DOING BUSINESS IN COSTA RICA

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1. TAXES

The Costa Rican tax system is based upon a territoriality principle of income. This means that the contributor will be taxed only for the income generated by activities developed in the Costa Rican territory and paid by or from Costa Rican sources. Costa Rica's Constitution seize the main principles that governs our tax system by establishing, among others, the following principles, Territoriality, Legal Reserve of Taxation Matter, Equal Protection before Tax Laws, General Application, Non Confiscation, Contributive Capacity and Proportionality.

A. BASE OF TAXABLE INCOME

Costa Rica is a "source" jurisdiction from an income point of view. That is, both Costa Rican tax residents and non-residents generally are subject to tax only on their Costa Rican source income.

Legal entities such as corporations, state enterprises, branch offices, subsidiaries, agencies, permanent establishments, trusts, inheritances (as long as it remains undivided), individuals residing in Costa Rica regardless of their citizenship or place of residence, individuals in a dependent labor relationship or rendering professional services, and physical and legal entities not specifically described and engaged in profit making activities in Costa Rica are subject to tax upon their annual gross income; this gross income includes earnings, benefits and rents, whether in cash or in kind.

Among entities exempt from income tax are: government organizations, religious institutions (regardless of creed), associations declared of "public interest" and other non-profit organizations, employer sponsored organizations (partially exempt), employees cooperatives, and companies operating under free trade zone status.

As mentioned above, taxable income is determined on the basis of gross income, less the expenses needed to produce the income, define by our tax law as deductible expenses, this will generate a net income, which produces the taxable income, which by the way is the amount subject to tax rate.

It is important to mention that capital gains are excluded from gross income provided that the activities generating them are not habitual or derived from the sale of depreciable assets.

B. RATES

1. 30% corporate rate on S.A.s and S.R.L.s.

2. Graduated rates from 10% to 25% on individuals.

3. 1% net assets tax which is creditable against income tax.

4. Dividends are not includable in taxable income. Rather there is a definitive withholding tax on distribution of "disposable" income ("disposable" income distributed by a corporation may include income which was not taxable to it — e.g. non-taxable capital gains). The withholding rate is 15% on distributions from a Costa Rican subsidiary to its foreign parent. The rate is also 15% on payments to individuals, though this rate is reduced to 5% if the distribution is from a company whose stock is traded on the exchange in Costa Rica.

5. In the case of branches, the rate is 30% on the taxable income of the branch, plus 15% on "disposable" income credited or remitted to the head office (in this regard, a Costa Rican tax tribunal has ruled that capitalized profits are not subject to the 15% tax).

6. On leases of capital assets, the rate is 15% in the case of capital assets used in commercial endeavors. The rate is 0% if the capital assets are used in industrial or agricultural applications.

7. The withholding rate on interest paid to non-residents is 15%, but is reduced to 0% if it is paid to an approved bank or financial institution.

8. The rate is 25% on royalties (royalties may be exempt if the recipient can show that it benefits from no credit for Costa Rican taxes applicable to the royalties).

9. The withholding rate on technical assistance is 25%, even if the technical assistance services are performed outside Costa Rica. This is a significant variation from the general "source" principle.

10. The catch-all withholding rate on income paid to a non-resident is 30%.

C. TAX ON PROFITS

The Tax on Profits, contained in article 1 of the Income Tax Act, is the regular Income Tax imposed on all types of income and unidentified and unjustified increases or accessions to wealth sourced within the boundaries of Costa Rica.

Corporate Tax Rate in Costa Rica ranges between a 10 and a 30 percent.

Corporations are subject to a 30% tax rate. Small corporations, defined in the law as those corporations with a annual gross income of less than US$ 100.000,oo are tax with taxes rates in the range between 10% to 20% .

Tax Rates among independent professionals vary according to the amount of income they have earned within the fiscal year, and thus, this will determine the tax bracket on which they falls.

