed to meet the country's energy demands in the next century.

Costa Rica has over 17,674 miles (28,443.50 km) of roads running from coast to coast and two international airports. The Juan Santamaría Airport is located in Alajuela and provides access to main global markets, while the Daniel Oduber Airport located in the western province of Guanacaste is used mainly for tourism. The Tobías Bolaños Airport in San José is primarily for local flights. Finally, Costa Rica has two international ports that are used by important shipping lines on both the Atlantic and Pacific coasts.

A total of 21 passenger airlines, 12 cargo airlines, 34 shipping lines, and 123 port shipping agencies are authorized to operate. Air and maritime shipping fees for Europe, North America, and Asia are competitive.

Chapter II:

Forms of Business Organization

Costa Rican law recognizes the following forms of business organization:

1. Corporations [Sociedad Anónima];
2. Limited Liability Companies [Sociedad de Responsabilidad Limitada];
3. Limited Partnerships [Sociedad en Comandita Simple], and;
4. General Partnerships [Sociedad en Nombre Colectivo].

Corporations

Corporations are the most common form of organization due to their structural flexibility. Since local law defines corporations as a bilateral agreement, they must be formed by at least two parties. However, once formed, a single party may legally own 100% of the capital stock without altering the legal status of the original corporation. In order to incorporate a legal entity, articles of incorporation must be drafted and executed before a notary public. Notification of incorporation must then be published in the “Official Gazette” and the articles of incorporation recorded in the Public Registry.

Founding parties (and any shareholders subsequent to organization) may be individuals and/or registered legal entities, regardless of citizenship or domicile.

By law, corporations are subject to the following requirements:

- **Company name.** The name may be one or several words in length, with or without meaning, and in any language. Generic names or names that have already been registered are not permitted. The company name must be followed by the words “Sociedad Anónima” or “S.A.” (equivalent to “Incorporated” or “Inc.”) to identify the nature of the business.
- **Legal domicile.** Since corporations are organized according to local legislation, by law they must be domiciled in Costa Rica and have a local address. This notwithstanding, agencies and branches may be established to carry out activities locally or abroad. Corporations are permitted to engage in worldwide operations.
- **Legal term.** Indefinite terms are prohibited by law. Accordingly, a fixed term must be specified, which may be reduced or extended at will. Terms generally range from 50 to 99 years.
- **Corporate purpose.** As opposed to other jurisdictions where comprehensive, meticulous, and lengthy descriptions of the corporate purpose are required, business purpose and local activities are broadly implied in Costa Rican law. However, although simple and general descriptions are sufficient and quite common, detailed descriptions are also permitted. A special body of regulations applies to corporations involved in banking, financial, trust, and securities activities.
- **Share capital.** Share capital is the money used to capitalize the corporation, and corresponds to a fixed amount. It is divided into common par value shares, each entitled to one vote. Shares must be registered, as local regulations prohibit bearer or non-par value shares. However, shares may be openly endorsed and, therefore, represent bearer shares for all practical purposes. There is no minimum share capital requirement. Shares are freely transferable unless the articles of incorporation contain provisions to the contrary (i.e. right of first refusal and other lawful restrictions). Shares may be issued as single units or as stock certificates. At the time of organization or some time thereafter, the corporation may authorize issuance of other types of shares in addition to common stock (such as preferred shares), with all the privileges, restrictions, limitations, and rights agreed by the shareholders, including but not limited to benefits, assets, specific activities, profits, voting, and related matters, all of which must be set forth in the articles of incorporation.

- Board of directors. Corporations must have a board of directors comprised of a minimum of a President, Secretary, and Treasurer. Additional board members may be appointed at will. Board members are not required to be simultaneous shareholders and there are no nationality or residence requirements.

As the (statutory) legal representative of the corporation, the President must hold full power of attorney. However, if advisable, other directors, as well as managers and outside individuals, may also hold other powers of attorney to act individually or jointly on behalf of the entity. The power of attorney may be restricted in order to ensure that the corporation maintains internal control.

Board members are appointed at the first shareholders meeting upon formation of the corporation and from time to time thereafter. Appointments of board members are for fixed terms determined at will in accordance with the articles of incorporation. Board members may also be appointed for the entire legal term of the entity.

Board meetings require the attendance of at least 50% of the corporation's members to be valid. Resolutions by the Board of Directors must be approved by the majority of the members present to be valid. Official board meetings may be held at any foreign location, when provided for in the articles of incorporation.

- Ordinary and Extraordinary Shareholder Meetings. Each type of meeting has a different purpose.

Ordinary: Annual meeting held within three months of the tax year end. The purpose is to discuss and approve (or reject) the financial statements of the previous business year; earnings distributions; appointments and/or revocation of appointments; and any other ordinary matters mentioned in the articles of incorporation;

Extraordinary: Meeting held at any time during the year for the purpose of amending the articles of incorporation; making changes and resolving issues related to share capital; and addressing all other issues referred to in the law and the articles of incorporation. Preferred shareholders may hold Special Shareholder Meetings. Quorum rules are applicable for the above-described meetings.

- Statutory examiner. Corporations may appoint one or more statutory examiners (individuals and/or corporations). The main responsibility of the examiner is to ensure

that all corporate rules, statutory obligations, and procedures are duly and adequately followed, to protect the interests of shareholders and other related parties.

- Registered agent. All corporations, business concerns of any nature, and foreign companies doing business locally must appoint a registered agent when none of the legal representatives reside in Costa Rica. The Registered Agent's sole (passive) legal duty is to be served with administrative and court notices on behalf of the corporation. The agent must be a local practicing attorney with a licensed law firm in Costa Rica.
- Legal reserve. Corporations are required to assign 5% of each year's net earnings to a legal reserve, up to 20% of outstanding share capital. The reserve need not be funded.
- Dissolution and liquidation. On or before expiration of the legal term, if agreed by the shareholders, or in the event certain circumstances occur (e.g. achievement of the corporate purpose or when the corporate purpose becomes impossible to achieve; or definitive loss of 50% of the share capital, unless the shareholders agree to reinstate such capital), corporations are dissolved and liquidated in a process whereby any remaining assets are distributed among creditors and shareholders.
- Books and records. Corporations must keep bound legal books (journals, general ledger, financial statements, shareholders registry, and minutes books of shareholder and board meetings) that have been stamped by Tax Authorities. Computerized accounting records are acceptable, provided summary entries are duly posted in the legal books.
- Incorporation costs. Regardless of the amount of share capital, all entities must pay a registration fee equivalent to 10% of the monthly minimum wage in effect at the time of incorporation. Registration fees plus other incorporation costs such as duties, stamp taxes, corporate books, and legal and notary fees amount to approximately US\$1,200.

Limited Liability Companies (LLCs)

In a limited liability company, the liability of partners is limited to their respective capital contributions. The legal structure of LLCs in Costa Rica is equivalent to the concept of "Partnerships" in the U.S., and LLCs qualify as partnerships for U.S. tax purposes. Incorporation procedures and costs for LLCs are very similar to those of corporations.

The most significant differences include:

- Capital stock: Instead of shares, LLCs divide capital stock into what local regulations refer to as “quotas”. Unless otherwise specified in the articles of incorporation, transfers of “quotas” require the unanimous consent of all partners.
- Management: LLCs are run by one or more managers or assistant managers who hold power of attorney, as set forth in the articles of incorporation.
- LLCs are not required to appoint a Statutory Examiner.

Limited Partnerships and General Partnerships

This type of business organization is seldom used, mainly because of the inherent direct personal liability, and management and exposure issues, among others.

Organization procedures are essentially the same as for corporations, although less complex.

Other Business Entities through which Business May Be Conducted

In addition to the aforementioned entities, foreign companies may conduct business in Costa Rica through parent company subsidiaries, provided that the following requirements are met:

Appointment of a legal representative(s) with full power of attorney to act on behalf of the subsidiary;

Statement of the subsidiary’s corporate purpose and the amount of its assigned capital;

Statement of:

- Corporate purpose of parent company
- Share capital of parent company
- Full names of all current officers and managers
- Legal term of parent company

Formal statement that the proxy (who will act on behalf of the Branch) and the Branch itself shall be subject to Costa Rican laws and jurisdiction with regard to acts performed or to be performed within the country and that the parent company waives the right to appeal to the laws of its local jurisdiction.

The power of attorney must be notarized and authenticated by the corresponding Costa Rican General Consul in the jurisdiction of the parent company where the power of attorney is granted.

Professional fees for incorporating a Costa Rican branch are in the order of US\$2,000.

In addition, any foreign company may appoint a proxy (proxies) to be its Costa Rican representative and conduct business within the country on its behalf. The requirements that must be fulfilled are similar to those for establishing a branch:

Statement of:

- Corporate purpose of parent company
- Share capital of parent company
- Full names of all acting officers and managers
- Legal term of parent company

Formal statement that the proxy shall be subject to Costa Rican laws and jurisdiction with regard to acts performed or to be performed within the country and that, consequently, the parent company waives the right to appeal to the laws of its local jurisdiction.

The power of attorney must be notarized and authenticated by the corresponding Costa Rican General Consul in the jurisdiction of the parent company where the power of attorney is granted.

Transfer of Legal Domicile to Costa Rica

Foreign corporations may transfer their legal domicile to Costa Rica provided this is permissible under the articles of incorporation. In order to execute the transfer, certified copies of the following documents are required:

- articles of incorporation and subsequent amendments;
- resolution authorizing the transfer when no provisions for such purposes are included in the articles of incorporation;
- full names of the officers and managers submitted to the Public Registry; and
- certificate issued by the Costa Rican Consul stating that the company is duly incorporated and exists in accordance to the laws of the country of origin.

Transfer of legal domicile does not imply dissolution of the parent company, which continues to operate under the laws and jurisdiction of its original legal domicile. However, the foreign corporation is subject to local legislation, including income tax regulations, for all activities carried out within Costa Rican territory.

Chapter III:

Offshore Corporations

In practice and given the regulatory environment, local entities can operate as offshore companies. Because Costa Rican tax legislation is based on the territoriality principle, income earned outside national territory (including distributions to shareholders) is not subject to local taxes. Therefore, a Costa Rican company may have investments in any currency and in any part of the world, and the corresponding foreign source income would not be taxed in Costa Rica.

The key requirement for offshore companies is that no business operations take place in Costa Rica. Tax Authorities have ruled that payment of legal and accounting fees to local individuals or entities to maintain offshore companies does not violate this requirement.

There is an important exception to the territoriality principle in the case of offshore financial entities. The Income Tax Law imposes an annual tax of US\$125,000.00 on non-domiciled banks and non-banking financial institutions that form part of a financial corporation whose holding company is domiciled in Costa Rica. That tax is also assessed on non-domiciled banks and non-banking financial entities that are exempt from withholdings on foreign remittances if they have ties to a bank or financial institution domiciled in Costa Rica. Ties exist if a Costa Rican company, bank, or economic interest group owns at least 25% of the foreign entity's share capital. The Tax Contingency Law increased the amount of this tax to US\$300,000.00 during the 2003 calendar year.

All Costa Rican companies must file annual tax returns, regardless of whether they are engaged in operations.

Although accounting records may be kept outside Costa Rica, a set of legal stamped books, including the journals, general ledger, and financial statements, must be kept in Costa Rica in local currency.

Costa Rican companies are not allowed to issue bearer shares. However, after incorporation, shares may be transferred by endorsement. Transfers are only recorded in the Stockholders Registry, which is not filed with any government institution and may only be requested for judicial proceedings.

Chapter IV: Agency

Costa Rican Agency Relationships

For nearly three decades, the Foreign Companies Agency Act (FCAA) has played a critical role in governing relationships between foreign companies and local representatives in Costa Rica. However, the entry into force of CAFTA may ultimately undermine the enforceability of the FCAA in these relationships.

FCAA provisions

In general terms, the FCAA governs the local commercial representation of foreign companies in Costa Rica. The Act regulates private agreements executed between foreign companies and local representatives whereby an agency or distribution relationship is established, whether or not these agreements are written. It is a highly protectionist law favoring the local entity. This protection has been considered to be a public policy issue. Accordingly, the FCAA applies even where a written agreement expressly or implicitly waives, circumvents, or modifies its application, provided that the factual elements of the representation relationship are proved. Thus, the benefits awarded by this body of law to local representatives, as well as the jurisdiction of Costa Rican courts, are unrelinquishable.

The FCAA establishes fixed indemnity for the local agent or distributor in essentially all cases of contract termination, although it also contains qualified causes for termination without liability for the foreign company (e.g. the commission of a felony by the local representative, breach of general loyalty-confidentiality obligations, etc.). In addition to

express termination of the relationship, which triggers fixed indemnity, the FCAA also establishes several instances where the foreign company may incur liability vis-à-vis the local representative (e.g. not renewing the agreement even when its term has expired, termination of the foreign company's operations, delay in payment of commissions or fees earned by the local representative, etc.).

It is important to stress that the FCAA grants local representatives a cause of action to seek fixed indemnity upon termination of the agency or distribution agreement. That indemnity is calculated by multiplying the equivalent of four months of gross income by the number of years (or fraction of a year over six months) of the contractual relationship, up to a maximum of 9 years, where monthly gross income is calculated as an average of total gross annual income during the previous two years (when the local party to the agreement is a distributor) or four years (for a representative or manufacturer). In the event of litigation, this is a substantial benefit for the local plaintiff, as it is not required to provide evidence of actual damages.

