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Recent Developments in International Taxation
Costa Rica

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Summary

In December 2018, the Costa Rican Congress approved a major tax reform (the ‘Reform’), that entered into force on 1 July 2019.

First, the Sales Tax Law was completely changed: sales tax was transformed into a value added tax (VAT). Then, the second amendment introduced several changes to the Income Tax Law, including the introduction of capital gains tax, thin capitalisation rules, transfer pricing and new deductibility rules regarding payments made abroad.

Capital gains

Regarding capital gains tax, the general tax rate is 15 per cent of the gain. However, another change introduced by the law is the concept of ‘global income’, and, in order to apply capital gains tax, the seller should consider whether the asset being sold was an asset that generated taxable income, which means whether it was an asset used in the ordinary trade or business of the taxpayer. If this is the case, then the applicable tax would be 30 per cent income tax and not 15 per cent capital gains tax. Nevertheless, capital gains tax should be paid, and the said payment will be considered as a payment on account for income tax at the end of year. If the asset was not involved in the commercial activity of the seller, then the applicable tax is 15 per cent capital gains tax, and this is considered as the final tax.

The law includes another exception for assets and rights acquired before the law entered into force on 1 July 2019. This exception was included as a solution for assets with low book values because, in Costa Rica, the revaluation of assets for tax purposes is not allowed; hence, most assets in company books have very low values, which means that when the asset is sold, the capital gain is too high, disproportionate and not true to market standards. Consequently, the seller is entitled to choose between 2.25 per cent tax on the sales price and 15 per cent tax over the capital gain, whichever is more beneficial. However, this option is only available for assets that were acquired before 1 July 2019.

In addition, under the new rules, when a non-resident that owns assets in Costa Rica sells an asset, they are subject to 2.5 per cent withholding tax from the buyer. The buyer is responsible for withholding, declaring and paying the tax on behalf of the seller. In addition, if the tax is not paid, the Costa Rican National Registry Office will not register the transfer of ownership of the asset. Furthermore, for those assets not subject to registration, the withholding would apply only if the buyer is a Costa Rican taxpayer.

Anti-avoidance rules and anti-hybrid rules

Even though the Costa Rican Tax Code already enabled tax authorities to apply anti-avoidance rules and anti-hybrid rules, based on the ‘substance over form’ principle, the tax Reform introduced specific regulations on these matters.

Regarding anti-avoidance rules, an article was introduced to the Tax Code, where the tax authorities are authorised to disregard any transaction by a taxpayer that has no other purpose than a tax benefit. This means that every transaction made by a taxpayer needs to have a business purpose, other than obtaining a tax benefit.

In addition, anti-hybrid rules were introduced to the Income Tax Law, and are applicable to transactions between related parties to prevent corporate groups from obtaining a tax benefit derived from mismatches in two or more jurisdictions resulting in double non-taxation of income.

Transfer pricing

Costa Rica adopted transfer pricing regulations in 2013; however, such regulations were not part of the Income Tax Law because it was only regulated by a decree.

One of the most important changes introduced by the Reform was that transfer pricing regulations were established in the Income Tax Law. This means that transactions between related companies (local or abroad) should comply with the arm’s length principle and should follow the same conditions (including profit margin) as if executed with a third party.

This margin should be documented through a transfer pricing study, which should be presented to the Tax Administration in the case of an audit and should be carried out for each fiscal period under analysis. If the company does not have this report, then it could be subject to penalties that range (approximately) from $2,000 to $28,000.

Double taxation treaties

Costa Rica approved and ratified the Agreement Between the Republic of Costa Rica and Mexico to Avoid Double Taxation on Income and Equity Taxes. As of April 2019, commercial operations between Mexican and Costa Rican taxpayers were regulated – mostly – by the rules contained in this agreement and not by the Income Tax Law. The agreement includes special conditions in tax matters for commercial transactions made by taxpayers of both countries. Included within the conditions established in this agreement is a five per cent withholding for the distribution of dividends (when participation exceeds 20 per cent of the capital stock), ten per cent for royalties and five per cent for interest payments.

This is the third agreement of this nature approved by the Costa Rican Congress. The other two are with Spain and Germany.

Organisation for Economic Co-operation and Development

After complying with several requirements established by the Organisation for Economic Co-operation and Development (OECD), such as reforms on public finances, corporate governance, competition and antitrust rules, anti-money laundering compliance and tax legislation, Costa Rica was invited to be the 38th member of the OECD, after passing the exhaustive review of 22 committees.

Costa Rica will be the fourth Latin American country to be incorporated into the OECD, joining Mexico, Chile and Colombia.

VAT: digital services

Regarding cross-border digital services, the tax Reform established that 13 per cent VAT would apply to any transaction made using a digital platform. The VAT Law established the obligation to withhold tax when services are rendered in Costa Rican territory, and established two different methods to proceed with the withholding: (1) through the bank issuing the card used in the transaction; or (2) through the digital service provider. In which case, the service provider would have to register in Costa Rica as a withholding agent, and comply with the monthly tax filing and payment. In addition, the law establishes that, if the service is used outside Costa Rica, the taxpayer can request the return of the tax to the tax authorities.

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