Tax on Profits is computed in the same manner as any other income tax, gross income is determined, then deductions are determined and you finally obtain the net taxable income; as mentioned above

As long as the income is sourced in Costa Rica according to the source rules established in Article 54 of the Income Tax Act, all individuals, corporations, partnerships, trusts, branches, permanent establishments and other types of entities receiving such type of income will be subject to this Tax.

As said in the preceding paragraphs capital gains are not taxed in Costa Rica, with the exception of the realization of two events: (a) the realization of a capital gain from the sale or transfer a depreciable tangible asset (Personal or Real Property) or; (b) if the realization of a capital gain derived from a habitual activity of the taxpayer.

D. TAX ON PROFITS WITHHELD AT SOURCE

There are several types of income subject to the Tax on Profits that must be withheld at source. In other words, the payer of such types of income or earnings must act as a withholding agent for the Tax Administration and retain specific amounts before they disburse the income or earnings. Examples of taxes on profits withheld at source include the 8 percent withholding tax on publicly traded securities and the tax on income derived dependent labor.

E. TAX ON AVAILABLE INCOME

This tax is imposed on after-tax profits on a net basis (no additional deductions allowed) or the remaining profits after subtracting the computed tax from the net taxable income.

There are only two types of taxpayers to this tax: (a) capital-formed entities and (b) physical person associations and other special types of entities such as branches and permanent establishments.

According to Section 18 a “Sociedad Anónima” that distributes or pays out any type of dividends, equity interests (except for stock dividends of the same company) or any other type of distribution that might be assimilated to a dividend, must withhold a 15% of the amount distributed, unless the company is publicly traded (trades stock in a stock market), in which the company must withhold a 5%.

There is an exception to this rule which is that the dividend or profit distribution is done to another shareholder which is a “Sociedad Anónima” domiciled in Costa Rica. In that case, the dividend is exempt from this tax.

Under Article 19, a physical person association is still taxed with a 15% on its after-tax profits, however the computation is different.

In this case the full amount (100%) of the after-tax profits that is remitted or sent back to the parent company will be taxed with a 15% of such amount on a net basis.

F. TAX ON REMITTANCES TO FOREIGN COUNTRIES

As the previous tax we discussed it is another withholding tax on a net basis. Its objective is to withhold a specified percentage on income sourced in Costa Rica, which will be remitted to another person or company in a foreign country.

The types of income that are withheld include dividends, salaries, rents, royalties, interest, income from telecommunications and transport, etc.

The withholding tax rate for dividends and interest payments is of 15%. If the remittance is not identified within one of these two categories, then the tax rate would be 30%.

In the case of this tax there is an exception for interest payments that determines that interest payments to foreign companies, financial entities or banks identified or acknowledged by the our Central National Bank (Treasury Bank of Costa Rica) as institutions regularly performing international financial.

Dividend Distribution Tax and this Withholding Tax are unique and final, this means, that the payment of one of the two taxes excludes the payment of the other. If you paid the Dividend Distribution Tax, you don’t have to pay the other Withholding Tax and vice versa. It is also important to establish the withholding agent remains severally and jointly bound with the taxpayer for the payment (withholding amount) of this tax.

G. SALES TAX

Sales tax is our own version of a value added tax. It is payable upon importation of merchandise into Costa Rica, and upon the sale of goods and certain services. The sales tax rate in Costa Rica is 13%. However, there is a list of products exempted, and on the hand other only the services included in the basic list included in article 1 of the Sales Tax Act are taxed.

Selective Consumption Tax

In addition to sales tax, some imported merchandise or sold goods may be subject to a selective consumption tax (Impuesto Selectivo de Consumo), The selective consumption tax is an excise tax similar to, and usually applied in conjunction with, the sales tax. The rate of this will depend upon the characterization of the merchandise or goods.

H. PROPERTY TAX

The property tax is established on annual basis and may be paid annually, by semester or by quarter depending of the procedure established by each Local Government (Municipality). At the present time, the property tax rate is 1,25 percent of the appraised value of the property.