Controversial resolution

Notwithstanding the above, a recent controversial decision of the First Chamber of the Supreme Court of Costa Rica ruled that a FCAA distributorship relationship could be terminated without liability for the foreign company, provided termination be based on terms agreed upon in a valid written agreement. The First Chamber held that termination terms agreed in written contracts do not contradict the public policy regulations of the FCAA. While this decision is a solid step in the right direction for the interests of foreign companies, under Costa Rican law prior judicial decisions do not represent binding legal precedent for lower courts. Nonetheless, the decisions are taken as a strong suggestion on how those courts should rule and help clarify legal issues.

CAFTA

The five Central American nations and the U.S. recently concluded negotiations to establish a Central American Free Trade Agreement (CAFTA). A key issue of CAFTA is modification of the Costa Rican legal framework for agency or distributorship agreements, i.e. the FCAA.

Specifically, Costa Rica agreed to apply general principles of contract law to these agreements and to be consistent with other CAFTA obligations and freedom of contract doctrine. Costa Rica further committed itself to establishing an exclusive relationship only if the agreement explicitly states that the relationship is exclusive. Finally, Costa Rica agreed that contracts will be considered terminated as of the agreed termination date,

and when no termination date is established, termination will be allowable provided ten-month's advance notice is given.

Costa Rica agreed to eliminate sections 2 and 9 of the FCAA (relating to termination and fixed indemnity as explained above). Costa Rica further agreed to encourage the parties involved to renegotiate their agreements and bring them into line with the new framework. However, Costa Rica also consented that elimination of sections 2 and 9 of the FCAA will not diminish or affect any rights acquired under the FCAA.

Provided CAFTA is ratified by the Costa Rican Congress under the above terms, agency relationships entered into after CAFTA shall be governed by general principles of contract law.

Chapter V: Trusts

A trust is a legal entity created by a grantor for the benefit of designated beneficiaries under both the laws of Costa Rica and the rules of the trust instrument. In a trust, the trustee has a fiduciary obligation to manage the trust's corpus and income for the economic gain of the beneficiaries.

The essential elements of the trust are:

The founder (or grantor);

The designated beneficiary or beneficiaries;

The trustee;

An asset or right sufficiently identified to enable title to pass to the trustee; and

Actual delivery to trustee with an intent to pass title.

Parties to a trust may either be individuals or entities.

Through a trust, the grantor transfers ownership of assets or rights to the trustee. The trustee is thereby obligated and compelled to use the trust property for certain legitimate purposes predetermined in the trust instrument. Assets and/or rights of any kind may be

transferred to a trust as long as they are subject to trade. The grantor may designate one or more trustees to act either jointly or separately.

Trusts are created in writing. If the trust assets are subject to registration under the laws of Costa Rica, the transfer itself must be recorded in the corresponding Registry in the trustee's name. This notwithstanding, the trust assets and/or rights of any kind are fully and legally segregated from those of the trustee.

Under Costa Rican law, a trustee is prevented from:

- Delegating his or her own fiduciary responsibilities. However, a trustee may appoint agents or special proxies to carry out specific procedures or duties for which s/he is liable;
- Directly or indirectly being or becoming a beneficiary of the assets s/he manages.
- Guaranteeing a fixed return on the trust assets.

The trustee is liable for any losses incurred by the trust due to fault, negligence, or mismanagement of trust assets. In order to reduce risk, the trustee may not, at any time, invest more than one third of the total trust assets (or their proceeds) in a single venture, unless specifically instructed to do so by the grantor. Trusts with secret purposes are strictly prohibited.

In recent years, trusts have become highly effective instruments not only for traditional purposes (testamentary), but also as investments, flexible guarantee structures, and for a wide range of corporate, commercial, and financial transactions. Trust agreements allow the parties to freely determine the specific terms and conditions that will govern their relationship, outside of the bounds of the often intricate and confusing provisions established in traditional legal regulations. Although trusts are governed by written law (Code of Commerce), applicable rules are simple and straightforward. This allows room for creativity and, in turn, highly efficient business dealings.

Chapter VI:

Corporate Taxation

Territoriality Principle

The Costa Rican income tax system is based on the territoriality principle, whereby only income derived from activities within Costa Rican territory and from Costa Rican sources is subject to income tax. According to article 1 of the Income Tax Law, “a tax is imposed on occasional or ongoing revenues received by legal entities and individuals and obtained within national territory, regardless of the recipient’s nationality or domicile”. This law also imposes a tax on occasional or ongoing Costa Rican revenues that are accrued or received by domiciled individuals and on any other type of income that is not legally exempt. Foreign source income is not taxable in Costa Rica.

Tax Year

The statutory tax year for companies runs from October 1st to September 30th. However, Tax Authorities may authorize local subsidiaries and foreign branches to adopt the tax year of the parent company. Banks use the calendar year as their tax year, and similar authorization may be granted to certain companies engaged in agricultural activities. Taxpayers with close commercial or administrative relationships with foreign entities may adopt the tax year of the foreign company if authorized by Tax Authorities.

Income Tax

General

Under the territoriality principle, all income earned in Costa Rica or derived from a Costa Rican source is taxed, regardless of citizenship, domicile, residence, place of incorporation, or location of board meetings. Such income includes the following:

- Real estate transactions (as a trade or business);
- Assets, goods, and rights invested or used in Costa Rica;
- Commercial, industrial, agricultural, or any other trade or business activities carried out within the country;
- Services rendered within the country.

All costs and expenses necessary to generate taxable income and to protect investments are deductible from gross income. Expenses incurred to obtain non-taxable income are not deductible. If expenses give rise to both taxable and non-taxable income, only those expenses incurred to generate taxable income are deductible.

Tax Authorities are empowered to reject any expenses treated as deductible if they consider:

- The expenses to be unnecessary for purposes of generating taxable income;
- The expenses to be excessive or unreasonable;
- The expenses to be applicable to a different tax year;
- There to be inadequate supporting documentation for the expenses;
- That the expenses have not been properly booked in the accounting records; or
- That proper income tax has not been withheld at source (if applicable).

Losses

Tax loss carryforwards may only be applied by industrial and agricultural companies. Operating losses incurred by commercial enterprises may not be carried forward. For agricultural and industrial companies, the carry forward periods are five and three years, respectively. Industrial companies that began operations after 1988 are allowed to apply net operating loss carryforwards for five years for losses incurred within the first five years of operations. However, losses incurred after the initial five-year period may only be carried forward for three tax years.

Rates

Corporate income tax is levied based on the size of the taxpayer. Accordingly, “small companies” are taxed at lower rates. The Costa Rican Income Tax Law defines small companies as entities with gross incomes of less than ₡49,043,000.

For the 2005 tax year, the following corporate tax rates are in effect:

Gross Income	Ordinary Tax Rate
Up to ₡24,381,000*	10%
Up to ₡49,043,000*	20%
All other companies	30%

The above rates are flat rates. Gross income is the parameter for determining the applicable tax rate. However, the rate determined is then assessed on the company’s net income.

Tax Returns

Taxpayers must file their tax returns within two months and fifteen days from the tax year end (i.e. December 31st for companies that use the statutory tax year).

Tax Payment

Income tax due must be paid when the tax return is filed.

A system is also in place to permit advance payment of quarterly taxes. Quarterly taxes are estimated at 75% of either the average tax paid in the previous three years or the tax liability for the previous tax year (whichever is greater). Taxpayers are entitled to apply any excess paid to the following year’s income tax liability or to other tax liabilities (except import duties and stamp taxes or other taxes not collected by Tax Authorities), or to request a cash refund. However, requesting a cash refund is a lengthy process and may take from six months to one year.

Withholding Taxes on Foreign Remittances

Remittances of Costa Rican source income to individuals or corporations domiciled abroad are subject to the following withholding taxes:

<i>Type of Income</i>	<i>Ordinary Tax Rate</i>
Transportation and communications	8.5
Wages, salaries, pensions in employer-employee relationships	10.0
All other wages, salaries, pensions, and professional services	15.0
Insurance payments	5.5
Motion pictures, TV programs, soundtracks, etc.	20.0
Soap operas and similar items	50.0
Dividends and similar earnings distributions	15.0
Dividends on shares registered and acquired through a local stock exchange	5.0
Interest and other financial payments (If the recipient is a foreign financial institution recognized by the Central Bank of Costa Rica, the withholding is waived.)	15.0
Royalties, trademarks, franchises, formulas, technical and financial services, and similar payments	25.0
Any other remittance of Costa Rican source income	30.0

Dividends

Dividends paid (or accrued) by corporations to individuals (both local and foreign) or to foreign entities are subject to a 15% withholding tax. When the shares of the payor corporation are registered with a local stock exchange and were bought on the same exchange, the withholding tax is reduced to 5%. Dividends paid (or accrued) to another Costa Rican corporation subject to income tax are exempt from withholding taxes. Additionally, the withholding tax is not applied if retained earnings are distributed to shareholders in the form of registered shares or quotas of the payor entity.

Tax Authorities are authorized to waive withholding taxes on dividends, interest, commissions, royalties, and insurance premiums remitted abroad, provided the beneficiary can prove that it is not entitled to a foreign tax credit for the tax assessed in Costa Rica and that the income will be taxed in the foreign country.

Other Withholdings

Employers are required to withhold income taxes from employees on a monthly basis. Both employers and employees are subject to monthly payroll taxes, payable through the Costa Rican Social Security Administration (see section on “Social Security System” for further details).

Income Taxes

Individuals engaged in business activities

The Income Tax Law assumes a given net income for certain individuals, limited liability companies, and individual companies, unless evidence to the contrary is provided.

Financing

In the absence of a formal loan agreement or other document specifying the interest rate, Tax Authorities will charge presumptive interest on lending or financing transactions. The applicable rate is the highest lending rate charged by the Central Bank of Costa Rica, or, if no such rate is available, the average lending rate charged by banks of the National Banking System.

Non-domiciled companies

Unless evidence is provided to the contrary, minimum taxable income is imputed to subsidiaries, agencies, and other permanent establishments of non-domiciled entities in Costa Rica as follows:

Transportation and Communications

Tax Authorities impute a minimum taxable income of fifteen percent (15%) of gross income derived from freight, passenger, and cargo operations, as well as from radiograms, telephone, telex, and similar services provided in Costa Rica.

Companies engaged in transportation and communication services may execute a special agreement with Tax Authorities whereby taxable income is computed by applying the company’s overall profit margin to Costa Rican source income derived from services or sales within the country.

Reinsurance

Tax Authorities assign a minimum taxable income of ten and one-half percent (10.5%) of the net value of reinsurance, refinancing, and insurance premiums of any kind, except life insurance that is either assigned to or contracted by the National Insurance Institute with foreign companies.

Media

Tax Authorities apply a presumptive income tax rate of thirty percent (30%) on gross income derived from cinematography films, series, and any similar form of public broadcast or exhibition of images or sound, as well as international news.

Capital Gains Tax

Capital gains are taxable and capital losses are deductible when derived from the sale of depreciable assets or from the sale of assets in the ordinary course of a trade or business. Sporadic capital gains derived from the sale of non-depreciable assets are exempt.

Taxable capital gains must be included as part of taxable income and are subject to the corresponding tax tables.

Transfer Taxes

A transfer tax of one and one-half percent (1.5%) is levied on the transfer of real property. This tax is computed based on the declared value of real property transferred or on the value reported to Tax Authorities, whichever is higher. Typically, both the buyer and the seller of real property are jointly liable for the tax, except where the contracting parties have agreed otherwise. The tax is assessed on the date the transaction is executed. In the case of vehicles, a two and one-half percent (2.5%) transfer tax is levied.

Sales (Value-Added) and Excise Taxes

The general sales tax is an imperfect value-added tax levied on the sale of merchandise and the import of merchandise into Costa Rican territory. With certain exceptions, most services are not subject to sales tax. This tax is assessed on value added and the final liability is calculated by subtracting total sales taxes paid on imports or purchases (of inputs used to manufacture goods sold) from total sales taxes derived from taxable sales during the same period. The sales tax is levied by the manufacturer, wholesaler, retailer, or customs authorities.

All individuals, legal entities, and “de facto” companies, both public and private, that habitually sell merchandise or render specific services in Costa Rica, or that import goods into Costa Rica, are treated as taxpayers and must be registered as such in the Taxpayer Registry.

In addition to sales taxes, excise taxes are levied on selected goods. However, taxpayers with sales of under $\text{¢}2,000,000$ (two million Costa Rican colones) during a three-month period are exempt.

Rates

The current general sales tax is thirteen percent (13%). A 5% tax is applied to energy consumed for residential purposes in excess of 250 kW/h. All other energy consumption is tax exempt. Currently, the sales tax on timber is 10% (ordinary sales tax less the 3% Forestry Tax). A table is used to determine excise tax rates.

Tax payment

Sales tax is payable monthly and is calculated on sales in Costa Rica during the preceding month, less taxes paid to suppliers during the same month. Taxes on imports are paid as part of import duties before the goods are released from customs.

The excise tax is payable when the invoice is issued or when the merchandise is delivered to the purchaser, whichever occurs first. The excise tax is due on imports when import documents or forms are officially approved by the customs agency.

Real Estate Taxes

Real estate taxes are assessed on land, buildings, and other permanent structures. This tax is managed, assessed, and supervised by the municipalities having jurisdiction over the administrative locality (“canton”) where the property is located. Local governments are the beneficiaries of property taxes.

Rates

The real estate tax is 0.25%.

Computation and payment

The real estate tax is computed on a calendar year basis and must be paid annually, semi-annually, or quarterly, depending on the requirements of the local government. The local government determines the tax base either by general or individual appraisal.

Stamp Taxes

Stamp taxes are levied on most legal documents and are determined based on either the monetary value stated in the document or on a specified amount per page.

Education and Culture Stamp Tax

A statutory education and culture stamp tax is assessed on the capital stock of all business entities. A ¢750 stamp tax is assessed at the time of incorporation, in addition to annual fees ranging from ¢750 to ¢9,000, depending on the amount of capital stock of the company.

Local Taxes

In general, local taxes vary depending on regulations for particular activities and regulations established among the different local governments or municipalities. Minor municipal taxes are similar between localities (i.e. garbage collection, street lighting, street cleaning, and others) and are generally paid quarterly.

Import Duties

Imports are subject to regional (Central America) and local taxes. The Central American system for determining import duties is based on the nomenclature from the International Convention on the harmonized merchandise designation and codification system (Harmonized System Convention). In Costa Rica, Custom Authorities determine the taxable base for goods according to the value of the transaction or sale, or the customs value defined by the World Customs Organization.

The existence of customs regimes in Costa Rica is based on the International Convention on Simplification and Harmonization of Customs Procedures (Kyoto Agreement, 1973) and the amendments thereto.

Rates for import duties (regional levies) normally range from 0% to 15%. However, once local levies are imposed (excise tax, 1% under Law No. 6946, and sales tax) the total tax liability for the import duty may exceed 100% of the item's value for certain "luxury items" (such as tobacco and goods subject to special regimes, such as milk, poultry, etc.).

Customs regimes in Costa Rica include systems that suspend, defer, or eliminate import duties, such as the Temporary Admission System, the Drawback System, the Free Trade Zone System, Repacking for Distribution, and others. The purpose of these systems is

to promote investment in the manufacture and trade of goods for export or use in certain activities (cultural, scientific, sportive, development, etc.).

Furthermore, Tax Authorities are empowered to authorize special sales tax treatment for purchases of goods by exporters when it is not feasible to apply the tax credit or the credit is difficult to recover.

Tourism

Specific taxes assessed on tourism activities include the following:

- Three percent (3%) tax on lodging: This tax is applied to daily room revenue only.
- Eight percent (8%) tax on international transportation: This tax includes air, maritime, and bus travel. International transportation companies and travel agencies are responsible for collecting this tax.
- Departure tax: This tax is levied on each national or foreigner who leaves national territory from any international airport. The current rate is US\$26.

Forestry

A Forestry Tax, equivalent to 3% of the value of timber, must be paid for imports or processing. However, sales tax on the import or processing of wood is reduced by the amount of the Forestry Tax (i.e. 10%).

Mining

Individuals or entities that are granted exploration permits and exploitation concessions are subject to the following taxes:

Surface taxes

- Non-commercial mining operations: One third of one base salary for each square kilometer or fraction thereof
- Commercial mining operations:
 - Exploration permit: One base salary for each square kilometer
 - Mining concession:

- Riverbed: three base salaries for each kilometer
- Quarry and mines: three base salaries for each square kilometer

Taxes

- A 2% tax is assessed on gross sales of minerals obtained from mining concessions.

Additionally, mining activities are subject to the taxes established in the Income Tax Law.

Finally, a 10% tax is due on the total amount of exemptions granted. In essence, this is a tax based on the value of tax incentives.

Tax Evasion: Felonies and Misdemeanors

Applicable legislation is intended to achieve the following:

- Impose economic sanctions for violation of administrative tax rules.
- Define minor tax-related crimes that are penalized with economic sanctions.
- Define tax-related crimes. Under new legislation, tax evasion and other crimes are subject to a strict Penal Code, which provides for incarceration for up to ten years. Although companies are specifically excluded from criminal charges, individuals representing or working for companies that are involved in illegal activities may be prosecuted and held personally liable.
- Increase the powers of Tax Authorities to investigate companies suspected of tax evasion, including searches of premises and seizure and confiscation of equipment, documents, books, and records.

Tax Treaties

A Tax Information Exchange Agreement (TIEA) has been subscribed by Costa Rica and the U.S.

Chapter VII: Individual Taxation

Income Tax

Individuals with Business Activities

As a general rule, corporate regulations also apply to individuals. However, individuals are subject to the following progressive tax table:

Self-Employed Income Tax Table for 2005	
Taxable Income	Tax Rate
Up to ¢1,629,000.00*	0%
From ¢1,629,000.00 to ¢2,433,000.00	10%
From ¢2,433,000.00 to ¢4,058,000.00	15%
From ¢4,058,000.00 to ¢8,132,000.00	20%
Above ¢8,132,000.00	25%

Individuals are eligible for annual tax credits of ¢12,360.00 (twelve thousand three hundred and sixty Costa Rican colones) for a spouse and ¢8,280.00 (eight thousand two hundred and eighty Costa Rican colones) for each child. Income tax returns must be filed annually.

Employees

Employees are subject to a progressive withholding tax, as follows:

Employee Income Tax Table for 2005	
Monthly Taxable Income	Tax Rate
Up to ¢367,000.00**	0%
From ¢367,000.00 to ¢551,000.00*	10%
Above ¢551,000.00*	15%

Employees are eligible for monthly tax credits of ¢1,030 (one thousand and thirty Costa Rican colones) for a spouse and ¢690 (six hundred and ninety colones) for each child. No other deductions or credits are allowed.

Monthly withholdings from employee salaries eliminate the need for these individuals to file annual income tax returns.

- Non-residents in Costa Rica are subject to a flat tax on income derived from personal services rendered in the country in an employer-employee relationship. According to our interpretation of articles 23, 26, and 59 of the Income Tax Law, the applicable rate is 10% . However, in some cases Tax Authorities have interpreted article 26 of the Income Tax Law to imply a 15% tax.
- Self-employed non-residents are subject to a 15% withholding tax on all income derived from personal services rendered in Costa Rica. These individuals are not required to file income tax returns in Costa Rica.
- Self-employed non-residents who receive rental or business income through a permanent establishment must file an annual tax return and are subject to the self-employment progressive tax established in the above table.

Employers may treat mandatory contributions under the Employee Protection Law as deductible expenses for income tax purposes. In addition, those contributions are exempt from social security and income taxes.

Definition of Resident

For income tax purposes, a resident is defined as any person who has maintained a continuous physical presence in Costa Rica for more than six (6) months during the same tax year. A work permit granted by Immigration Authorities could lead Tax Authorities to conclude that the taxpayer should be classified as a resident. Tax residence usually begins after six months have passed. Until that time, the person is considered to be a non-resident.

Furthermore, Tax Authorities may treat individuals as residents if their sole source of income is salary, even if they have resided in Costa Rica for less than six months.

Taxation of Benefits

In general, cost of living and other cash allowances paid directly to the employee (except the statutory Christmas bonus) are treated as salary and subject to the progressive rates that apply to employees. Bonuses (except the statutory Christmas bonus) and benefits in kind (i.e. housing, company car, education, etc.) are subject to a flat 15% withholding tax (no deductions or credits are allowed) and to social security taxes. However, for lower-level employees who fall in a lower tax bracket or pay no taxes, bonuses are generally treated as salary and are therefore subject to the progressive withholding tax table.

Partnerships

This type of business organization is seldom used, mainly due to the direct personal liability it implies. Parties are subject to payment of income tax.

Tax Amendment

The Costa Rican Legislative Assembly is currently analyzing a proposed amendment to tax legislation. This amendment would reform the entire Costa Rican tax system and reform includes changes to Income Tax and the General Sales Tax, as well as broadens the authority of the Tax Administration to audit taxpayers. The amendment related to income tax considers the following:

- Change in the concept of income (from “income produced” to “income received”). Capital gains will be taxed.
- A global income tax system would replace the current system, where different schedules are applicable depending on the origin and nature of income obtained by individuals. Under the new system, income will form part of a general tax base and

taxpayers will be individually responsible for declaring and reporting that income to Tax Authorities. Withholdings will also be made by employers. The schedule applicable to individuals would have rates ranging from 5% to 30%. The corporate income tax would continue at a 30% rate but may be lowered in future years under certain conditions.

- Worldwide income: Costa Rican resident individuals and entities will be taxed on income earned abroad, which is contrary to the present territoriality system. In the case of passive income, capital must be registered with the Tax Administration in order to be taxed at the 10% rate. Active income is taxed at ordinary rates applicable to individuals and corporations.
- In addition, foreign tax credits would be available to avoid double taxation, and rules on transfer pricing, controlled foreign corporations, and tax havens would be sanctioned.

In addition, the current sales tax would be replaced with a classic value-added tax (VAT) that would be assessed on all services rendered and goods transferred within the national territory.

Chapter VIII:

Labor Regulations

Description of the Labor Force

Traditionally, the Costa Rican labor force has been characterized as relatively well-educated, skilled, and having a significant degree of potential. This is primarily the result of a historical emphasis on an educational system that is largely subsidized by the Government. Universities, technical institutes, and vocational schools provide individuals of all levels with satisfactory technical and professional training. The Costa Rican labor force is known as being both stable and productive. In general, labor relations reflect the nation's peaceful and democratic traditions. Management/labor conflicts and differences are typically resolved through dialogue and mutual respect.

The Labor Code of 1943 governs labor issues. The Ministry of Labor and Social Welfare, the Costa Rican Social Security Administration, and Labor Courts throughout the country are responsible for ensuring compliance.

General Labor Principles

Fundamental Rights

The Costa Rican Constitution guarantees certain fundamental rights for the domestic labor force and, in some cases, the labor force providing services abroad. Such rights are specifically established in the Labor Code and may not be waived by any employee in Costa Rica. The main treaties of the International Labor Organization (ILO) concerning fundamental rights are applicable to employment relationships in Costa Rica.

Foreign Labor

In order to work legally in Costa Rica, a foreign national must hold a work permit issued by the Immigration Office. Foreigners with a permanent residency card or a refugee card are allowed to work without a work permit.

Local and foreign companies doing business in Costa Rica may apply for authorization from immigration authorities to bring in temporary workers, namely high-ranking executives and/or technicians, from other countries. The process for obtaining such authorization must be initiated before the employee arrives in Costa Rica.

Employment Contracts

As a general rule, Costa Rican labor laws require written employment contracts between the employer and the employee. However, the absence of a written contract does not restrict the rights of the parties to the employment relationship. The Labor Code stipulates certain mandatory clauses that must be included in employment contracts in order to comply with labor regulations.

Termination of Employment

An employer may terminate employment when:

- It unilaterally decides to terminate the contract, in which case the employee is automatically entitled to severance benefits; or
- The employee breaches the employment contract under the provisions of the Labor Code, allowing the employer to order immediate dismissal without severance pay.

An employee may terminate an employment contract when:

- S/he resigns voluntarily, thereby forfeiting severance pay; or
- The employer acts unfairly, allowing the employee to immediately terminate the contract with entitlement to severance pay.

Acceptable causes for dismissal by the employer without severance pay, or for employee termination of the contract with rights to severance pay, are established in the Labor Code.

Severance Benefits

Employees are only entitled to severance benefits when their employment contract is terminated by the employer without just cause, or when the employer's conduct forces the employee to terminate the relationship.

Severance benefits consist of:

- **Advance notice.** The employee is entitled to a variable amount, in accordance with the following rules: After twelve months of continuous service, the employee is entitled to one month's salary; from six to twelve months, fifteen days' salary; and from three to six months, one week's salary. In lieu of advance notice, the employer has the option of permitting the employee to continue to work and to receive the usual salary for that time period;
- **Length of service.** The employee is entitled to variable indemnity based on length of service, as follows: From three to six months of service, seven days' salary; from six to twelve months of service, fourteen days' salary; and after one year of continuous service, from nineteen to twenty-two days' salary per year. Such scale is found in the Labor Code.

In no event may length-of-service indemnity exceed eight months' salary. Payment is computed on the average of the last six months of compensation prior to termination.

Although not part of the severance package, a Christmas bonus must be computed and paid on a pro-rata basis upon termination of employment. In addition, accrued vacation and unpaid salaries must be granted to the employee.

Christmas Bonus

The Christmas bonus is an additional one-month salary paid to all employees after one year of service, payable each year during the first two weeks of December. If the employee has not worked one full year, the bonus is paid pro-rata.

Vacation

All employees are entitled to a two-week paid vacation for every fifty weeks of continuous service. Upon termination of the employment contract, if vacation was not used or only partially used, the employee is entitled to payment at a rate of one day's salary for each month worked during any given year.