Real Property Transfer Tax There is a 3 percent real property transfer tax. This tax is computed upon the registered value on the transfer deed at the time of the sale.

I. PATENTS AND MUNICIPAL TAXES

In order to be able and legally authorized to do business in a determined political subdivision in Costa Rica a license to perform such activity must be obtained. In order to obtain such license a tax must be paid to the Local Government of such political subdivision, such tax is called a patent. The tax rates and computation varies from Local Government to Local Government, however it is usually a percentage of the gross profits generated by such activity.

J. CAPITAL GAINS

Capital gains are taxable, to both resident individuals and resident companies, only if they arise from "habitual" activities. "Habitual" activities are narrowly defined. Sale of stock generally produces non-taxable capital gain, unless the gain is realized by one that engages in the purchase and sale of stock as its principal and predominant activity. As noted above, however, non-taxable capital gain received by a corporation results in "disposable" income, the distribution of which attracts withholding tax.

It is possible that such capital gains would be subject to the 30% catch-all withholding rate.

K. TAXABLE YEAR

The law and regulations fix the taxable year from October 1st to September 30th.

L. METHOD OF ACCOUNTING

Costa Rican legislation generally mandates the use of the accrual method. However, the cash method may also be used with prior approval from the tax authorities.

M. LIMITATION ON DEDUCTIONS

Costa Rican subsidiaries may deduct payments to its foreign parent for technical, financial or other assistance, or for patents, formulae, trademarks and similar items, up to an aggregate of 10% of gross sales. The deduction is available only if the Costa Rican company has in fact withheld any corresponding withholding tax due.

N. NET OPERATING LOSSES

Operating losses may be carried forward for 3 years for most activities, and for 5 years in agricultural activities. Carrybacks are not allowed.

ABOGADOS

O. VALUED ADDED TAX

VAT generally applies to sales of goods and services at a rate of 10%.

P. REORGANIZATIONS

There are no provisions regarding reorganizations in the tax law or regulations.

Q. CONSOLIDATED RETURNS

No consolidation is permitted under the Costa Rican Tax System.

R. FREE TRADE ZONE REGIME ("Regimen de Zonas Francas")

The Costa Rican government currently operates a free trade zone regime to provide incentives, including many tax exemptions, for export operations.

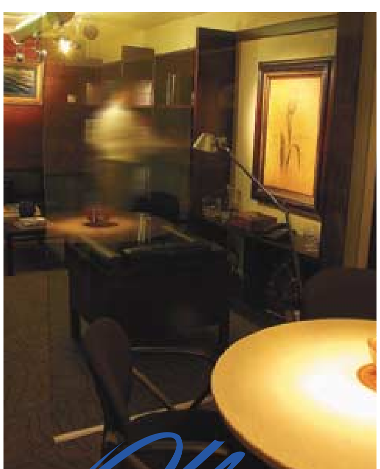
Companies that operate under the Free Zone Regulation have the following benefits:

- Exemption of import taxes and surcharges on imports (raw materials and inputs)
- 100% exemption of taxes on profits.
- Exemption of export taxes of local and excise taxes and of profit repatriation taxes.
- No restrictions on capital repatriation.
- Streamlined and centralized processing of documentation required for installation and operation.
- Possibility to sell in the local market (up to 25% of total sales)

2. LABOR

According to the Costa Rican Labor Code, "…an employment relationship exists when there is an exchange of services for money and the employer exercise direction and control over the employee's duties..."

The Code also grants equal protection to both verbal and written agreements.



A. WORK SCHEDULE

The total weekly period shall not exceed forty-eight hours during day shift and thirty-six hours at night shift. Different work periods could be applied under special conditions, example, if the work to be performed is not dangerous or unhealthy, the work period could be of ten hours during the day and of eight hours during the night not exceeding forty-eight hours per week.