Maternity and Sick Leave

Maternity leave entitles pregnant employees to a one-month leave of absence prior to delivery and three months after delivery. Pregnant or nursing employees may only be dismissed with just cause, and authorization from the Labor Ministry must be obtained prior to any dismissal.

Leaves of absence related to partial work disabilities (e.g. illness) are authorized by the Social Security System after a medical exam. Minimum sick pay is equivalent to 60% of salary.

Occupational Risk Insurance

All employers must carry one or more insurance policies with the National Insurance Institute [Instituto Nacional de Seguros – INS] to cover occupational risks. Policy premiums vary based on the employer's activity and headcount.

Wages

The mandatory minimum wage is applicable to all jobs. Such wages are adjusted twice a year by the National Wage Council, based on an official cost-of-living index. Employers are free to choose their compensation structure, provided the minimum wage is observed.

Overtime

Overtime is legal. However, employees may not work for more than twelve consecutive hours, except in extraordinary circumstances. Employers may not require employees to work overtime on a regular basis.

Overtime pay is generally equivalent to the hourly rate plus 50% (i.e. time and a half). These rules only apply to regular and administrative employees. Special rules apply to night shifts.

Social Security System

A public institution accessible nationwide known as the Costa Rican Social Security Administration [Caja Costarricense de Seguro Social – CCSS] manages the Social Security System and the National Health System together with the Ministry of Public Health and the Ministry of Labor and Social Welfare. These institutions provide benefits related to disability, illness, old age, death, maternity, health, retirement, etc. Employer and employee social security taxes are mandatory. They are calculated as a percentage of monthly salaries and amount to 23% for the employer and 9% for the employee, with no

cap on the amount of income taxed. The system includes: 1) Healthcare (medical treatment); 2) Disability and Retirement; and 3) Supplemental Pensions. All three are mandatory for legal employers and their employees.

The Social Security System does not prevent employers or employees from becoming affiliated with supplemental pension, health, or retirement plans managed by public or private entities that are authorized to operate by the Pensions Superintendency [Superintendencia de Pensiones – SUPEN], a regulatory agency.

Employee Protection Law

Employee Protection Law No. 7983 enacted on February 16, 2000 establishes an additional employer contribution amounting to 3% of the employee's monthly salary, payable during the entire term of employment. Contributions are deposited in a compulsory retirement savings account opened in the employee's name in an accredited entity. Fifty percent of the contribution is transferred annually to the employee's mandatory supplemental pension fund. The remaining 50% is deposited in a savings fund.

The CCSS collects the above contributions through a Centralized Collection System. That office is currently authorized to close a company or business for five days when information requested by authorities is not provided, or when social security contributions are two months past due.

Chapter IX:

Intellectual Property

Costa Rica provides adequate protection for owners of intellectual property rights, and is in full compliance with the World Trade Organization's standards, as set forth in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Protection is effective in the initial stages (i.e. registration and custody of intellectual property assets), as well as against infringement of rights by third parties regardless of intent or bad faith.

Several laws make reference to intellectual property rights, including the Trademark and Other Distinctive Signs Act; Undisclosed Information Act; Copyrights and Related Rights Act; Invention Patents, Industrial Designs and Models, and Utility Models Act; and Protection for the Layout Designs of Integrated Circuits Act.

Costa Rica has ratified the most important international treaties, including the TRIPs Agreement, the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, and the Rome Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations, as well as the World Intellectual Property Organization's Copyright and Performances & Phonograms Treaties, to name a few.

Intellectual property assets protected by the Costa Rican laws described above are:

- **Copyrights and Related Rights.** Copyrights are granted to authors of literary and artistic works such as books, drawings, paintings, musical compositions, software, and

others. Related rights are granted to performers, producers of videos, phonograms, and broadcasting entities for their respective works.

The Copyrights and Related Rights Registry, which is the entity responsible for registration and custody, is an agency of the Public Property Registry. However, registration is not required in order to be protected.

Protection of copyrights and related rights exists from the moment of creation. Nevertheless, registration is recommended for increased security, and required for the purpose of claiming ownership.

- **Trade Secrets.** Trade Secrets are protected by the Undisclosed Information Act, which designates the Industrial Property Registry as the entity responsible for the custody of documents containing trade secrets.

In order to obtain protection under the Undisclosed Information Act, a trade secret must meet the following requirements:

- a) The information must be secret (not general knowledge or easily accessible information);
- b) The information must be in the control of someone who has taken all reasonable measures to keep it secret; and
- c) Commercial value must be derived from its secrecy.

- **Trademarks and other distinctive signs.** The Trademarks and Other Distinctive Signs Act protects intellectual assets such as trademarks, service marks, certification marks, collective marks, and trade names. Once registered in the Industrial Property Registry, the law provides protection for a ten-year term, renewable for indefinite, equal terms. Trade names have no expiration date, but may be cancelled if the commercial establishment being protected moves or closes without notifying the Registry.

Famous marks are protected against piracy. Accordingly, the owner of a famous mark may prevent its unlawful use. The Industrial Property Registry may deny or cancel the registration of a famous mark, as well as prohibit its use.

Starting in 2005, under a sunrise provision, the Trademark Act provides for cancellation of valid, registered trademarks as a result of failure to use those marks for commercial purposes. This means that a trademark may be cancelled by the Registry if the owner has not used that trademark for a valid commercial purpose within a specified period of time. Previously, owners were allowed to register virtually any trademark – provided it met the legal requirements – even if it was not to be used for an indefinite period. Currently there is no requirement to demonstrate use or intent to use in order to apply for registration or renewal, but now there is a risk in simply stockpiling marks, whether legitimately (they may be valuable or usable in the future) or in bad faith.

- **Invention Patents.** New and non-obvious inventions (machines, products, tools, etc.) with an industrial application are protected under the Invention Patents, Industrial Designs and Models, and Utility Models Act. Costa Rica's Industrial Property Registry provides patent protection for 20 years from the date of filing in the country of origin, either in Costa Rica or abroad.
- **Industrial Designs and Models and Utility models.** Industrial designs and models are covered under the aforementioned Act, granting protection for 10 years. Industrial designs are compositions of lines and colors. Industrial models are any plastic forms that are used to give a unique appearance to an industrial or artisan product and aid in manufacturing. Finally, utility models are models of existing tools, instruments, or utensils that have been improved or designed for a special use.
- **Layout Designs of Integrated Circuits.** Integrated circuits are covered by the Protection for the Layout Designs of Integrated Circuits Act. An integrated circuit is defined as a product, whether final or otherwise, where at least one element is active and some or all of its interconnections are part of the body or surface of a piece of material that is meant to perform an electronic function. Integrated circuits are only protected when they are original. Protection is granted for 10 years from either the date of initial commercial exploitation or filing for protection, whichever occurs first.

Infringement of Intellectual Property

In 2002, the Law of Procedures for the Enforcement of Intellectual Property Rights was enacted. This law was an important step towards protecting intellectual property assets against infringement of rights. It contains several precautionary measures against infringement, such as immediate suspension of fraudulent activities, border measures, and confiscation of fraudulent goods. Additionally, the law provides for civil enforcement, as well as criminal actions.

Administrative actions may be taken before the Intellectual Property Registry or judicial claims filed in courts of justice. Both measures assure the claimant of the possibility of returning to the original state (prior to infringement) and of being compensated for damages.

There are currently several legislative initiatives to strengthen enforcement of intellectual property protection, which include longer jail terms, larger monetary awards, stronger and more specialized prosecution, and broader access to relief.

Chapter X:

Foreign Investment

Attitude towards Foreign Investment

Costa Rica has long been recognized as a regional leader of social and economic development in Latin America. The country provides the highest standard of living in the Caribbean Basin, economic stability, and political stability, with the longest-standing democracy in Latin America. As a result, the business environment in Costa Rica is also fairly stable.

The Costa Rican government welcomes foreign investment. All major political parties support this positive attitude. Since 1982, Costa Rica has consistently improved investment conditions. CINDE is Costa Rica's association of private sector leaders that actively promotes investment through its offices located in several countries.

The last few successive administrations have been moving away from State controls and towards an open economy in anticipation of free trade agreements with nations like the United States, Trinidad and Tobago, Venezuela, and Colombia. Several free trade agreements are already in force, including agreements with Mexico, Chile, Canada, the Dominican Republic, Panama, and Central America. A number of Bilateral Investment Treaties (BITs) have been signed, such as those with Germany, France, Taiwan, Spain, Switzerland, Canada, Chile, United Kingdom, Venezuela, Argentina, Holland, Paraguay, South Korea, Poland, etc.

Foreign investment in Costa Rica is strongly encouraged, as evidenced by the wide range of incentives available.

Export-Related Operations

Export-related investments in Costa Rica are generally structured under one of the following two incentive systems:

- Free Trade Zones
- Special Drawback

Free Trade Zone Incentive System

The Free Trade Zone System is comprised of regulated, non-residential areas called “Free Trade Zone” parks. By definition, these are primary zones for offshore tax and customs operations designated for economic activities related to the importation of inputs and raw materials, manufacturing and assembly, or marketing and trade of products, as well as the development of export services.

Operating facilities, tax incentives, excellent communication systems, electric power, public utilities, and a highly qualified work force are the basis for the dynamic development of enterprises established under this system.

Six types of companies can be established in a Free Trade Zone:

- Export processing industries that produce and process goods for export.
- Trading companies that distribute non-traditional products.
- Service companies that provide services to non-domiciled clients or to other beneficiaries of the Free Trade Zone system. Financial entities and companies that provide professional services in a Free Trade Zone are excluded from the benefits of the system.
- Individuals or corporations dedicated to scientific research that aids technological development in Costa Rica.
- Vessel construction, repair, and maintenance industries that provide and operate dry dock facilities, shipyard services, and similar work.
- Firms to which concessions have been granted for managing Free Trade Zones.

New investments

Participation in the Free Trade Zone System is only available to companies making new investments in Costa Rica, and under the following conditions:

- An initial new investment in fixed assets of at least US\$150,000.00 for companies located within an industrial park. However, the Government might also authorize these companies to establish secondary production plants outside of the park, provided this is necessary to solve specific problems regarding workforce, raw materials, transportation, etc.
- An initial new investment in fixed assets of at least US\$2,000,000.00 for companies located outside an industrial park and authorized to operate under Free Trade status.

Tax incentives

In certain situations, Free Trade Zone companies are entitled to the following tax incentives:

- Exemption from all taxes and consular fees on the importation of raw materials, processed or semi-processed goods, components and parts, packing materials, and all other merchandise and goods required for operation.
- Exemption from all import duties and consular fees on the importation of equipment, machinery and vehicles necessary for operation, production, administrative activities, and transportation. Vehicles and vehicle parts eligible for exemption are:
 - Chassis with one- or two-ton cargo capacity, single cabin
 - Trucks or truck chassis
 - One- or two-ton cargo capacity pick-up trucks
 - Vehicles with a minimum 15-passenger capacity
- Exemption from all taxes and consular fees on the importation of lubricants and oils required for operation.
- Exemption from all taxes associated with the export or re-export of products.

- A ten-year exemption from taxes on net capital and assets, property, and transfers of real property effective as of the date of commencement of operations.
- Exemption from sales and excise taxes on purchases of goods and services.
- Exemption from all taxes on foreign remittances.
- Exemption from all taxes on profits or taxable income, dividends paid to shareholders, or sales, as follows:
 - For companies located in “greater relative growth” areas, a one hundred percent (100%) income tax exemption for the first eight years and a fifty percent (50%) exemption for the next four years.
 - For companies located in “lower relative growth” areas, a one hundred percent (100%) income tax exemption for the first twelve years and a fifty percent (50%) exemption for the next six years.
- Entities established in Free Zones located in “lower relative growth” areas, as defined by the Ministry of Planning, are eligible to receive a credit equivalent to ten percent (10%) of total salaries paid during the year immediately preceding the current year, upon submission of payroll documentation to the Costa Rican Social Security Administration.
- Customs clearance is simplified and takes place directly at the Free Trade Zone park facilities.
- Companies classified as export processing entities may sell up to 25% of their total production in the Costa Rican market. Introduction of these products into Costa Rican territory is subject to the same taxes and import duties as merchandise imported directly from abroad. In the case of firms that export services, up to 50% of services may be provided within national territory.

Independent handling of foreign currency

Companies in Free Trade Zones are not required to remit foreign currency earned from sales in foreign markets to the Central Bank of Costa Rica. Instead, they are given flexibility in managing their foreign currency and may repatriate capital to pay for licenses, fees, royalties, and imports at their own discretion.

Services provided by Free Trade Zone operators

Once a project is established in a Free Trade Zone, the new company receives benefits such as:

- Personnel recruitment
- Arrangements for personnel training at Costa Rica's Instituto Nacional de Aprendizaje (INA), a national training institute, and Instituto Tecnológico de Costa Rica, a technical institute.
- Coordination with local industries and organizations for raw materials and procurement services
- Education and housing
- On-site medical facilities
- On-site day care facilities
- 24-hour security
- General maintenance
- Landscaping
- On-site customs agency
- Courier services
- Satellite communications
- Post office and banking facilities
- Sewage disposal plant

Transition to GATT and WTO incentive rules

According to the WTO agreement reached in Doha, Qatar on November 14, 2001, incentive systems exclusively applicable to exports (such as the Free Trade Zone system) are expected to end by December 31, 2007. Companies operating under the Free Trade Zone system at that date will be taxed at a preferential 15% rate. That rate will be exclusively available to companies that make a significant contribution to modernization of the productive sector and social development, and to entities considered to be “pioneers” because of their use of advanced technology, as established in the Tax Reform Bill.