If the working day is continuous and the lunch break does not exceed thirty minutes it will be considered part of the work period and thus a paid rest. Employees have the right to enjoy at least one fixed day of absolute resting during each week or following six days of continuous work.

B. OVERTIME

Payable as time-and-a half and the workday cannot exceed twelve hours. Overtime is not permitted when the working conditions are dangerous or unhealthy.

C. HOLIDAYS

There are nine legal or payable official holidays. If a worker works on a Holiday or on his day off the employer will have to pay him double-time. The Holidays with mandatory payment are: January 1, April 11, Thursday and Friday of Holy Week, May 1, July 25, August 15, September 15 and December 25.

The August 2 and October 12, there are also holidays but payment is not mandatory.

If April 11, July 25 and October 12 fall on Tuesday, Wednesday, Thursday or Friday the Holiday may be enjoyed on the next Monday.

D. WAGES/PAYMENT

Minimum wages are adjusted by National Salary Council twice a year based on the inflation index. Payment is by time period or unit/piece work. The company is free to determine method and timing of payment. Blue -collar workers are paid weekly or twice a month, white-collar and domestic workers monthly.

E. TRIAL PERIOD

In every labor contract or relation for an indefinite term there will be a three month trial period. The company can decide not to hire the individual during those three months and not incur in any responsibility other than the payment of vacations(one day per month) and the proportional part of the Christmas bonus. After the three month trial period, it is assumed that the company has hired the individual and all provisions of the Labor Code are in force, both for the company and the employee.

F. FOREIGN EMPLOYEES

At present there is no limit as to percentage of foreign employees that may be hired. Their legal status must allow them to work in Costa Rica and this is coordinated by the Migration Directorate.

G. SEVERANCE PAYMENT:

The Costa Rican Labor Law provides that severance payment is the economic compensation to which the employee or his family are entitled, when the employment agreement is ended due to an unjustified dismissal by the employer, the employee's retirement, or due to employee's death. Severance payment must be calculated according to the average salary of the previous six months and in accordance to the seniority of the employee (period labored).

H. NOTICE (Pre Aviso)

The notice period is defined as the obligation of the parties within a work relationship to notify the other party of its decision to terminate the work relationship between them. This notice must be given by the corresponding party in writing.

The amount of notice required depends on the length of time that the employee has worked for that particular employer.

This option is effective if the employee decides to leave voluntarily and put an end to the labor relation.

If previous notice period is not given by the employee to his employer when he wants to end the labor relation, the same time frame amount can be collect by the employer to his employee following a special proceeding.

I. PAID VACATIONS

The worker is entitled to a minimum of two weeks of paid vacations for every fifty weeks of continuous activity under the same employer. If terminated before accumulating those fifty weeks of employment, the employee is entitled to one vacation day per each month worked.

In the event of dismissal, with or without just cause, before enjoying his time off the employer must pay the amount corresponding to the vacation periods not taken. The amount is determined by multiplying the employee's daily (gross) wage by the unused vacation days.

As a rule, the Labor Code does not allow employees to accumulate vacation time, except in cases when the employee carries out technical or confidential tasks that make his replacement difficult.

J. THIRTEENTH MONTH SALARY (Aguinaldo)

This refers to the additional benefit paid by the employer known as the thirteenth month salary, in other countries known as Christmas bonus. It is equivalent to the average of the last twelve months ordinary and extraordinary salaries received by the employee (from the period of time between December and November of the following year).

This benefit must be paid to the employee within the first 20 days of the month of December.

In the event of dismissal, with or without just cause, the employer must pay the proportional amount of the Christmas Bonus due for the period of time the employee has worked.

K. RESERVE PROVISIONS

The Law suggests that employers should keep reserves for the payment of: Vacations: 3.85%, Christmas Bonus: 8.33%, Holidays: 2.47%, Severance: 8.33%.

L. SOCIAL SECURITY BENEFITS

Costa Rica has a mandatory social security system that provides all citizens with medical care, disability payments, and retirement benefits.

Costa Rican social security system is structure upon the contribution of both parties of the labor relationship, the employer and the employee.

Regarding the employer, our social security system helps bringing fully paid attention to the employee assuming his pay roll payment in case of illness, incapacity and providing the rehabilitation of the employee.

The total employer contribution is 23. 9% to 27% of the payroll, depending on labor risk: a) Sick Leave: the sick leave is payable by the employer at 50% of salary for the first three days. From the fourth day on, Social Security pays 60%. Maternity leave is payable at the same 50% rate for four months (120 days: 30 days before and 90 after birth) while Social Security covers the remaining 50%. In case of absence by injury or accident, the National Insurance Institute covers 75% of the injured worker's salary without time limitation from the first day.

The employee contribution is 9%. Both amount calculated on the gross salary the employee receives, which must be reported to the Social Security Bureau .

The Costa Rican Social Security Bureau (Caja Costarricense del Seguro Social), is the entity authorized by law to recollect the employee's and the employer's social contributions.

M. INJURIES ON THE JOB/WORKERS COMPENSATION INSURANCE

Every employer must have worker's compensation insurance to protect workers from accidents. The National Insurance Institute sells the worker's compensation policy. The employer may also be responsible for independent contractors if they are under his direction. If a worker is injured and the employer does not obtain insurance as required, the employer will be liable for all expenses incurred by the worker as a result of the injury.

N. WORKER'S PROTECTION ACT

The Workers Protection Act, enacted in February 2000, established an additional mandatory contribution by employers of 3% of salaries paid to employees, 50% of this contribution goes to a mandatory individual pension account that every employee must have with a public or private pension fund operator, and the other 50% goes to a mandatory individual capitalization account that every employee must also have. Amounts transferred by employers to individual capitalization accounts will be considered advance termination payments and released to employees in the event of termination of the employment relationship, regardless of the cause of termination.

O. PENSIONS

Costa Rica's pension system is state-run, with employer quotas paid into the Social Security Institute with respect to every paycheck. However, many companies also have special arrangements with their employees.

3. IMMIGRATION

Costa Rica offers foreign citizens an array of options in terms of residency. In general terms, for the approval of a residency application, it is crucial for the beneficiary to demonstrate enough means to initiate a business activity in the country or to show a strong financial basis (either in Costa Rica or abroad) to the government.

In general, a residency applicant must prove that he or she will not be a burden to the country by demonstrating that enough income is generated either as their primary financial support or as the means for the establishment of a secondary source of income such as a business venture or other investment projects.

4. COMPANY LAW

Costa Rican law recognizes a wide variety of organizations, including general and limited partnerships, capital stock corporations, individual enterprises of limited liability, trusts, foundations, civil associations and cooperatives. Foreign companies may operate legally through local branches, joint-ventures, wholly-owned subsidiaries and other variations on the recognized organizations.

Regardless of the method of operation, an enterprise doing business in Costa Rica must be registered with the Commercial Registry, thus becoming a "Costa Rican" enterprise regardless of the nationality of its owners or officers. Foreigners may act as officers, directors, partners or trustees in local companies, make use of negotiable commercial documents and execute any kind of legal contract.

Limited liability companies provide the same protection to their parent companies as corporations. Branches are considered to be the same entity as the foreign principal, which may consequently subject the latter to unexpected local claims. Of course, the insertion of one or more subsidiaries between the ultimate parent company and a Costa Rican branch can provide the same protection to the ultimate parent offered by corporations and limited liability companies.

A. CORPORATIONS

1. **Formation** A Costa Rican corporation (*sociedad anónima* or *S.A.*) may be established either privately or by public subscription. The organizers must execute its bylaws[1] before a notary public, register the incorporation deed in the Commercial Registry, and publish notice of the incorporation in the Official Gazette. The corporation must have its domicile in Costa Rica.

2. **Shareholders and Shares** The corporation must be formed by a minimum of two organizers. After formation, the corporation may have any number of shareholders.