Nevertheless, the OMC Commission for Subsidiaries and Compensatory Measures could establish new Free Trade Zone amendments, if necessary. Some countries could potentially be allowed to operate for an additional two years under the Free Trade Zone system. We do not know if Costa Rica will qualify as one of those countries.

Special Drawback Incentive System

The Special Drawback Incentive System allows companies to import raw materials duty-free for further processing, and to then re-export those materials (although a portion may be sold locally).

Raw materials and inputs may remain in Costa Rican territory for 1 year. Machinery and equipment may remain in the country for a period of five years. Thus, under the Drawback System, payment of import duties is temporarily suspended until it is decided whether the goods will be cleared through customs or returned to the country of origin.

The main tax benefits of the system are:

- Suspension of import duties on:
 - Raw materials
 - Semi-finished goods
 - Machinery and equipment
- In the case of locally purchased goods, Tax Authorities may grant exemption from VAT and excise taxes, provided the goods are used to produce merchandise for sale abroad.

- These benefits are granted to companies that re-export 100% of their production. If the company chooses to sell a portion of its production locally, it must:
- Obtain authorization from local authorities
- Pay import duties on raw materials or semi-finished goods used to manufacture locally purchased goods.
- Pay the percentage of import duties on machinery and equipment that is equivalent to the percentage of production sold locally (i.e. if 20% of production is sold locally, 20% of import duties must be paid).

In order to be eligible for the above incentives, the beneficiary must provide collateral for the temporarily imported goods as a guaranty that the taxes will be paid.

Payment of Environmental Services

Under Law No. 7575, the government awards payment of environmental services to compensate proprietors or landowners for helping protect the environment in Costa Rica by preserving forests, biodiversity, bodies of water, and landscapes on their property.

Under this system, the owner is entitled to obtain an annual lump sum over the term of a 5-year contract. Each year, the government defines the areas that will benefit, the procedure, and the amount to be paid. Usually the beneficiary is required to enter into a 5-year contract to protect the forest or provide other environmental services. For contracts to be signed in 2003, the government will pay 50% of the incentive at the time the contract is subscribed and 20%, 15%, 10%, and 5% in the second, third, fourth, and fifth years, respectively. Several modalities of services are considered for payment of services: forest management, conservation, and reforestation.

Contracts for payment of environmental services must be recorded in the Public Registry as liens on the property for the period of time specified by the corresponding Forestry Law regulations.

Fonafifo, the Institute in charge of administering the payments of environmental services promotes parallel activities that create sustainable development (i.e. ecotourism and biodiversity studies and research).

Agriculture Incentives

The law provides for exemption from all taxes and custom duties on imports of machinery, equipment, and materials to be used for agriculture and livestock activities, and goods and fuel required for fishing (except sports fishing).

Furthermore, agricultural entities are exempt from all taxes and assessments, except customs duties on raw materials required for manufacturing, and inputs for agricultural activities and banana packing.

Chapter XI:

Tourism and Real Estate

Tourism

Costa Rica is certainly an exquisite and promising tourist destination. Located in Central America, this part of the isthmus covers a miniscule 0.01 percent of the planet's surface, and yet is host to approximately six percent of the world's biodiversity. Our country is renowned for its amazing landscapes, well-developed national parks, and biological reserves.

Tourism in Costa Rica drives the Costa Rican economy. One of the main indicators of the increase in tourism in the country is the number of foreign tourist arrivals. In 2004, the number of visitors topped 1.4 million, which is an increase from 16% to 20% with respect to 2003. According to information provided by the Costa Rican Tourism Board (ICT) and the Central Bank, revenues in 2004 amounted to nearly US\$1.5 million, compared to US\$1.2 million in 2003.

Tourism is one of the sectors that generates the most foreign currency for the country and creates a significant number of direct and indirect employment. Tourism authorities predict that the tourism sector will grow by 10% this year.

Hotel occupancy during the first three months of 2005 increased by 15% compared to the 2004 period, for a total occupancy rate of 90%.

Costa Rica has a number of laws that regulate tourism activities. The Costa Rican Tourism Board Act created the ICT, an entity in charge of supervising tourism activities and regu-

lating tourism publicity both locally and abroad. The Tourism Industry Act declares tourism activities to be a public service, and article No. 7 establishes a tax of 3% payable to the ICT. This tax is withheld by hotels and other tourism establishments. Company and Tourism Activity Rules regulate the granting of a Tourism Declaration to a company or particular tourism activity. A company or activity awarded a Tourism Declaration must sign a Tourism Agreement with the ICT in order to obtain certain benefits, such as tourism incentives and publicity on the ICT website. The ICT gives a star rating to hotels, restaurants, and certain tourism companies after evaluating the establishments based on the Tourism Board's manual.

Tourism Incentives

In order to apply for a tourism contract, the activity must first be officially recognized as tourism related. The most significant criteria for making such a determination include the activity's potential to contribute to the country's balance of payments, create employment opportunities, and satisfy demand for tourism services.

Major incentives are provided for the following activities:

- Hotels.
- 100% exemption from excise taxes and custom duties on imports or local purchases of equipment and furniture necessary to establish new ventures. Although the value added tax (VAT) is assessed on imports and purchases intended to improve existing projects, the investor recovers the amount paid through tax credits (if related to assets used in providing the service).
- 100% income tax exemption on retained earnings for 12 years. This exemption is not included in tourism contracts after April 3, 1992.
- Accelerated depreciation for all goods, as stipulated in the Income tax Law.
- Concession of municipal patents required for operating.
- International and local air transportation for tourists.
- Exemption from excise taxes and custom duties on spare parts.
- Water transportation for tourists.

- Exemption from excise taxes and custom duties that exceed 5% of imports, and exemption from excise taxes on local purchases of goods necessary to build docks, aquariums, yacht clubs, and resorts.
- Travel agencies solely dedicated to the receptive tourism business.
- Exemption from excise taxes and custom duties on vehicles with a 15-person minimum capacity.
- Car rental.
- 50% exemption from excise taxes and custom duties on vehicles acquired for leasing to tourists.

Environmental Regulations

The entity in charge of awarding environmental licenses is the National Technical Environmental Secretariat [Secretaría Técnica Nacional Ambiental – SETENA].

New Environmental Impact Study regulations published in June 2004 clearly defined the process for obtaining an environmental license or feasibility approval for all activities, including tourism projects. Those regulations divided the activities into three categories based on their environmental impact and the type and nature of the activities, expert criteria, size, and other important elements:

Category A: High potential impact

Category B: Moderate potential impact

B1: Moderate to high potential impact

B2: Low to moderate potential impact

Category C: Low potential impact

In general terms, activities with a low potential impact must complete a Preliminary Environmental Assessment Form in order to decide which instruments are applicable for purposes of obtaining an environmental license (i.e. Declaration of Environmental

Commitments, Environmental Management Plan, Environmental Impact Study – exhaustive or directed, or all of the above). Activities with a high potential impact must complete an exhaustive or directed environmental impact study, depending on the recommendations of the Technical Secretariat.

Once the instruments have been validated and approved, the applicant must provide a bond to cover compliance and environmental liability before the approved activities may commence. Subsequent reports or other requirements must be submitted to SETENA in order to continue the activities and provide evidence of environmental compliance.

Real Estate Transactions

National Public Registry

Costa Rica has a safe and well-developed mechanism for title registration and transfer of land and vehicles. Central to the system is the National Public Registry, or NPR, which is managed by the Ministry of Justice in the Executive Branch. All real estate titles must be recorded in the NPR, where a full description of recorded real estate is available to the public (including information such as location, boundaries, measurements, and owner). Also available is a complete history of prior real estate transactions as well as information on pending land transfers, annotations, liens, or other restrictions on properties. There are two systems in use for real estate registration:

a) Books (manual entries): Initially used to record land and land-related transactions. The system relied on handwritten or typewritten books organized by the province where each property was located. Each piece of land was assigned a unique property number for the corresponding province. An example of a property recorded with this system would be:

Province:	Guanacaste
Number:	143098
Book:	1038
Page:	244
Entry:	2

Although no longer used, certain properties have only been recorded in this manual system. Moreover, title to most properties recorded in the newer Folio Real system can be traced back to an original record in the books system. No online or on-site computer or automated access method is available for information recorded in these books that can be accessed directly by the public.

b) Folio Real: Introduced in the 1990's, this newer system incorporates and summarizes important information about a certain property on a single card. Each transaction related to a particular piece of land is recorded on a new card that is later microfilmed, allowing users to research past transactions. The Folio Real system also assigns a unique ID to each piece of land located within a particular province. For classification purposes, each province was assigned a number:

San José:	1
Alajuela:	2
Cartago:	3
Heredia:	4
Guanacaste:	5
Puntarenas:	6
Limón:	7

The first number of the unique ID assigned to each property in the Folio Real system corresponds to the province. The province number is followed by and separated with a dash from the property number, which typically has four to six digits. The last three-digit number of the unique ID is reserved for properties owned by several owners in differing or equivalent proportions (i.e. "000" for a property owned by a single person or entity, or "001" and "002" for a property with shared ownership. An example of the unique ID of a property recorded under this system would be:

Property number: 5-110456-000

A fourth and final element of a property's unique ID may be the letter "F". This indicates that the property is jointly owned.

Information on the Folio Real card for any property in this system is available free of charge online for anyone with access to the Internet.

Changes in property titles, real estate claims, liens, and real estate transactions in general must be filed and recorded with the NPR in order to be officially recognized. Supreme Court rulings have consistently upheld that any document not filed or recorded with the NPR has no bearing on third parties who act in good faith. For example, the sale of a lot not filed by a buyer with the NPR would not prevent the seller from selling the same lot to a third party who acquires it in good faith, nor will it prevent that third party from val-

idly recording the sale. Of course, the initial buyer would have full legal recourse against seller, but not against the second buyer, as long as s/he acquired the lot in good faith. This clearly illustrates the importance of the system as a means of protecting parties to real estate transactions and providing reliable public information.

One of the NPR's underlying principles is the principle whereby rights are granted to parties in the order in which the documents that grant those rights are filed and made public through the NPR. A second very important and related principle whereby documents are to be recorded in the same chronological order in which they are filed.

Transfer procedure and closing costs

The initial step in any transfer of property should be an NPR title search to determine the status of title and the characteristics of the property to be acquired. A Municipality search should also be conducted in order to verify that all real estate and other related local taxes have been paid. The NPR and Municipal searches are normally conducted by the buyer's civil notary public, although anyone can perform the searches using publicly available information.

The second step of title transfer requires the involvement of a licensed Costa Rican civil notary public. The notary must transcribe the transfer deed in his notarial record book, wherein the original deed is signed by the seller, buyer, and the notary.

Once the deed has been executed, the notary must issue one or more copies for recording (the notarial certified copy) and filing with the NPR. Once recorded, the notary should also send a copy of the deed to the corresponding Municipality.

Before filing the deed, all closing costs must be paid by the parties. Market practice dictates that the seller and buyer pay equal portions of closing costs, although the parties may agree otherwise. Closing costs and fees are currently established by statute. Notaries may not increase or decrease their statutorily established fees at their own discretion without incurring professional - and possibly tax - liabilities.

Closing costs for land transfers are as follows:

Item	Amount
Notary Public Fee	1.25% of purchase price
Land Transfer Tax	1.5% of a) purchase price or b) previous recorded value of land, whichever is greater
Registry Stamps	1.3% (accurate estimate) of a) purchase price or b) previous recorded value of land, whichever is greater

Provided all taxes are paid and there are no errors in the deed itself, a transfer deed will usually be recorded within seven business days of the date of filing with the NPR.

Buying real estate through a corporation

It is common market practice to acquire a corporation for the sole purpose of acquiring real estate. Thus, many real estate owners have chosen to own their properties through corporations.

When a corporation is used solely for the purpose of owning a certain piece of property, a buyer may acquire the corporation as a means of purchasing real estate. This procedure has important advantages as well as disadvantages, as analyzed below.

Advantages

Cost:

The first and most obvious advantage is cost. A corporation is acquired through the execution of a stock purchase agreement or the endorsement of stock certificates. Both of these are simple procedures not subject to special formal requirements (as opposed to transfer of property title). There are no statutory closing costs, taxes, or fees, and the involvement of a civil notary is not required. Legal fees for drafting stock purchase documentation can be freely contracted by the buyer and his counsel for the transaction.

Time:

Transactions can be closed faster, mainly because no notice or filing with the NPR is required. Since title to the property is still held by the acquired corporation, no title trans-

fer notice or filing with any office is required and no registration process is completed. The stock transfer is only recorded by the corporation and remains private information. However, upon acquisition of the corporation, the buyer should immediately hold a Shareholders Meeting and appoint a new Board of Directors. This second process does require registration.

Disadvantages

Liabilities:

When acquiring a corporation, the buyer must conduct a careful and comprehensive investigation of the corporation's liabilities (with the NPR, Tax Authorities, and Municipal Government). Nevertheless, full disclosure of all existing and contingent liabilities cannot be assured. A full guarantee that the corporation is free of claims, judicial or administrative proceedings, or any other liabilities that may affect the property in the future cannot be obtained. These risks may sometimes be mitigated (although not eliminated) through contractual provisions protecting the buyer from future undisclosed liabilities.

Coastal Properties:

There are no licenses, certificates or authorizations required in order to own residential real estate. Different permits are required depending on the type of construction, the intended use of the construction, and the location.

This notwithstanding, Costa Rican law establishes restrictions with respect to ownership of coastal properties, for both foreigners and nationals. These restrictions are set out in the Terrestrial Maritime Zone Act. Under this Act, the terrestrial maritime zone is the property of the State and may not be bought or sold. The first two hundred meters of coastal property on both the Atlantic and Pacific coasts comprise the terrestrial maritime zone. The first fifty meters of the two hundred are known as the "public zone". This zone is open to the public, and private possession or occupation of this area is not permitted. The remaining one hundred and fifty meters are known as the "restricted zone". Entities or individuals may use (but not own) land located in the restricted zone, as long as they have been granted a validly issued concession agreement. Those concessions are typically granted for terms of between 5 and 20 years and may be renewed. Concessions for private use are granted by the local Municipal Government, and concessions for tourism-related activities are granted by the ICT. Concessions may be assigned as long as prior consent for the assignment is obtained from the Municipal Government or ICT, as the case may be.

Because the Terrestrial Maritime Zone Act establishes that this area is public, title to land located on the coast must be read in relation to that Act. In the event of a conflict between a private title and the Terrestrial Maritime Zone restrictions, the provisions of article No. 129 of the Constitution will take precedence. Because the general rule in the history of Costa Rican legislation has been that maritime private property is subject to maritime zone regulations, registered title to property within the maritime zone is only permitted if that property has been exempted from the zone restrictions by special legislation.

There are also limitations specific to foreign ownership of land within the terrestrial maritime zone. Article No. 47 of the Terrestrial Maritime Zone Act establishes that concessions for the use and enjoyment of the restricted zone shall not be granted to:

- Foreigners who have resided in Costa Rica for less than five years,
- Offshore entities,
- Local entities incorporated by foreign nationals, or
- Local entities more than 50%-owned by foreign nationals.

In conclusion, there are limitations on the purchase and transfer of properties within the maritime zone that must be regulated pursuant to this law.

Papagayo Gulf

In 1974, the Central American Development Bank (BCIE) analyzed Central America's tourism potential, and selected Papagayo Gulf as the most favorable location to develop a premium tourism project. Consequently, the Costa Rican Legislature enacted Act No. 5847, whereby a loan was obtained to develop this area.

Papagayo Gulf was excluded from the jurisdiction of the Terrestrial Maritime Zone Act. Therefore, a special system applies to Papagayo Gulf. The development and management of this area was assigned to the ICT, while the Municipalities are only entitled to collect the corresponding concession tax.

Currently, ICT continues to develop Papagayo pursuant to an approved Master Plan. Papagayo's success has attracted market leaders, such as Four Seasons and other renowned hotels and developers.

Chapter XII: Banking

Overview of the Banking System

The banking system is currently comprised of the Central Bank, three State-owned commercial banks, two service banks created by law, more than twenty private banks, and nearly seventy financial institutions. The Superintendency General of Financial Entities [Superintendencia General de Entidades Financieras – SUGEF] regulates all financial institutions (both banks and non-banking financial institutions).

The Costa Rican Central Bank is responsible for monetary, credit, and foreign exchange policies. It is an autonomous public institution with administrative independence. However, it operates in close coordination with the Executive Branch of government. Its main function is to control monetary variables.

State Banks

The three State commercial banks are autonomous public corporations with administrative autonomy, although they are subject to government regulations. They operate under a Board of Directors appointed by the Executive Branch for an eight-year period.

State banks include the following:

- Banco Crédito Agrícola de Cartago
- Banco de Costa Rica
- Banco Nacional de Costa Rica

The two service banks created by law are:

- BANHVI (a home mortgage bank): Created to help provide home loans to low-income families. Funded by the Costa Rican government.
- Banco Popular: Funded through statutory payroll withholdings.

Private Banks

Private banking has traditionally been restricted in Costa Rica, primarily in that private banks were previously not allowed to offer checking and savings accounts. These restrictions were lifted in September 1996. Most private banks offer checking accounts in US dollars through offshore subsidiaries, as well as locally held checking and savings accounts in both national and foreign currency. Other demand financial vehicles are permitted and frequently used. There are over twenty private banks operating in the country.

Non-Banking Financial Entities

According to Costa Rican law, non-banking financial entities are corporations that act as financial intermediaries in local and/or foreign markets to obtain working capital and general financial resources for activities carried out by individuals and business entities. Currently, finance companies represent a small percentage of the total financial system, and most of their transactions are for terms of less than one year.

Services Available

Banks usually engage in the following services:

- Financing of production activities
- Import/export financing
- Loans to the general public
- Business loans in conjunction with the Central Bank
- Time deposits in both local and foreign currency
- Fixed term deposits

- Checking and savings accounts in colones and US dollars
- Draft collection
- Letters of credit
- Direct payments
- Credit card operations
- Foreign exchange transactions
- Wire transfer services
- Financing of working capital
- Financial intermediary activities
- Trust agreements
- Bonded warehouses
- Time deposits
- 24-hour ATM service

All banks also offer certificates of deposit in colones and US dollars. No interest accrues after the maturity date.

Other Stock Exchanges and Public Offerings

The Costa Rican National Stock Exchange [Bolsa Nacional de Valores, S.A.] began operations in 1976, and has grown to become a stable and reliable fixture of the economy involved in the trading of securities through brokerage firms. The Costa Rican National Stock Exchange publishes daily, weekly, and monthly bulletins with full disclosure of all transactions. It also provides access to buyers and sellers in a regulated environment through registered brokers-dealers. Trading almost exclusively involves government securities. The trading volume in the equity market represents approximately 1% of total annual trading volume.

The National Securities Commission [Superintendencia General de Valores – SUGEVAL] is the governmental entity that regulates local securities markets. The regulatory framework is defined in the Securities Market Regulatory Act of 1997 (SMRA). The National Financial System Oversight Board [Consejo Nacional de Supervisión del Sistema Financiero – CONASSIF] authorizes public offerings of securities, which are regulated and supervised by SUGEVAL. Public offerings without prior authorization are not permitted in Costa Rica.

The SMRA regulates primary market activities by requiring timely disclosure of important information on the issuer and the instrument issued, whenever a public offering of securities has been made. The SMRA defines a public offering of securities as any offer, explicit or implied, that purports to issue, allocate, trade, or deal in securities with the public or particular groups. Filings to obtain CONASSIF's authorization for a public offering require i) a formal request; ii) information on external audits performed on the issuer and affiliates, if requested; iii) and registration of an informative prospectus for the securities being issued.

SUGEVAL's authorization is required in order to provide financial advisory or brokerage services, if such services are publicly offered or marketed. In order to engage in broker transactions on the local exchange, a firm must be a shareholder of the National Stock Exchange and be authorized by SUGEVAL.

Pension Funds

The recently enacted Employee Protection Law is expected to strengthen the operation of private pension funds. These pension funds complement the basic pension system managed by the Social Security Administration. Funding comes from mandatory contributions by employers on behalf of their employees, amounting to 3.25% of monthly salaries. An additional 1.5% is also contributed as employee savings. Pursuant to this new legislation, pension funds may only invest in securities issued by authorized banking and financial institutions or in securities registered with SUGEVAL.

Pension funds are managed by special-purpose companies known as Supplemental Pension Fund Operators [Operadoras de Pensiones Complementarias – OPCs], which must be authorized by the Pensions Superintendency [Superintendencia de Pensiones – SUPEN], a regulatory agency. Pension funds are expected to play an important role in the development of the local capital market

Chapter XIII:

The Central America-Dominican Republic- United States Free Trade Agreement

The Central America-Dominican Republic-United States Free Trade Agreement (known as CAFTA-DR) was signed in 2004. As of publication of this document in April 2005, the Agreement had not entered into force. Its main objective is to regulate trade relationships between the signatory countries (the United States of America, Costa Rica, Nicaragua, El Salvador, Honduras, Guatemala, and the Dominican Republic). The Agreement is divided into two main sections. The first section deals with regulatory aspects in the areas of trade of goods and services, investment, intellectual property, dispute settlement, etc., while the second section focuses on market access, whereby the parties establish progressive and reciprocal elimination of tariffs and other trade restrictions.

The Agreement is of extreme importance to all the signatory countries. The U.S. is Costa Rica's primary trade partner, while Central America and the Dominican Republic together represent the second largest export market for the U.S. in Latin America, after Mexico, and its tenth largest export market worldwide. Nearly 80% of products originating from Central America and the Dominican Republic already entered the U.S. duty free prior to CAFTA-DR as a result of unilateral American initiatives such as the Caribbean Basin Initiative (CBI) and the Generalized System of Preferences (GSP). However, the duty-free relationship becomes reciprocally binding under CAFTA-DR.

In September 2001, the governments of Central America and the U.S. agreed to launch an exploratory phase that would ultimately lead to the official start of negotiations (the Dominican Republic joined the process later). Beginning in November 2001, and through-

out 2002, a series of five workshops took place between the six countries, where the parties exchanged valuable trade-related information that would form the scope of the negotiations. At the end of this process, the countries committed to negotiating a free trade agreement beginning on January 8, 2003.

During 2003, the five Central American countries and the U.S. met for nine regular and several extraordinary negotiation rounds. Nicaragua, El Salvador, Honduras, and Guatemala closed negotiations with the U.S. in December 2003. Costa Rica, on the other hand, continued negotiating with the U.S. during January 2004 in order to reach a satisfactory balance, ultimately concluding the process on January 25. During negotiations, the Dominican Republic expressed an interest in joining the process. Once negotiations had been concluded, the DR agreed to abide by the regulatory aspects established by the six signatory countries, and to begin negotiations with the U.S. and Central America regarding market access. The Agreement was signed by the seven countries on August 5, 2004.

The next step in the process is ratification of the Agreement by each Congress, to ensure that it first enters into force as local law. The Agreement shall be effective once the U.S. and at least one other signatory country ratifies it internally and notifies the Depositary. For subsequent signatories, the Agreement will enter into force 90 days after the date of notification. However, unless the parties agree otherwise, no signatory country may provide notification of ratification more than two years from the first date of entry into force. The Depositary shall be the General Secretariat of the Organization of American States.

As of publication, only the Congresses of Guatemala, El Salvador, and Honduras had concluded their applicable legal procedures with respect to the Agreement. The Congresses of Nicaragua and the Dominican Republic are in the process of approval, with Nicaragua reportedly close to concluding. In the U.S., preliminary hearings have taken place in the Senate and the Committee of Ways and Means of the House of Representatives. Once the President of the U.S. introduces the bill into Congress, the process takes 90 days. Both chambers may discuss the bill simultaneously, but the House of Representatives may only vote during the first 60 days, while the Senate votes in the last 30.

The Government of Costa Rica has not yet introduced the bill to the Legislative Assembly because it is tying ratification of the Agreement to approval of the Tax Reform Bill. This measure has been strongly opposed by the private productive sector, which is urging the President to submit the CAFTA-DR immediately for approval regardless of the status of tax reform legislation.

Chapter XIV:

Energy Market and Regulations

Background

Costa Rica currently has enough power generating capacity to meet local demand, and has even become an exporter of electric power to other Central American countries. Despite its small area of just 19,730 square miles (51,000 km²), it has more than 150 rivers that are rated as class 3 or higher. Costa Rica's three mountain ranges and low coastal plains, along with its tropical climate, make this small nation a wealth of hydroelectric power potential. Costa Rica also has 64 volcanic formations, 8 of which are active, which provide a promising source of geothermal power. However, the majority of Costa Rica's installed capacity (73.9%) is derived from hydropower, and most planned projects to increase capacity involve hydropower. Other smaller sources of power include thermal, geothermal, and wind plants.

The Costa Rican Power and Telephone Company [Instituto Costarricense de Electricidad – ICE] is a government monopoly that controls the generation, transmission, and distribution of electricity. ICE was created in 1949, and since its founding, ICE has successfully provided the Costa Rican population with access to electric power, achieving a 97,04% national electrification rate. However, the country's debt service, particularly with respect to internal debt, has made it increasingly difficult to finance other sizeable projects and it has become necessary to procure private investment in the power generation industry.

With a total installed capacity of approximately 1,958.66 MW, an additional 1,696 MW will be needed by 2014. The country has about 1,056.8 miles (1,691 km) of main transmission lines. While several small facilities are currently under development or construc-

tion, the Costa Rican government would like to reap the benefits of economies of scale by building one or more large, efficient facilities. The Garabito Thermal Generation Plant, which could potentially supply 120 MW of power, is currently seeking sources of financing for the project under ICE supervision. Other projects include Pirris, which plans to start operating in 2009 with a capacity of 128 MW, and Cariblanco, which is expected to launch operations in 2007 with a capacity of 80 MW. There are also several important projects involving the construction of transmission lines, primarily financed by the Inter-American Development Bank. These projects include construction of the La Amistad Transmission Circuit to connect Costa Rica and Panama, and the installation of 500 kilometers of fiber optic lines to transmit energy as well as information. Another transmission line project is the installation of power lines for the Papagayo Tourism Point.