   Corporations have no minimum capital requirements, but at least 25% of the subscribed capital must be paid in full upon formation.

   Ownership of stock is registered in a private registry not open to the public, and shares are freely transferable unless the charter provides otherwise. Dividends may only be paid from profits. Dividends are often given in shares to avoid the 15% withholding tax on cash dividends.

3. **Management** A Costa Rican corporation is managed by a board of no less than three directors, who need not be shareholders.

   At least one of the directors must be vested with managing power and legally represent the corporation. In practice, the chairman or President of the board is the managing director and the other two directors act as Treasurer and Secretary. The bylaws may specify other legal representatives and may permit them to delegate some or all of their powers to other members of the board. The board of directors may also appoint one or more corporate "managers." Board of Directors' meetings may be held outside of Costa Rica when the location is designated in the bylaws. The company must have a Resident Agent, normally an attorney with office in Costa Rica. The Resident Agent must be registered in the Mercantile Registry and will be in charge of receiving all legal notifications.

4. **Supervision and Auditors** One or more statutory auditors exercise control over the management. The auditor is appointed by the shareholders, need not be a member of the board (but cannot hold another office or be related to another officer), and reports exclusively to the shareholders' meeting. The auditor's legal duties include requesting monthly balance sheets, reporting on yearly balance sheets, calling meetings of shareholders, being present at board of directors' and shareholders' meetings, receiving complaints from shareholders and reporting on such complaints to the board of directors.

B. LIMITED LIABILITY COMPANIES

1. **Formation** A Costa Rican *limited liability company* (*sociedad de responsabilidad limitada*, *limitada*, or *S.R.L.*) possesses many of the same attributes as the corporation, such as legal personality and liability limited to capital contributions.

[1] In Costa Rica a single document (herein called the "bylaws") contains the provisions generally contained in both the articles of incorporation and bylaws of a U.S. company.

ABOGADOS

The organizers must execute its bylaws before a notary public, register the bylaws in the Commercial Registry, and publish notice bylaws in the Official Gazette.

2. **Quotaholders and Quotas** The S.R.L. must be formed by a minimum of two organizers, whether individuals or companies, each of whom owns at least one quota. However, the status of the entity is not altered by the fact that a single person or company may, in time, become the sole quotaholder. All quotas must be fully paid-up within one year of the S.R.L.'s constitution. Subscription of quotas cannot be offered to the public. Quotas have equal rights and one vote each, and thus the S.R.L. may be less suitable for special or complex control or equity structures than a corporation. Quotas may only be transferred with the prior approval of quotaholders representing at least three-quarters of the company's capital.

3. **Management** A Costa Rican S.R.L. is managed by a one or more managers or assistant managers, who need not be quotaholders. The managers are either named in the bylaws or appointed later by the quotaholders' meeting, which may also remove them at any time. The S.R.L. business form does not contemplate an auditor.

C. BRANCHES

Branches of foreign companies may be established by appointing a representative with a full power of attorney for all of the branch's business.

5. REAL ESTATE

A. PROPERTY AND LEASING

The general rule in Costa Rica is that foreign citizens have the same rights as Costa Rican nationals. Thus, there are no legal restrictions that would specifically affect a foreign entity or a Costa Rican entity owned by foreign capital that desires to rent or purchase real estate. Notwithstanding the general rule, the participation of foreign citizens in corporations owning beach-front properties is limited to 49%.

B. LEASING PROPERTY

Costa Rica's Civil Code generally regulates all types of leasing in the national territory. Rules for the leasing of real property are divided between those covering urban properties, which are also governed by a Law for Residential Leases, and those covering rural properties, which generally come from the Code.

C. ENVIROMENTAL IMPACT STUDIES

The establishment of many development activities in Costa Rica requires an environmental impact assessment study. The National Environmental Technical Secretariat (SETENA), from the Environment and Energy Ministry, is in charge of defining the need of such a study for each project.

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