The legislative challenges that lie ahead for the current and future administrations will determine opportunities for increased participation of the private sector in the energy business. One example is the reforms being made to the ICE law, which is currently under discussion in Congress. Until the ICE monopoly is eliminated, any infusion of necessary private capital will be limited and subject to existing regulations.

Current Regulatory Environment

In 1990, the Costa Rican legislature enacted Independent Power Producer Act No. 7200, which permitted development of small Independent Power Projects (IPPs) with a capacity of up to 20 MW. These projects are developed under the Build, Operate, and Own (BOO) modality, under a 15-year Power Purchase Agreement with ICE for 100% of power produced. However, the same Act also stipulates that power generated by BOO projects may not exceed 15% of the nation's total installed capacity.

The 1990 IPP Act was certainly a milestone for private power generation in Costa Rica. Nonetheless, it quickly became apparent that the 20 MW/15% limits represented a serious constraint on the development of the much needed private power sector. As a result, the Act was amended in 1995 to include a second chapter. Accordingly, Act No. 7508 of 1995 introduced important amendments to the 1990 Act, including changing the requirement that 65% of the capital stock of all generating facilities be held by Costa Rican nationals. The new legislation lowered domestic equity ownership requirements to just 35%. It also authorized ICE to purchase power equivalent to an additional 15% of the nation's total installed capacity from IPPs through competitive international public tenders. Those new power projects, regulated by Chapter II of the IPP Act, have the ability to generate up to 50 MW, and must be structured as Build, Operate, and Transfer (BOT) projects under long-term Power Purchase Agreements with ICE for 100% of power pro-

duced. Although contract structures may vary, in all cases ownership of power generating assets reverts to ICE upon conclusion of the term of the Power Purchase Agreement, which is generally 15 to 20 years.

Overall, the IPP Act has been a successful and important piece of legislation. Over its 10-year lifespan, it has made development possible for about 34 BOO and BOT projects, with a combined generation capacity of approximately 225 MW. The Costa Rican Independent Power Producer Chamber estimates investment for construction of these power generation facilities to be around US\$400 million. Furthermore, the investment and development opportunities created by this Act have attracted world-class developers, as well as world-class financial institutions such as the Central American Bank for Economic Integration (CABEI), the Danish Development Agency (Danida), the International Finance Corporation (IFC), the Inter-American Investment Corporation (IIC), the Inter-American Development Bank (IDB), and the Commonwealth Development Corporation (CDC), among others.

ICE has recently awarded contracts for BOT projects totaling 89 MW to private operators, which is an indication of the country's eagerness to attract private and foreign investment.

CAFTA

The five Central American nations and the United States of America recently concluded negotiations towards a Central American Free Trade Agreement (CAFTA). A key issue of CAFTA is Annex 1, where Costa Rica permits access to the Electric Power Market. According to this Annex, Costa Rica reserves the right to grant concessions for the transmission, distribution, and trade of electric power based on demand for the service. Priority will be given to concession holders already supplying the service.

These enterprises may enter into joint ventures with public or private enterprises to supply their services, subject to the provisions stipulated by law.

Private persons may invest in activities for the operation of limited capacity power plants not exceeding 20,000 kW, provided they meet the following requirements:

- (a) ICE may purchase electricity from enterprises in which no less than 35% of capital is owned by Costa Rican nationals.
- (b) Foreign enterprises that sign a power purchase contract with ICE must establish a branch office in Costa Rica.

Chapter XV:

Insurance

The National Insurance Institute [Instituto Nacional de Seguros – INS], is the government monopoly that controls the Costa Rican insurance industry. INS offers coverage for most types of insurable risks (e.g. fire, earthquake, automobile, crops, life, medical, occupational hazard, flood, avalanche, professional liability, etc.). In certain circumstances, policies can be purchased from foreign providers, mainly when no insurance is available locally to cover a particular risk.

As with other industries currently under government control, there has been a push toward eliminating the State monopoly on insurance underwriting. INS is currently one of the largest insurers in Central America, which is indicative of the sizeable insurance market in the region. Although it is not yet clear whether INS will be privatized, it is highly likely that the monopoly will be eliminated in the near future, resulting in business opportunities for foreign insurers in a virtually untapped market.

This notwithstanding, under CAFTA-DR, Costa Rica agreed to transition to an open market as seamlessly as possible. The specific agreements under CAFTA-DR are summarized as follows:

- By no later than January 2007: Create an oversight authority, most likely an Insurance Superintendent. The superintendent system already exists in the banking (“Superintendency General of Financial Entities,” known as SUGEF) and securities (“National Securities Commission,” or SUGEVAL) industries. The Insurance

Superintendent is expected to be a technically independent agency with full authority to oversee the industry, issue administrative regulations and guidelines, and conduct administrative proceedings.

- By no later than the date of entry into force: Open the insurance market and eliminate the INS monopoly. This does not mean that Costa Rica will be required to allow insurance suppliers to do business or solicit clients in national territory. The markets for mandatory occupational hazard insurance and mandatory automobile insurance will not be opened until January 2011.
- By no later than January 1, 2008: On a non-discriminatory basis, Costa Rica shall allow insurance providers of any CAFTA-DR signatory country to compete in the supply of consumer insurance services in national territory.

Chapter XVI:

Government Contracting

The government contracting market is an interesting market for individuals or companies that wish to obtain contracts with the Costa Rican Government. For 2005, the budget for procuring non-personal goods and services is in excess of US\$33 billion/US\$3.3 billion.

The main government entities that contract for goods and services are Refinadora Costarricense de Petróleo (a Costa Rican oil refinery – Recope), Instituto Costarricense de Electricidad (the Costa Rican power and telephone company – ICE), Caja Costarricense de Seguro Social (the Costa Rican Social Security Administration – CCSS), Instituto Nacional de Seguros (the Costa Rican national insurance institute – INS), Compañía Nacional de Fuerza y Luz (the national power company – CNFL), Banco de Costa Rica (a national bank), and Consejo Nacional de Vialidad (a national public road council).

Hydrocarbons, construction materials and services, telecommunications equipment, electric power generation equipment, medical equipment, medicines, chemicals, reinsurance, consultancy services, public infrastructure construction and maintenance, etc. are some of the main purchases made by the above entities.

Coverage

The government contracting system is currently regulated by Government Contracting Law No. 7494 of May 2, 1995 [Ley de Contratación Administrativa – LCA], which establishes the mandatory principles and procedures applicable to agencies of the executive,

legislative, and judicial branches, as well as the Elections Board, Controller General of the Republic, Ombudsman, municipalities, autonomous institutions, non-governmental public entities, and public companies for purposes of contracting services.

Likewise, when partially or fully funded by public resources, contracted services provided by individuals or legal entities are subject to the regulations established in the LCA.

Exceptions

Pursuant to article 2 of the LCA, employer-employee relationships, public loans, and any other activities subject to a special body of contracting regulations are excluded from such Law.

Likewise, non-governmental public entities that are more than fifty percent (50%) funded by their own resources or union dues or contributions, and public companies whose majority stockholders are private individuals rather than public sector agencies, are exempt from the provisions of the LCA.

The bid procedures established in the LCA do not apply to the following activities:

- a) Customary government activities (i.e. the direct supply of public utility services, such as water, electricity, telephone, etc.).
- b) Agreements subscribed with the governments of other countries or with international public law institutions.
- c) Contracts between public law entities (e.g. agreements or contracts between ministries and companies or State-owned banks).
- d) Contracting activities that, given their nature, the present circumstances, or the immaterial monetary amount may not, or should not, be submitted to a public tender process, either because only one provider is available or due to special security, timing, or other relevant considerations.
- e) Purchases made with petty cash funds.
- f) Contracts for the construction, installation, or supply of offices or services abroad (e.g. construction of embassy buildings).

g) Activities excluded by law.

h) Activities excluded by a resolution of the Controller General of the Republic for reasons of the public interest.

All other contracting activities are governed by the LCA and the bid procedures described therein.

Government Contracting Principles

The LCA and jurisprudence of the Constitutional Court establish a number of principles that are intended to regulate and guide government contracting procedures. Those principles are described below:

- Bidding must be open to maximize bidder participation.
- Equal treatment for all potential bidders. This means that restrictions may not be imposed on the bid process and any preferential treatment is prohibited.
- The request for bid proposals must be openly publicized and full access given to the file, reports, resolutions, and, in general, any information related to the process.
- Proceedings must be legal and transparent. This means that contractor selection procedures must be clearly, specifically, and concretely defined in advance.
- The Government shall be subject to established procedures to ensure bidders of the rule of law and the legal certainty of the process.
- Compliance with formal bid procedures.
- The principle of balanced interests shall be upheld. This means that the contractor is treated as a collaborator, whose rights and obligations are balanced with the Government's interests.
- The parties shall demonstrate good faith, which means that the actions of both the Government and bidders must reflect clear ethical standards.
- The Government is both entitled and empowered to amend the contracts.

- The Government is required to maintain the economic balance of the contract, either by compensating the joint contractor for any negative repercussions of its decisions, due to the effect of contractual amendments, reasons of the public interest, or any other general or specific reason that ultimately affects the initial amount of the contract.
- Government contracting activities must be subject to control and oversight.

The above principles, which have been defined as constitutional principles by the jurisprudence of the Constitutional Court, must be upheld by both the bidders and the Government. Failure to do so to the detriment of either of the parties shall entitle those parties to file an appeal.

On the Bidders

According to the LCA, any interested party may participate in the various contracting procedures. Bids may be presented individually, jointly, or as a consortium, at the discretion of the parties.

Various bidders may form a consortium (temporary association) in order to combine their resources and experience. The parties to the consortium are held jointly and severally liable to the Government for any and all consequences derived from their own participation and the participation of the consortium in the contracting process or execution of the agreement.

Several bidders may also participate jointly when it is permissible under the terms and conditions of the bid process, and when, given the nature of the good or service being provided, it is possible or in the public interest for various components of the bid to be provided by different entities. In those cases, the joint bidders shall accurately delineate the components of the service for which they are individually responsible with respect to the overall proposal. Otherwise, they shall be held jointly and severally liable to the Government for any and all consequences derived from their participation in the contracting process and execution of the agreement.

Representation

Interested parties may participate directly or through a foreign company representative. In the latter case, an indication must be made that the interested party is presenting a proposal through a representative.

The foreign company representative may also participate directly on behalf of a third party, when a certified copy of the existing representation agreement is supplied.

Entities may also participate as distributors, offering market or catalogue prices, or through bids made by the manufacturer, exporter, or foreign company, as appropriate, provided those documents are furnished with the proposal.

Finally, bidders may participate through any form of representation recognized by civil law, such as full (unlimited or limited) power of attorney, specific full power of attorney (for a business, bid or contracting procedure), general power of attorney for day-to-day management functions, and special power of attorney (specific for each act).

The type of power of attorney is selected at the discretion of the interested party, who should consider the nature and requirements of the bid, as well as the jurisprudence on powers of attorney that has been issued by the Controller General of the Republic and the Constitutional Court.

It is important to bear in mind that full and general powers of attorney must be granted through a notarial instrument and recorded in the Costa Rican Public Registry.

Procedures

The LCA defines the contracting procedure that must be used by the Government, namely international public tender, public tender, bid by invitation, restricted tender, auction, or direct contracting.

Determination of Procedures

Determination of the appropriate procedure (in cases where a particular procedure is not prescribed by law) depends on the amount of the contract and the budget available to the contracting institution for procuring non-personal goods and services.

The LCA classifies institutions into categories (A through J) based on the available budget for procuring non-personal goods and services, and defines monetary limits for each category (which are adjusted annually by the Controller General of the Republic). Those categories and limits are then used to determine the appropriate contracting procedure, i.e. international public tender, public tender, bid by invitation, restricted tender, or direct contracting.

The following limits have been established for 2005:

Category	Budget for procurement of goods and services	Contracting Procedure						Appeal	Contract Approval		
		Public Tender	Bid by Invitation	Bid by Invitation	Restricted Tender	Restricted Tender	Direct Contracting	Appeal	Controller Authorization	Internal Approval	Internal Approval
		Greater than or equal to	Less than	Greater than or equal to	Less than	Greater than or equal to	Less than	Starting at	Starting at	Less than	Greater than or equal to
A	Greater than 37,300,000,000	204,000,000	204,000,000	90,500,000	90,500,000	28,300,000	28,300,000	102,000,000	77,000,000	77,000,000	10,000,000
B	37,300,000,000 to 24,900,000,000	193,000,000	193,000,000	29,000,000	29,000,000	9,660,000	9,660,000	78,200,000	69,000,000	69,000,000	9,000,000
C	24,900,000,000 to 12,400,000,000	135,000,000	135,000,000	19,300,000	19,300,000	8,690,000	8,690,000	54,100,000	47,000,000	47,000,000	8,000,000
D	12,400,000,000 to 6,220,000,000	96,600,000	96,600,000	15,500,000	15,500,000	7,730,000	7,730,000	39,800,000	34,000,000	34,000,000	5,000,000
E	6,220,000,000 to 1,240,000,000	67,600,000	67,600,000	13,500,000	13,500,000	6,760,000	6,760,000	29,800,000	30,000,000	30,000,000	4,000,000
F	1,240,000,000 to 622,000,000	58,000,000	58,000,000	11,600,000	11,600,000	5,800,000	5,800,000	25,500,000	26,000,000	26,000,000	3,300,000
G	622,000,000 to 373,000,000	38,600,000	38,600,000	7,730,000	7,730,000	4,830,000	4,830,000	17,000,000	18,000,000	18,000,000	2,500,000
H	373,000,000 to 124,000,000	29,000,000	29,000,000	5,800,000	5,800,000	2,900,000	2,900,000	12,800,000	14,000,000	14,000,000	2,000,000
I	124,000,000 to 37,300,000	19,300,000	19,300,000	3,860,000	3,860,000	1,930,000	1,930,000	8,500,000	9,000,000	9,000,000	1,500,000
J	37,300,000 or less	9,660,000	9,660,000	1,930,000	1,930,000	1,000,000	1,000,000	4,250,000	5,000,000	5,000,000	750,000

As indicated in the above table, the larger the budget for procuring non-personal goods and services, the higher the limits for the various contracting procedures.

The different contracting procedures essentially vary in terms of the method for requesting proposals, the term for receiving bids, and the required guarantees.

Following is a description of the various contracting procedures:

Public Tender

The public tender process is a contracting procedure used for contracts for a specified amount (see above table), all sales or disposals of assets (real or personal property), leasing of assets, and public works concessions.

In accordance with the General Regulations for Government Contracting [Reglamento General de Contratación Administrativa – RGCA], publication of the request for proposals in the “Official Gazette” is mandatory. Additional publication in local or foreign newspapers as may be determined by the Government is optional. The terms and conditions for the request for proposal must be made available to the interested parties from the date of publication.

Likewise, any changes to the terms and conditions must be published in the “Official Gazette,” at least three business days prior to the deadline for bid submittal, provided the changes are not major.

The RGCA stipulates a minimum term for bid submittal of 25 business days for construction proposals or works concessions, 20 business days for proposals to supply imported goods or goods to be imported, and 10 business days for all other business.

When the Government makes modifications that change the original object of the tender, the terms for bid submittal must be extended by 30 and 15 business days, as appropriate.

The LCA requires a bid bond equivalent to between one percent (1%) and five percent (5%) of the amount of the proposal to guaranty this contracting procedure. The exact percentage is defined in the tender terms and conditions based on the complexity of the contract. Alternatively, the Government may set a fixed amount for the guaranty (which must be between one percent and five percent of the estimated contract amount).

Once the bids have been submitted and opened, the Government has five business days from the date of opening to begin to analyze the formal aspects of each bid. At least three business days are then granted to any bidders that need to correct errors or supply relevant information or documentation that has been omitted. No substantial changes may be made to the tender at this time (i.e. changes in object, price, term for delivery, guarantees).

Once the bid has been analyzed and evaluated, the contract is awarded within the term stated in the terms and conditions. If no such indication is made, the contract shall be awarded within 20 business days from the date the bids were opened.

The reasons justifying the award shall be published in the “Official Gazette”

International Public Tender

International public tender is the contracting procedure typically used when the contracting is being funded by an international organization that requires an international invitation to bid.

This procedure is also used when the Government considers it to be in the public interest, such as the case of public works concessions.

In addition to the customary publication in the "Official Gazette," this procedure requires publication of notices in foreign newspapers, or notification through business attachés in local embassies.

Public tender rules apply for all other matters.

Bid by Invitation

The bid by invitation procedure is used in the cases stipulated in the LCA, based on the budget for procuring non-personal goods and services, and according to the estimated amount of the transaction (see "Contracting Limits" table).

In bids by invitation, the Government invites all qualified suppliers of the good or service listed in the registry of suppliers by direct invitation delivered to the address specified by each supplier.

However, if the number of registered suppliers for a given service is greater than ten, the Government has the option of issuing an invitation through a notice published in the "Official Gazette."

Likewise, if the number of registered suppliers for a given service is less than five, the Government shall publish an invitation to bid in the "Official Gazette."

The minimum term for bid submittal in this process is ten business days.

The contract is awarded within the term stated in the terms and conditions. If no such indication is made, the contract shall be awarded within 15 business days from the date the bids were opened.

The opening of bids, selection, and awarding of the contract, or cancellation of the bid process shall be governed by the rules and regulations for public tenders.

Restricted Tender

The restricted tender process is used in the cases stipulated in the LCA, based on the budget for procuring non-personal goods and services, and according to the estimated amount of the transaction (see “Contracting Limits” table).

In restricted tenders, the Government selects or invites at least five suppliers of goods and services (from its registry of suppliers), who have a history and statements of satisfactory compliance with the object of the contract.

If the number of registered suppliers for the object of the contract is less than five, the Government shall make a record of that fact in the corresponding file and invite the qualified bidders.

When the invitation is issued, the Government will include a copy of the list of terms and conditions in a file that shall be made available to any supplier interested in participating in the bid process.

The minimum term for bid submittal is three business days.

The contract is awarded within the term stated in the terms and conditions. If no such indication is made, the contract shall be awarded within 5 to 10 business days from the date the bids were opened.

The opening of bids, selection, and awarding of the contract, or cancellation of the bid process shall be governed by the rules and regulations for public tenders.

Auction

The auction procedure is used to sell or lease real or personal property when considered to be in the Government’s best interest.

The auction procedure is as follows:

Government appraisers first appraise the property to be sold or leased, in order to determine the base price.

The invitation to participate in the auction is then published in the “Official Gazette”. The notice shall include a list of assets to be auctioned, with a description of their nature, lo-

cation, and base price; the place, date, and time they can be examined (at least five business days before the auction date), and liens or taxes due thereon; the date, time, and place the auction will be held; and any other relevant information.

There must be at least ten business days between the date of publication of the auction notice and the date of the auction.

Finally, the auction is held. The Government shall designate an auctioneer to preside over the auction.

The asset is awarded to the highest bidder. For the process to be complete, a performance bond must be immediately paid to the Government equivalent to ten percent (10%) of the value of the asset sold at the auction.

The interested party shall have three business days to settle the outstanding balance. Otherwise, the bond paid to the Government will be forfeited.

Upon conclusion of the auction, a document will be drawn up containing the results of the auction, which shall be signed by the auctioneer and the successful bidder.

Direct Contracting

Direct contracting is used in the cases stipulated in the LCA, based on the budget for procuring non-personal goods and services, and according to the estimated amount of the transaction (see “Contracting Limits” table).

Direct contracting is also appropriate when: i) the object of the contract is a service that only one person can provide, such as the supply of exclusive articles produced by a single manufacturer (where no substitutes are available), authentic spare parts, or goods and services of artistic or literary content, ii) for security reasons, it is advisable to limit participation to select individuals, iii) the contract is for the purchase or leasing of properties that, given their location, nature, conditions, or position, are the only properties suitable for the proposed objective.

Direct contracts may be subscribed with individuals, non-governmental organizations, or private entities that aim to assist the Government, without seeking to profit from the respective operation.

Direct contracting can also be used in cases where wholly unforeseen circumstances affect or seriously compromise the ability to continue providing essential public utility services.

Finally, when it is in the public interest, the Controller General of the Republic may authorize direct contracting under other conditions not provided for in the LCA by issuing a reasoned resolution.

For the above cases, the Government shall consult its registry of suppliers to select the ideal contractor. Where possible, at least three quotations must be requested.

Appeals

The LCA essentially provides for three types of appeals, including objections against the terms and conditions of the bid process with the intent of eliminating any restrictions on participation, and appeals against the award to cancel the contract.

Objections

Objections may be filed by any potential bidder or representative who claim procedural defects, a violation of the fundamental principles of the contracting process, or a violation of applicable laws.

Moreover, any entity legally organized to protect the interests of the community that will be affected by the project or occupying the area where the project will be executed is entitled to object to the terms and conditions of the bid.

In the case of public bids, the objection must be made to the Controller General of the Republic during the first third of the term granted for bid submittal. The parties must demonstrate authority to file the objection and expressly set out the terms and conditions being challenged, and/or the violation of any principles, standards, or procedures for the tender process.

Once the objection has been received, the Controller General of the Republic shall give audience to the Government for 3 days to address the appeal. The Controller General of the Republic then has 10 days to reach a final decision.

For the procedure of accepting bids by invitation, objections are filed with the entity that handles the proceedings during the first third of the term for bid submittal.

Objections must be resolved by the officer in charge within 10 business days, or all claims will be upheld by default.

Whenever an objection is upheld, the Government must make the corresponding changes within 3 business days and proceed to notify the interested parties by the same means used for the invitation to bid.

Appeals

Appeals are filed to challenge the contract award and are appropriate as stipulated in the LCA, based on the budget for procuring non-personal goods and services, and according to the estimated amount of the transaction (see “Contracting Limits” table).

Anyone with a legitimate, actual, and direct interest, or who has submitted a bid on behalf of a third party, as a representative of that party, is entitled to file an appeal.

For such purposes, the appellant must demonstrate eligibility to be the new successful bidder of the tender process.

Appeals must be filed within 10 business days from publication or notification of the award, and include an indication of the standards, principles, or procedures that have been violated.

Likewise, in the event of disagreement with the technical appraisals or scientific assessments made by the Government, the appellant must present reasoned arguments by submitting reports and studies from qualified, independent experts.

Within the first 10 business days of filing, the Controller General of the Republic shall determine whether to accept or dismiss the appeal. If accepted, a court order is issued to open the case file, and the Government and successful bidder are given audience for 5 days to address the case.

Prior to issuing a decision, a final hearing will be held for 3 days to give the parties the opportunity to present their concluding remarks.

Appeals must be resolved within 30 business days from the date of the court order to open the case. Such term may be extended by 15 business days, if necessary, to obtain expert testimony that, due to its complex nature, could not be produced during the normal resolution period.

The final decision or order to terminate the appeal concludes the process of recourse through official channels. Within three days from notification thereof, the interested party may challenge the final decision (without overturning it) before the Superior Court of Administrative Litigation through special proceedings regulated by articles 89 and 90 of the Law Regulating the Administrative Litigation Jurisdiction.

Motion for Reconsideration

When an appeal is not permissible due to the amount of the contract, the parties may file for reconsideration of the award through a motion for reconsideration by the same entity that issued the award, within 5 business days of notification thereof.

However, if the head of the entity has not yet approved the award, the interested party may file its appeal with the acting officer in charge.

If the motion is upheld, the Government shall notify the successful bidder by no later than 48 hours from the time the motion was filed. The successful bidder then has a period of 3 business days to make a statement on the matter.

The Government must reach a decision within 15 business days from the date the answer to the appeal is presented.

The decision handed down by the Government concludes the process of recourse through official channels. However, within 3 days from notification thereof, the interested party may challenge the final decision (without overturning it) before the Superior Court of Administrative Litigation through special proceedings regulated by articles 89 and 90 of the Law Regulating the Administrative Litigation Jurisdiction.

On Contracts

Under Costa Rican law, contracts are legitimate when the award is final and the performance bond is paid (if required). Accordingly, the signing of the contract (which can be in the form of any document) merely represents formalization of a contract that is already considered to be legitimate.

For contracts to be effective (executable), they must (if warranted, given the amount) be approved by the Controller General of the Republic or receive the internal approval of the Government, as the case may be. The only contracts that are exempt are those for small monetary amounts, as indicated in the "Contracting Limits" table.

Contracts may be executed once it is authorized or approved.

Rights and Obligations

The LCA establishes a number of rights and obligations for the parties to a government contract, including the following:

The Government's rights include: i) the right to terminate the contract due to breach of contract by the contractor, ii) rescind the contract due to force majeure, acts of God (being required to pay the contractor for the portion of the contract that has been executed and any reasonable expenses incurred by the contractor for purposes of full execution of the contract), or for reasons of the public interest (being required to pay the contractor for the portion of the contract that has been executed and to compensate for damages), iii) the right to amend the contract (expanding or reducing the object of the contract by up to fifty percent), iv) the right to oversee the project, and v) the right to execute bonds (in the event of breach of contract by the contractor).

In turn, the Government is obligated to adhere to the contract and uphold all acquired commitments, as well as to process any requests made by the contractor within 30 business days. If no action is taken by the Government during that period, the requests shall be granted by default.

Likewise, the contractor has the right to expect all contractual agreements to be upheld, as well as maintenance of the financial-economic equilibrium of the contract, and payment of interest (the Government shall pay the contractor accrued interest from the date on which payment was due until the date of issue of the corresponding payment document, calculated by applying the borrowing rate for obligations in colones and the prime rate for obligations in US dollars).

In turn, the contractor is obligated to uphold the agreement and verify that government contracting and contract execution procedures are properly carried out.

Finally, the rights and obligations of the contractor may not be transferred without the prior express consent of the contracting Government and the Controller General of the Republic, when more than fifty percent (50%) of the object of the contract is transferred.

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